WAYPOINT
INVESTMENT PARTNERS

2020 Year in Review

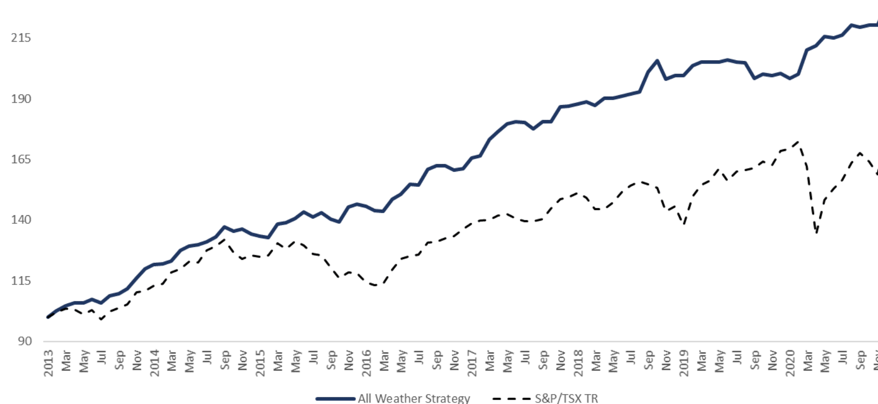
For 2020, the All Weather Strategy generated a positive 17.6% return versus the S&P/TSX Total Return Index of 5.6%. The portfolio's derivative positions benefited from increased market volatility that occurred early in the year along with a general recovery in many of our large equity positions. The Canadian market's positive performance can be attributed to Shopify and Gold stocks which together account for the entire annual return.

Investors' inability to forecast and predict *change* was most evident in 2020. From the lens of the equity markets, had you asked investors in March whether stocks would end the year positive, we suspect few would have made the wager. In the medical community, a scientific breakthrough provided a COVID vaccine after many experts suggested this was an impossibility and on the political front, a landslide polling prediction developed into one of the most divisive election outcomes in United States history.

The All Weather Strategy is designed to keep investors from worrying about the volatility associated with macro economic and political events such as those we experienced in 2020. Investors often find it difficult to remain invested, reacting to market volatility and realizing material losses in one's wealth. Many investors suffer from emotional reactions to market performance, locking in losses and missing out on the subsequent recoveries. Worse are those investors that live off their savings, being forced to liquidate investments during drawdowns to pay for their day to day lifestyle. The consequences of such circumstances are likely being felt by many this year.

At Waypoint Investment Partners, we focus on generating absolute returns by mitigating drawdowns that can impact an investor's wealth. We demonstrated the benefits of this approach in 2018 and again in 2020.

Fig 1: Waypoint All Weather Strategy vs. S&P/TSX Total Return Index



The Year Ahead

As students of market history, we observe many signs that suggest we are in the latter stages of this market cycle. In our view the high levels of corporate debt, extended equity valuations and low interest rates are a recipe for elevated volatility over the next several years and the All Weather Strategy was designed with this view in mind.

In the early 1970s, economist Hyman Minsky first developed his hypothesis of financial instability. He argued that financial crises are endemic in capitalism because periods of economic prosperity encouraged borrowers and lenders to be progressively reckless. Following a crisis, as confidence builds, people start to take on more and more risk; lending is done on less favourable terms; greater leverage is used in portfolios and on the balance sheets of businesses; speculative investments and schemes become more commonplace. As prices continue to rise, every fault of human psychology will work towards drawing in more investors until we reach a peak that ends up collapsing under its own weight with no causal factor.

Since the beginning of the Pandemic and the market lows in March of this past year, we have witnessed one of the most rapid transitions from fear to exuberance. We respect the magnitude of central bank intervention and the narrative that seemingly endless stimulus and low interest rates give investors few alternatives; however, we cannot help but notice several examples that make us feel that we are closer to that Minsky Moment.

