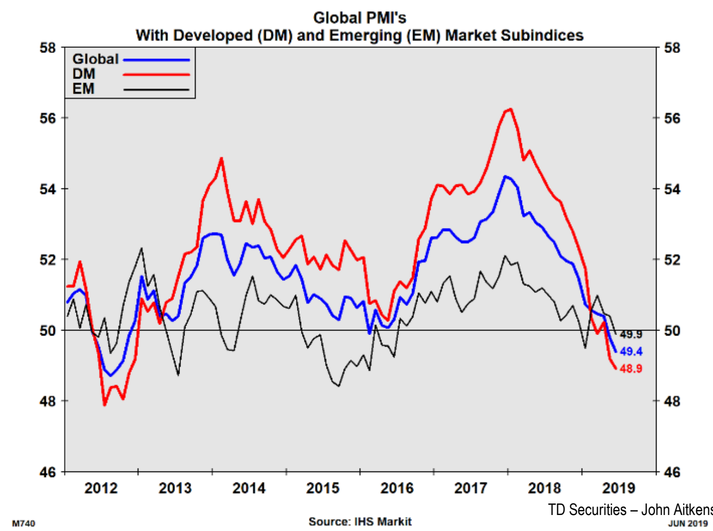
Manitou

Investment Management Ltd.

Quarterly Commentary
June 30, 2019

"The proper funding of the present debt will render it a national blessing... the creation of debt should always be accompanied with the means of extinguishment."

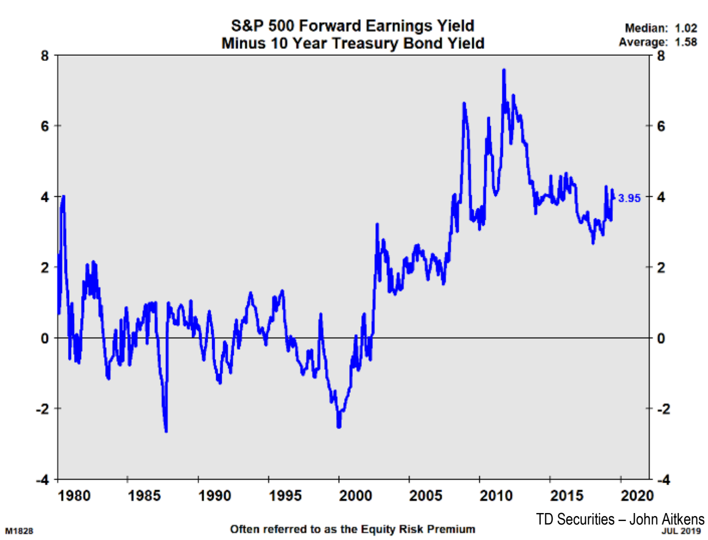
Circa 1795, long before his story came to Broadway, Alexander Hamilton made this shrewd comment that is just as relevant today. Governments' ability to repay debt may depend on increasing personal and corporate taxes, but there is a limit to the levers they can pull. Furthermore, the underlying quality of "IOU's" from countries with weaker economies and bonds from lower quality companies are inevitably subject to closer scrutiny. Unsustainably high debt levels could potentially lead to a global crisis of confidence.



Moving on from this dour assessment, let's look carefully at the global economy and business cycle, which tie into our portfolio strategy. As clearly demonstrated by the Purchasing Manager's Indices in the first chart, global economies are slowing, largely as a result of uncertainty around trade talks, Brexit and heightened geo-political tensions in the Middle East. The World Bank, Federal Reserve and the Bank of Canada expect annual GDP growth in the US and Canada to be 2% to 2.5% while Europe is expected to grow at a more moderate rate. In addition, oil prices will likely remain in a trading range of $50 to $65 for WTI as lower global demand is balanced by OPEC production restraint.

