Manitou
Investment Management Ltd.

Quarterly Commentary
December 31, 2019

A Tale of Two Markets

What a difference two years can make! In 2018 investors witnessed a sharp market sell-off in the fourth quarter followed by a bullish uptrend in 2019 that has continued into 2020. Giving credence to the expression," The Market goes up like an escalator and down like an elevator," the sell-off in the final quarter of 2018 was quick and steep. The S&P/TSX and S&P 500 indices fell by -10.11% and -8.62% respectively. In the case of the S&P 500, it was the first time in history that it recorded a negative full-year result after increasing steadily during the first three quarters. In contrast, both indices were up over 20% in 2019. This bifurcated period in market history can in large measure be explained by Chart 1 that demonstrates the strong correlation between the Federal Reserve Discount Rate and the price of the S&P 500 Index.

In 2018 investors were focused on Central Bank interest rate policies that began to moderate from extreme stimulation to normalization. Paradoxically, during this same period average earnings of S&P 500 companies were up about 20%. This was largely due to Trump's corporate tax cut and a host of prevailing economic factors supporting growth. Given the severity of the 2018 fourth quarter decline, it seems stock market behaviour (driven by large ETFs and algorithmic trading) disregarded these positive economic drivers of corporate performance.

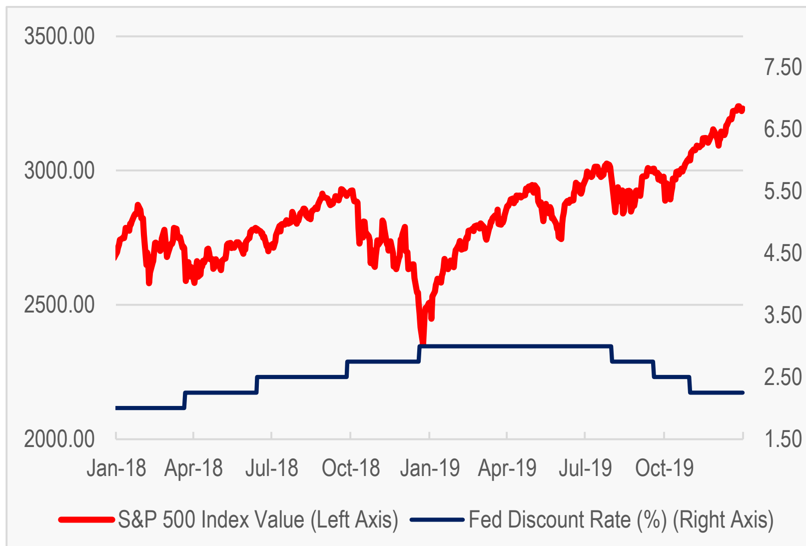

Chart 1- *Source: S&P Global Market Intelligence; United States Federal Reserve*

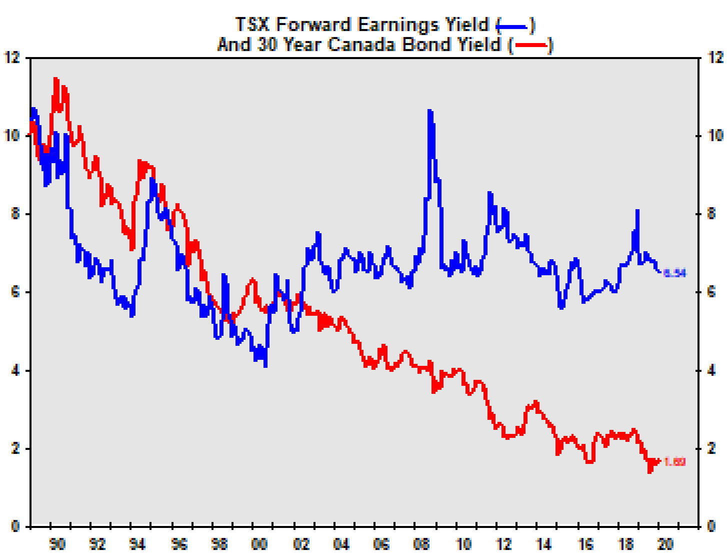

Chart 2 – *TD Securities John Aitkens – Jan. 2020*

In response to the sell-off, Fed Chairman Powell retrenched from his previous position of monetary tightening, by implementing three successive rate cuts. This brought the yield on ten-year US Treasury Bonds to sub 2% levels; thereby providing the fuel that stimulated the stock market rally of 2019 that remains in place today.

