Starlight Capital

FOCUSED INVESTING

Starlight Capital
Mutual Fund Portfolios

Semi-Annual Update
As of June 30, 2020

Market Review

At the start of the year, equity markets were concerned with turmoil in the global energy market which impacted global commodity prices and currency markets. There were also concerns about the United Kingdom's withdrawal from the European Union, COVID-19 the U.S. presidential impeachment process and global government debt limits and international trading relationships.

Since the latter part of February 2020, financial markets have experienced significant volatility and weakness in response to the COVID-19 pandemic. Equity markets have experienced elevated volatility in the face of rising unemployment and sharply declining economic output as investors have sought liquidity and safety in the face of uncertainty.

COVID-19 has significantly impacted the global economy as countries have enforced shelter-in-place orders to slow the spread of the virus. The shelter-in-place orders and subsequent shuttering of businesses has resulted in severe economic contraction in many global economies. Governments and central banks have responded with significant monetary and fiscal stimulus programs designed to stabilize economic conditions and bridge the gap in economic activity. At this time, the duration and magnitude of the COVID-19 outbreak is unknown, as is the efficacy of the government and central bank interventions.

Global credit markets have also seen similar levels of volatility as investors question the ability of some businesses and industries to remain liquid and solvent during the economic shutdown. Global long bond yields have fallen to historic lows as investors flock to safe havens and prioritize capital preservation over capital compounding. When the year started, Credit Suisse forecasted 2020 consensus earnings per share (EPS) growth of 10.1%. After anticipated downward revisions, 2020 was expected to deliver 5.0% EPS growth. After accounting for the global shutdown, consensus estimates now see corporate earnings and dividends contracting by 20% to 40% in 2020 before rebounding in 2021 and 2022.

In this environment, investment income becomes a priority as the global low growth outlook could lead to lower earnings growth and lower trading multiples. This leaves investment income as the key driver of absolute and relative performance. Companies trading at elevated multiples are vulnerable and companies with compromised business models are vulnerable. As global EPS and dividends are expected to decline by approximately 30%, stock selection is key.

Performance VS Benchmark

	YTD	1 year	Since inception
Starlight Global Real Estate Fund - Series F	**-9.9%**	**-1.1%**	**2.1%**
FTSE EPRA/NAREIT Developed Total Return Index (CAD)	*-17.0%*	*-12.0%*	*-0.6%*
Starlight Outperformance	7.1%	10.9%	1.5%
Starlight Global Infrastructure Fund - Series F	**-3.5%**	**3.7%**	**10.4%**
S&P Global Infrastructure Index (CAD)	*-15.4%*	*-11.3%*	*1.7%*
Starlight Outperformance	11.9%	15%	8.7%

Source: Bloomberg LLP and Starlight Capital as of June 30, 2020. Inception date as of October 2, 2018.

Portfolio Contributors and Detractors

Starlight Global Real Estate Fund

The top contributing real estate sectors to the fund's performance during the period were Industrial REITS, Specialized REITs and IT Consulting & Other Services with the Real Estate Operating Companies sector being the top detractor from performance.

Major geographic weights were in Canada and the United States (U.S.) representing over 80% of the NAV at period-end. Preference was given to countries with the ability to maintain strong fiscal stimulus to their economies for the duration of the pandemic. Significant sector allocations included Residential, Industrial and Specialized REITs at 28.6%, 23.2% and 14.8%, respectively (average portfolio weight of 26.0%, 23.9% and 11.6%, respectively). Exposure to the Real Estate Operating Companies sector was reduced by 5.1% to 5.9% at the end of the period (average portfolio weight of 7.7%).

Two of the top contributors to Fund performance for the period were Equinix Inc. and Granite Real Estate Investment Trust. One of the top detractors from Fund performance was New Residential Investment Corp.

Starlight Global Infrastructure Fund

The top contributing infrastructure sectors to the fund's performance during the period were Real Estate, Utilities and Information Technology with the Energy sector being the top detractor from performance.