Offsetting the weakness in manufacturing is a solid services segment that represents in excess of 70% of US GDP. The job market remains positive in both the US and Canada, unemployment is below 4% and consumer confidence is still strong. Further, the Bank of Canada's accommodative stance has given a short-term lift to the Canadian Dollar.

Turning to the historically low interest rate environment, there are several interpretations as to the cause: central banks have been excessively accommodative, investors fear a major recession, or low and even negative rates are a currency hedge for many Europeans. This prompts the question of asset allocation and whether it makes sense to own bonds or equities at this point in time. The second chart demonstrates that the earnings yield on the S&P500 offers a healthy premium over 10-year treasury bonds.



As we have stated in previous letters, a handful of tech giants have disproportionately skewed the market cap-weighted valuation of the S&P500. This has contributed in part to the strong outperformance of the US market over the last couple of years.

Concerns aside, we believe our disciplined process and focus on capital preservation will enable us to justify holding many of our existing portfolio companies that have sustainable competitive positions and strong balance sheets. At the same time, we will strive to uncover others worthy of investment.

Patient Investing

Several weeks ago, our partner Steve Scotchmer presented a 'think piece' he wrote on long-term investing. The report highlighted the power of tax-free compounding over the long-term. For the purpose of illustration, ***we assume two portfolios generate the same absolute return of 10%, with one invested over 25 years and the other over 50 years. In addition, we assume one is taxed only once at the end of the investment period, whereas the other is taxed at the same end-date, but is also taxed each year along the way. In all cases taxes incurred are assumed to be at a rate of 26.76%. The annual turnover rate is assumed to be a modest 15% per year. As the simplified calculation below shows, the differentials are staggering:***

25-year holding period

- **$1 million @ 10% X 25 years taxed in year 25 at 26.76% = $8.2 million**
- **$1 million @ 10% X 25 years assuming 15% turnover per year taxed at 26.76% each year = $6.9 million**
- **Difference is $1.3 million**

50-year holding period

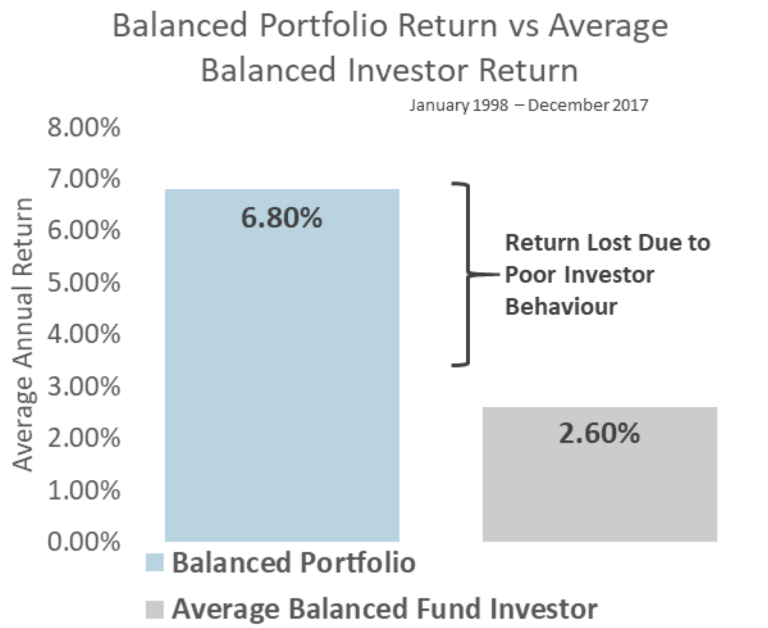
- **$1 million @ 10% X 50 years taxed in year 50 at 26.76% = $86.2 million**
- **$1 million @ 10% X 50 years assuming 15% turnover per year taxed at 26.76% each year = $60.3 million**
- **Difference is $25.9 million**

While Steve's report focused on various methods of tax-free compounding, his primary focus was on investing in companies that could be owned for decades. Granted, it is rare to hold a company with confidence over 25-50 years, but there are a few noteworthy 25 year + compounders currently held by Manitou such as Berkshire Hathaway, Microsoft, 3M, JNJ, Visa, MasterCard, LVMH, and Spirax Sarco Engineering.