Record Share Issuance

U.S companies sold $368 billion in new stock last year, 54% more than the prior high according to data compiled by Bloomberg. IPOs raised $180 billion in 2020 – the most ever. Special purpose acquisition vehicles or blank cheque companies raised $80 billion in 2020, more than they have in the last decade in total, and those who made an acquisition on average doubled, and those who did not, still gained approximately 20%.

Highest Level of Retail Call Option Purchases

Recently, over a 30 day period, an average of more than 22 million calls traded across U.S. exchanges – close to a record according to Bloomberg. This is largely driven by retail investors - over 18 million calls in size of 10 contracts or less were purchased in the first week of December, the highest ever, according to Options Clearing Corp.

The S&P "5"

Historically, the five biggest stocks never represented more than 18.2% of the S&P index, a peak last seen at the height of the 'dot-com' bubble in March 2000. Currently Apple, Microsoft, Amazon, Tesla, and Facebook represent 19.5% of the index, almost double the long-term average of 12.5%.

Plug Power Green Tech

Green technologies have become a theme of rampant speculation by retail investors. The increased level of attention on ESG mandates is a significant contributor to the sector's momentum. At Waypoint Investment Partners we agree that our future is brighter with increased focus on corporate ESG policies, however, the adoption of this framework is not a guarantee for business success.

One example of this is Plug Power. The company designs, develops, and manufactures fuel cells for electric lift trucks and material handling equipment. In 2018, the company had revenues of $175 million, losses of $75 million and an enterprise value of $557 million. In the last 12 months, Plug Power's revenues were $307 million, losses were $99 million and today (January 18, 2021) the enterprise value is $28.4 BILLION. That's a lot of forklifts.

Space Fund – Maxar Technologies

ARK Invest was created in 2016 and has since become one of the most successful investment firms focused on innovation. The firm's most cited claim to fame has been their early investment in Tesla; one of the best performing stocks of the past 5 years. Most recently, the company announced that it was starting a "Space Exploration ETF". On this announcement alone, companies such as Maxar Technologies were up 30% simply on speculation that they may be included in this new fund. We do not profess to be space exploration experts but are quite confident that the Starship Enterprise remains an object of fiction, for now.

Why Long Volatility and Why Now

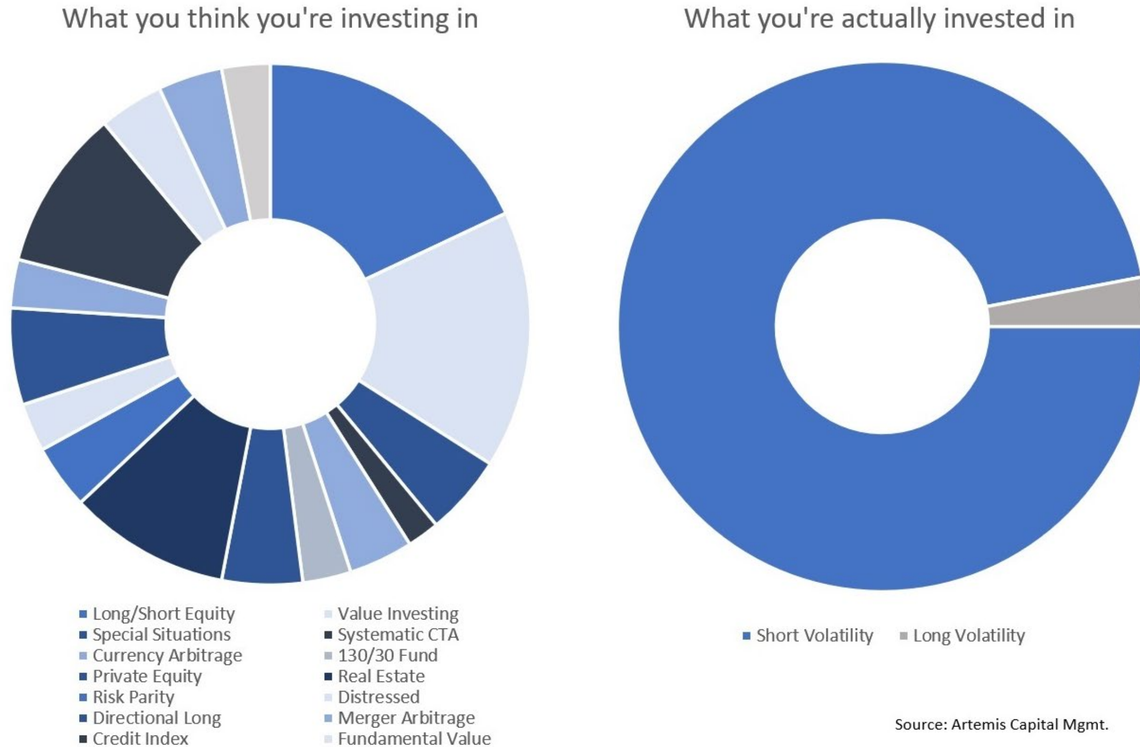
As we move into 2021, our team is speaking with clients and offering up our thoughts on asset mix. The efficacy of the traditional 60/40 equity fixed income portfolio has been challenged by many market participants. We share in this view and believe the historical relationship between bonds, stocks and inflation is a basis for investors to revisit their existing asset mix.