Major geographic weights were in Canada and the U.S. representing approximately 65% of the NAV at period-end. Preference was given to countries with the ability to maintain strong fiscal stimulus to their economies for the duration of the pandemic. Significant sector allocations included Utilities, Industrials and Real Estate at 27.6%, 15.0% and 15.0%, respectively (average portfolio weight of 22.4%, 22.1% and 11.7%, respectively). Exposure to the Energy sector was reduced by 12.8% to 4.1% at the end of the period (average portfolio weight of 9.8%).

Two of the top contributors to fund performance during the period were Cargojet Inc. and NEXTDC Limited. Keyera Corp. was one of the top detractors during the period.

Portfolio Dividend or Distribution Increases

	YTD	1 year	Since inception	Average increase Since Inception
Starlight Global Real Estate Fund	14	25	49	6.6%
Starlight Global Infrastructure Fund	17	28	57	8.7%

Source: Starlight Capital as at of June 30, 2020. Inception date as of October 2, 2018.

Outlook and Positioning

Given the pace of the economic decline, we expect the global economy to experience a short and deep recession, with global economic output contracting for calendar year 2020. We are not anticipating a V-shaped recovery as secondary infection waves are likely to impact the ability and pace at which cities and countries re-open. In response to the volatility driven by COVID-19, portfolios have been concentrated into geographies with the fiscal capacity to continue to stimulate their domestic economies should the outbreak last longer than anticipated or require a second lockdown.

Starlight Global Real Estate Fund

The portfolio has been concentrated into four global sectors that we believe will collect a significant portion of their monthly rent based on historical performance and current observation.

The industrial sector has proven to be very resilient as consumers have been forced to adopt e-commerce at a faster pace. While online sales grew by 15% in the U.S. in 2019 40 million U.S. citizens purchased items online for the first time in April of 2020. This long-term structural driver of industrial real estate performance has been accelerated by COVID-19 and we believe these stocks will continue to perform.

The multi-family sector has also historically proven to be very resilient during economic downturns and we expect this trend to continue. In contrast to other real estate subsectors, tenants actually live in the real estate they lease. This has historically resulted in greater occupancy and revenue stability during economic downturns and appears to be the case during this downturn. Many of the fiscal stimulus programs enacted by global federal governments include direct payments to households to subsidize their rents as they shelter in place.

Finally, data centre and cell tower REITs have largely benefited from COVID-19, as traditional in-person interactions have been replaced with digital interactions. The increased demand for digital storage capacity, access and communication has driven utilization rates higher and pulled corporate expansion plans forward, driving strong performance of data centre and cell tower businesses.

Starlight Global Infrastructure Fund

The portfolio's weighting in four global sectors has been adjusted to reflect the reality of global equity markets after COVID-19. The Industrial weighting has been repositioned to reduce the portfolios exposure to transports which have been negatively impacted by COVID-19. Instead, the industrial weighting has been shifted to more resilient subsectors such as waste collection and cargo delivery.

The portfolio was underweight Utilities going into the downturn as the sector was trading at historically high valuations. The COVID-19 driven downturn allowed us to allocate more capital into global utility companies, with a focus on renewables.

The Energy weighting of the portfolio was reduced in January after delivering a 36% total return in 2019. The reduced return/risk ratio of the sector and higher volatility made the sector less attractive. After the COVID-19 outbreak accelerated, the underweight in the Energy sector was maintained as the demand destruction caused by the virus is likely to overwhelm any supply cuts engineered by the Organization of the Petroleum Exporting Countries (OPEC).

Finally, data centre and cell tower REITs have largely benefited from COVID-19, as traditional in-person interactions have been replaced with digital interactions. The increased demand for digital storage capacity, access and communication has driven utilization rates higher and pulled corporate expansion plans forward, driving strong performance of data centre and cell tower businesses.

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The views in this Quarterly Update are subject to change at any time based upon market or other conditions and are current as of July 22, 2020. While all material is deemed to be reliable, accuracy and completeness cannot be guaranteed.

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There are ongoing fees and expenses associated with owning units of an investment fund. An investment fund must prepare disclosure documents that contain key information about the fund. You can find more detailed information about the fund in these documents.

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