At the crux of Steve's report are two words which are central to the way we invest; ***quality*** and ***patience***. In our last two quarterly letters we wrote extensively about **quality** in terms of financial strength (Balance Sheet strength and dependable Free Cash Flow generation) and the importance of management. In this one we focus on ***Patience***.

On a few occasions we have referenced Dalbar's Quantitative Analysis of Investor Behavior[1], which measures the effects of investors' decisions to buy, sell and switch into and out of mutual funds over short and long time periods. Below is the latest Dalbar data available for the period ending 2017. Since its inception in 1994, each Dalbar report has reached the same conclusion; patience is profitable.

[1] Average Balanced Fund Investor "Quantitative Analysis of Investor Behavior, 2018" DALBAR. Inc. Morningstar.



Performance of Balanced Portfolio based on 60% S&P500 / 40% Barclays Aggregate Bond Index (USD).

While high-frequency trading is often associated with both active and passive asset management, research consistently shows that a "buy and hold" approach leads to greater returns. In fact, a 2016 study conducted by Fidelity Investments found that the best performing portfolios were those held by clients that had either forgotten about them or passed away.

In recent times, our portfolio turnover has declined and we expect this trend to continue as our global library reaches critical mass, which we estimate to be approximately 220 *"own-able"* companies. Lower turnover should not be misinterpreted as a lack of devotion to research. We are constantly learning more about our existing holdings while searching for new opportunities. For the companies we own, our analysts monitor and digest new information to ensure that the companies' moats remain protected. Additionally, any new high-quality company added to our library is thoroughly analyzed by consistently following our research process. However, they may not be added to portfolios for years due most often to high valuations. A colleague once observed, *"Clients see our errors of commission and generally never see our errors of omission. Likewise, they give credit for our good judgement when visible, but generally never know of the good judgement that resulted in avoiding danger".*

Quality, performance and patience go hand in hand. We are striving to be patient investors in the most tax-effective way possible. Lower turnover reflects our view that existing holdings possess more favourable long-term prospects than alternatives.

In conclusion, the backdrop in which we currently invest is mixed with both positives and negatives. Such is generally the case. However, as concerns about sustainable global growth increase so too does our emphasis on quality.

Manitou Mandates Annualized - June 30, 2019

	QTR %	YTD %	1 Year %	2 Year %	3 Year %	5 Year %	7 Year %	10 Year %	Since Inception December 1999 %
Manitou Global Equity Composite	**2.20**	**13.83**	**9.47**	**12.14**	**15.32**	**12.06**	**15.79**	**14.31**	**9.77**
Benchmark	1.96	12.13	6.30	9.94	11.44	10.02	13.21	11.98	5.81
Excess Return	0.24	1.70	3.17	2.20	3.88	2.04	2.58	2.33	3.96

Benchmark: 12/31/1999-12/31/2017 50% S&P 500, 50% S&P/TSX Composite Index; 01/01/2018 – S&P Global 1200 Index.

	QTR %	YTD %	1 Year %	2 Year %	3 Year %	5 Year %	7 Year %	Since Inception December 2009 %
Manitou Equity Composite (“North American”)	**1.80**	**12.79**	**8.06**	**10.49**	**12.43**	**9.69**	**14.15**	**12.59**
Benchmark	2.32	14.87	6.83	9.97	11.64	10.45	13.53	11.61
Excess Return	-0.52	-2.08	1.23	0.52	0.79	-0.76	0.62	0.98

Benchmark: 12/31/2009-12/31/2017 50% S&P 500, 50% S&P/TSX Dividend Composite; 01/01/2018 - 50% S&P/TSX Composite Index, 50% S&P 500.