The question of whether owning equities is the best way to protect and grow capital after a ten-year bull run continues to be top of mind for most investors. Chart 2 demonstrates the large premium return that TSX companies provide over long-term Canadian bonds. A similar premium exists in US and international markets.

Turning to current economic conditions, Chart 3 shows substantial deterioration in the Global Purchasing Managers Indices over the last two years. Development in the Chinese and European economies have slowed materially while the impact of Brexit has taken its toll on the UK.

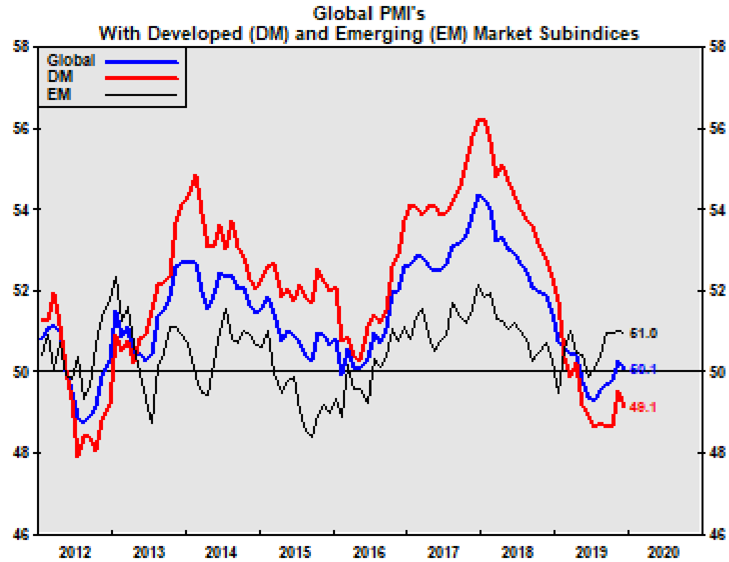

Chart 3 – *TD Securities John Aitkens – Jan. 2020*

While expected growth rates have been scaled back by Central Banks in North America and abroad, the reality is that employment remains strong in the US and has bounced back in Canada. Consumer debt has been paid down substantially in the US, but remains high in Canada. We believe this increases the likelihood of a rate cut in Canada, which should have a knock-on effect of tempering the recent strength in the Canadian dollar.

The signing of “Phase One” of the US-China trade agreement should (at least temporarily) cool the political rhetoric by President Trump. However, it is too soon to gauge the market impact of impeachment and the hotly-contested, November US election.

Looking further into 2020, we believe the global economy is likely to slow further. Interest rates should remain low by historical standards and in aggregate most companies in both North America and Europe will be hard-pressed to show above average sales growth. Premium multiples will continue to accrue to a narrow range of businesses that can capitalize on their ability to increase earnings and generate free cash flow. A recession is unlikely to occur should these conditions prevail.

2019 Full-Year & Fourth Quarter Performance Commentary

2019 was a solid year for Manitou portfolios, as they exceeded our absolute return objective of CPI+7%. On a relative basis we kept pace with the strong markets. When considered in the context of our relative out-performance in 2018, 2019 results are consistent with our style and approach which are designed to under-perform in buoyant markets and preserve capital during down-markets.

The following outlines some of the significant outperformers and detractors held in various Manitou portfolios during 2019:

Apple’s share price increased significantly over the last year due to several factors including a lower than expected decline in iPhone sales in addition to an increase in wearables such as the Apple Watch and Air Pods. The contribution from services such as Apple Pay and the App Store also had a positive impact on profitability.

Importantly, the reduction in the US corporate tax rate benefitted all US companies, which in the case of Apple resulted in the repatriation of a portion of cash held overseas as well as the initiation of a sizeable share buyback programme. In spite of trimming the stock twice due to valuation, we continue to own Apple.