Most investors' asset mix is comprised of strategies that benefit from mean reversion in financial markets. When you look at the return profile of today's popular investment strategies, they are generally characterised by stable returns, followed by periods of significant drawdowns, followed by recovery.

Whereas many people believe they are properly diversified because they have diverse exposure to strategies such as value investing, credit, private equity, real estate, and others; in reality, they are overly exposed to one asset class – Short Volatility. This idea has become increasingly publicized due to the work of institutional managers such as Chris Cole (Artemis), Michael Green (Logica), Diego Parrilla (Quadriga) and others.

Several market drawdowns that have occurred over the last decade demonstrate this fact; Investors have seen correlations within their asset mix rise to 1, causing many of their investments to fall simultaneously. At Waypoint Investment Partners we believe that investors require exposure to at least one asset class that is truly uncorrelated – for us, this is our Long Volatility strategy.

Figure 2: Asset Mix



An Idea for 2021 - A View on Canadian REITs

Prior to 2020, the Canadian REIT index had compounded investor returns at 12% annually with a 50/50 mix of capital appreciation and dividends over the period. In 2016, the sector become an official member of the Global Industry Classification Standard further bringing attention to the asset class in public markets. For investors seeking income, REITs became a "go to" asset class given the stable and growing dividends and general perception of asset stability.

By March 2020, the index had declined approximately 30%, shaking investor confidence. Furthermore, the Coronavirus pandemic was perceived to directly impact real estate more so than other market sectors. Real estate securities levered to retail, office and apartment sub-sectors have yet to recover from early declines and remain an area of controversy in the eyes of investors.

At the bottom, real estate securities were pricing in rent declines, dividend cuts and an overall secular decline in the broad asset class. While we agree that there are secular challenges with some of these assets, we would argue that best in class assets in the real estate sector can always be redeveloped to meet market demands. In our view we feel that the combination of quality assets and strong management teams are a recipe for success.

The yields offered by many of these securities today are attractive on an absolute basis; even those companies that decide to cut dividends will free up capital for share buybacks or development opportunities. As we move throughout 2021, we believe these securities can re-rate as vaccine tailwinds benefit the sector.

In essence, we believe the euphoria that benefited the sector has largely abated and that investors are receiving adequate compensation, with a margin of safety, for the prices to revert and reflect fundamentals; in the meantime, we are receiving healthy dividends to compensate for our patience.

To all of our stakeholders, we want to express our gratitude for your continued support throughout 2020.

As always, please contact us with any questions or comments.

Sincerely,

Waypoint Investment Partners