	QTR %	YTD %	1 Year %	2 Year %	3 Year %	5 Year %	7 Year %	Since Inception December 2010 %
Manitou Canadian Equity Composite	**1.86**	**15.65**	**6.64**	**9.55**	**11.48**	**7.33**	**10.88**	**8.87**
Benchmark	2.58	16.22	3.87	7.09	8.39	4.67	8.27	5.43
Excess Return	-0.72	-0.57	2.77	2.46	3.09	2.66	2.61	3.44

Benchmark: S&P/TSX Composite Index.

	QTR %	YTD %	1 Year %	2 Year %	3 Year %	5 Year %	Since Inception August 2013 %
Manitou US Equity Composite	**1.39**	**13.40**	**10.49**	**12.71**	**16.40**	**16.87**	**16.91**
Benchmark	2.02	13.41	9.69	12.73	14.42	15.33	17.41
Excess Return	-0.63	-0.01	0.80	-0.02	1.98	1.54	-0.23

Benchmark: S&P 500 Index.

	QTR %	YTD %	1 Year %	2 Year %	3 Year %	5 Year %	7 Year %	Since Inception December 2011 %
Manitou Focus 5+ Composite	**-0.29**	**16.83**	**12.20**	**13.26**	**17.38**	**19.18**	**22.89**	**22.15**
Benchmark	2.32	14.86	6.83	9.96	11.45	10.03	13.22	12.87
Excess Return	-2.61	1.97	5.37	3.30	5.93	9.15	9.67	9.28

Benchmark: 50% S&P 500, 50% S&P/TSX Composite Index.

	QTR %	YTD %	1 Year %	From Incep. Dec 2017 %
Manitou International Equity Composite	**3.31**	**9.19**	**9.38**	**6.93**
Benchmark	0.99	8.53	-0.85	1.04
Excess Return	2.32	0.66	10.23	5.89

Benchmark: S&P EPAC BMI.

	QTR %	YTD %	1 Year %	2 Year %	3 Year %	5 Year %	7 Year %	Since Inception March 2009 %
Manitou Income Fund	**1.41**	**3.93**	**5.58**	**3.83**	**2.82**	**3.20**	**3.08**	**3.92**
Benchmark	1.31	3.61	4.82	2.58	1.68	2.21	2.17	2.72
Excess Return	0.10	0.32	0.76	1.25	1.14	0.99	0.91	1.20

Benchmark: 75% iShares Canadian Short Term Bond Index ETF, 25% iShares Canadian Universal Bond Index ETF.

Past performance is no guarantee of future results.

Manitou Mandate Commentary

The preceding table outlines performance for all Manitou Mandates except the Manitou Total Return Yield Fund. On the whole, performance has been relatively disappointing for the second Quarter of 2019, but shows marked improvement year-to-date. As managers of concentrated portfolios of reasonably-priced, high-quality companies, we maintain our discipline of careful stock selection based on a fundamental, bottom-up approach.

The principal contributor to this quarter's returns in the Manitou Global Equity Fund was Dentsply Sirona +15.42% and the largest detractor was 3M -17.70%. Dentsply Sirona made significant strides in executing its strategy of achieving above-industry growth, increased profitability and higher free cash flow generation. 3M declined on no firm-specific news, but was most likely impacted by the slowing US industrial sector.

For the Manitou Equity (North America) Mandate the principal contributor was Computer Modelling Group (CMG) +20.02% and the most significant detractor was 3M -17.70%. CMG outperformed on the back of solid quarterly results.

The top performer in the Manitou Canadian Equity Mandate was Computer Modelling Group (CMG) +20.53% and the bottom contributor was Tucows -25.36%. Tucows declined after having missed guidance in the second quarter.

