PALOS

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Palos Weekly Commentary

Issue **No. 1** | **JANUARY 06, 2020**

Palos Funds

By Charles Marleau, CIM

What worked and what didn't in 2019 and how the funds are positioned in early 2020

2019 was a difficult year for active managers as headline news created many uncertainties. Active managers carried more cash than usual, held large short positions, or were long volatility. These protection trades were costly. The Palos Income Fund LP and Palos Equity Income Fund, which are active funds, fared well when compared to other actively managed funds. These funds were up 18.34% and 14.63%. The TSX Composite was up 22.88% for the same period. I'm pleased with our performance, especially because the Palos Income fund was holding up to 9% of cash at various times during the year. Similarly, the Palos Equity Income Fund held 10% in fixed income securities and 9% in cash. We managed the funds both cautiously and prudently.

During the first three quarters of 2019, most of the positive return came from defensive sectors like REITS, gold, consumer staples, and utilities. Growth stocks also performed well in 2019, especially technology. Valuations in the defensive and growth sectors reached historical highs and we took profits in these sectors as they reached new highs. On the other hand, we slowly increased the funds exposure into reflation assets and cash as value could only be found in cyclicals and industrials. The Funds were probably a bit early on our shift to cyclicals as this sector struggled for first three quarters of 2019.

In the 4th quarter we saw strength in the depressed cyclicals sectors. The real question is, was this a change in sentiment or just a short-term rally? I don't know the answer to that, but what I can tell you is that the cyclicals remain in deep value territory and there are indications that the underlying commodities should trade higher over the coming months and year. The positive news on the China/US trade dispute, recent U.S. interest rate cuts which should drive the US dollar lower, and China adding stimulus are positives for higher commodity prices.

Palos Funds cont.

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I continue to believe that the primary risk for investors is a bursting of the trade fear bubble. In such an eventuality, investors could be in for a real surprise. In the 4th quarter of 2019 we saw the trade fear bubble slightly deflate and cyclicals started to catch a bid. I continue to believe that our balanced investment strategy is the best approach in this market. The funds are well-diversified across defensive, cyclical, and growth stocks. However, it would not be prudent to significantly overweight cyclicals as headline risks continue to be a wild card. Managing risk will continue to be our priority in 2020.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$8.50	0.01%
Palos Equity Income Fund - RRSP	PAL101	$5.71	-0.05%
Palos Merchant Fund L.P. (Dec 31, 2018) [2]	PAL500	$1.82	6.59%
Palos WP Growth Fund - RRSP	PAL210	$7.68	0.31%
Palos-Mitchell Alpha Fund (Fund Initiated on Jan 29, 2019) [3]	PAL300	$10.37	0.00%
S&P TSX Composite (Total Return with dividends reinvested)			0.02%
S&P 500 (Total Return with dividends reinvested)			0.15%
S&P TSX Venture (Total Return with dividends reinvested)			1.71%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			1.79%
Canadian Government 10-Year			1.54%
Crude Oil Spot			US $63.05
Gold Spot			US $1,552.40
US Gov't10-Year/Moody BAA Corp. Spread			198 bps
USD/CAD Exchange Rate Spot			US $0.7692

[1] *Period ending January 03, 2020. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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