Airbus, a widely held stock across several Manitou mandates was a significant contributor to performance throughout 2019. In short, deliveries increased in addition to a positive mix effect. The company's backlog is approximately nine years at present with deliveries expected to be 75 planes per month during this time period. These well-communicated events have contributed to a significant improvement in free cash flow, a decrease in debt and an uplift in profitability. We remain positive on our investment thesis.

LVMH was a significant outperformer in 2019. Luxury demand surged globally, but most importantly in China as personal disposable income increased and as more millennials were exposed to the power of international brands. As a disciplined capital allocator, LVMH strengthened its position throughout the year by acquiring the hotel chain Belmond, launching a new luxury house Fenty with Rihanna, establishing a relationship with Stella McCartney as the chief environmental strategist and acquiring the iconic Tiffany jewelry brand as a means of expanding in the hard luxury segment. LVMH continues to be a core holding.

MasterCard was a significant contributor over the last year. The company continues to lead in global payments growth, benefitting from the transition from cash to electronic payments. This trend is now broadening from consumer payments on cards (e.g. tap to pay) to mobile commerce payments, real-time interbank payments and business-to-business payments. Given its position in this space, we believe MasterCard can sustain its organic growth rate in the medium-term. With its financial strength and industry position, MasterCard is able to invest in emerging payment capabilities, which when combined with the company's installed base, global acceptance and brand recognition, result in the continued conviction of our investment thesis.

Walgreens is one of our widely held stocks that missed guidance throughout the year. The company continues to execute its strategy of increasing efficiency at both the front- and back-end of its store network through improvements in services, logistics and IT. Accordingly, transformational costs associated with this plan weighed on the group's ability to increase profit margins. Adding to the negative result is the disruption occurring in the US relating to prospective changes in US healthcare legislation, negative sentiment associated with drug pricing as well as the changing industry structure. In light of these industry-specific headwinds, we have lowered our targeted intrinsic value on Walgreen's, but continue to believe in our investment thesis.

3M underperformed during 2019. The company missed guidance as end-markets slowed globally with the exception of the healthcare industry. Guidance was lowered and restructuring efforts were initiated with the announcement of over 2,000 layoffs during the first quarter of 2019. However, the company continues to engage in M&A activity and is committed to continuously investing in R&D. 3M remains a high-quality company in our opinion and we remain positive with respect to our long-term thesis.

Uni-Select, which was discussed extensively during our recent investor event in November performed poorly during 2019. Management leveraged the Balance Sheet post the acquisition of The Parts Alliance in the UK leaving little financial flexibility to address the competitive disruption that occurred with its Finish Master business in the US. Eventually management was changed and a strategic review was initiated, but confidence in our investment thesis deteriorated. As a result, we chose to exit our position completely across all mandates during the last quarter of 2019.

Apache, as well as oil stocks in general, had a difficult year with price volatility increasingly part of the global conversation. Pipeline delays in North America led to costly transportation by rail for Canadian oil sands players. Permian players shuttered many rigs as a result of lower oil and natural gas prices throughout the year. Apache suffered despite consistent output from the North Sea and Egypt. Compounding these issues, in December, the share price declined significantly after management announced cryptic results with respect to its first drill in Suriname, off the coast of South America. After speaking with management several times throughout the year, we remained confident in the quality of Apache's assets and management's strategy. Shortly after New Year in January 2020, Apache announced a joint venture with Total SA of France to further develop the Suriname oil field, illustrating the company's confidence in the size and potential of the asset. The company's share price has surged from a low of $18.33 on December 3rd, 2019 (when we added aggressively) to approximately $33.00 today. In response to the significant share price increase, we trimmed our position back significantly, but continue to own Apache in anticipation of further positive news to come.

Like any asset management firm, we do not have a crystal ball to predict future market movements. Nonetheless, through thorough analysis of high-quality companies, we can position ourselves to weather any disruptions that inevitably occur. Our steadfast dedication towards excellence in everything we do, will in our opinion, contribute toward our objective of delivering superior results over the long-term.

As indicated in the cover letter to the 2019 year-end report, we will be hosting our annual conference call on February 5th. During this call we hope to answer questions, while also providing details of some of the initiatives underway, which are intended to improve upon the success we've achieved over the past 20 years.