The Manitou US Equity Mandate's top performer was CME +15.94%, with Tucows the bottom performer -25.96%. Of note, CME was the bottom performer for this mandate during the last quarter Q1'19, illustrating the volatility of US markets and the stock's correlation to interest rates.

The top performer for the Manitou F5+ Fund was Dentsply Sirona +15.39% and the largest detractor for the fund was Tucows -26.39%.

The Manitou International Equity Fund's top performer was Alcon +37.94%, a global eye care specialist that was recently spun out of Novartis and the bottom was Fairfax India -11.14%. Market sentiment is positive with respect to Alcon's prospects as an independent and focused company. Fairfax India declined on no firm-specific news.

The Manitou Income Fund reported good results for the quarter. Given the slowdown in Canadian GDP towards the end of last year due to trade uncertainties, Canada's 3 to 5 year average bond yield fell from 2.45% last October to 1.4% at the end of June. Conversely, bond prices rallied as did the fund's performance. With a flattish yield curve, we continue to maintain a relatively short fund duration of approximately 3 years.

The Manitou Total Return Yield Fund's valuation lags the quarter-end by one month. Key contributors during the quarter ended March 31, 2019 were Timia Capital Corp, Easy Legal Finance and the Mortgage Company of Canada (MCOC). In the case of Timia, Manitou participates directly in the revenue streams of the underlying loan. The average internal rate of return on these loans was just under 20%. Our primary holding with Easy Legal generates a return of 11.75% and the yield on the MCOC equity is currently 8.5%. Detractors for the quarter were the Heirloom Investment Fund and High Rock Capital Management. In both cases, the deterioration of an individual underlying holding was significant enough to produce a negative return for the period. We continue to consolidate the portfolio around key holdings driven by a desire to reduce the correlation to public market investments and improve the fund's yield.

New Additions

A new name that was added to both the Manitou Global and Manitou International Mandates is EssilorLuxottica. The company is the global leader in the ophthalmic optics and eyewear industries by market share. EssilorLuxottica is vertically integrated from the research and development, design and manufacture of ophthalmic lenses and frames, to the distribution of these products through wholesale and retail channels to fully-owned as well as independent laboratories.

Essilor was founded in 1849 in France and Luxottica in 1961 in Italy. Both companies were successful as independent entities, but were officially combined as a merger of equals on October 1st, 2018.

EssilorLuxottica's scale and commitment to R&D are among its formidable competitive advantages. The company is present in more than 160 countries with 70 brands sold in 10,000 retail outlets including e-commerce. EssilorLuxottica owns many brands including Oliver People's, Rayban and Oakley and produces as well as distributes luxury sun and ophthalmic frames under license agreements for brands such as Burberry, Chanel and Tiffany & Co. In addition, the company owns retail chains including LensCrafters, Sunglass Hut, and Pearl Vision. Essilor is the largest global producer of corrective lenses sold under various brands such as Varilux graduated lenses, Crizal, Transitions and Foster Grant.

Merging the two companies was initiated by Mr. Leonardo Del Vecchio, the founder and CEO of Luxottica. A merger was attractive given the companies' overlap and complementary positions in many segments. Most importantly, the combination strengthened EssilorLuxottica's position against the disruption from emerging e-commerce players and positions it well to capitalize on an attractive and growing end-market.

EssilorLuxottica has a consistent record of profitability, balance sheet strength and free cash generation. Growth opportunities exist particularly in emerging markets and due to an ageing global population. Initial synergies are expected to be between €400mn to €600mn and sales growth to be 5% for 2019. Operating margins are currently 16% although management commented in May 2019 that it expects upward revisions to targets once the integration process is fully developed.

EssilorLuxottica is led by an entrepreneurial management team with an owner/operator mindset. Mr. Del Vecchio continues to hold 33% of the combined company and the majority of employees are owners as well. Press reports alleging boardroom disagreements regarding the appointment of the future CEO negatively affected the share price during the last quarter giving us an opportunity to initiate a position in this high-quality company.