PURPOSE
INVESTMENTS

PURPOSE CREDIT OPPORTUNITIES FUND – Q4 / 2018 COMMENTARY

FOR ACCREDITED INVESTORS ONLY

QUICK FACTS

SERIES F	LGQ781
MGMT FEE	0.85%
SERIES A	LGQ780
MGMT FEE	1.85%
PERFORMANCE FEE	20%
INCEPTION DATE	June 30, 2014

SANDY LIANG, CFA

Sandy Liang has more than 25 years of experience managing credit investments. He spent 17 years in Wall Street, leading fixed income for Cobalt Capital Management, and as a Senior Managing Director at Bear, Stearns & Co., where he was voted to Institutional Investor Magazine's All-America Fixed Income Research Team for seven consecutive years.

Market Overview

In 2018, virtually every risk asset category generated negative returns to varying degrees, with higher interest rates the culprit in the first half of the year and downshifting economic growth wreaking havoc on returns in fourth quarter. In 2018, the S&P 500 lost 4.4% (USD), the S&P/TSX Composite Index lost 8.9% and the high yield ETF hedged version (XHY) lost 3.6%. With that backdrop the Credit Opportunities Fund returned positive 1.2% for year.

Fund Performance

In the fourth quarter alone, the S&P500 returned -13.5%, XHY returned -4.8% and the Fund returned -6.7%. Over the past three years the Fund has returned 8.7% on an annualized basis compared with 9.3% for the S&P500 and 5.0% for XHY. The fund is absolute return driven, is primarily comprised of corporate debt, and thus has significantly less risk than equities.

The top corporate bond return contributors in 2018 were Largo Resources 9.25% of 2021, Curo Financial 12% of 2022 and Bi-Lo Holdings (Southeastern Grocers) 9.25% of 2019. The Fund has exited the Curo Financial and Bi-Lo positions as both bonds were called/cancelled. The Largo Resources position has been reduced due to the company (a producer of vanadium) applying free cash flow proceeds to debt reduction. The top corporate bond detractors to return were Curo Financial 8.25% of 2025, MEG Energy 7% of 2024 and Baffinland 8.75% of 2026. Curo Financial bonds were a new issue to refinance the company's 12% notes that were a winner for the Fund. The MEG Energy bonds were sold and swapped into a different MEG Energy issue to take advantage of a tax loss benefit and stay in a similar security – prices for MEG bonds have since recovered ahead of a pending vote by common shareholders in response to a hostile takeover bid by Husky Energy. Baffinland is a low-cost producer of high grade iron ore – we believe the market for the high grade material is going through a secular demand increase due to its favourable environmental qualities compared with lower grades. The Baffinland bonds have significant asset value protection in the 2x-3x area and the company is 25%-owned by ArcelorMittal, the world's largest steel producer.

During the fourth quarter the Fund reversed its long-standing short position in government debt and took on a long position. This is a short-term strategic change given the negative correlation between long bonds and equities while growth expectations from capital markets are being downgraded.

The Fund has a small number of credit-related common equity positions that in aggregate are never weighted more than 20% of NAV (currently at 13% of NAV). The top equity contributors to return for the year were Enova International (ENVA) and Pyxus (PYX- formerly Alliance One). The Fund has since exited the Pyxus position after a run-up due to its new cannabis ventures. Enova International remains a long position – we currently view the position as strategic as we continue to expect secular earnings growth and multiple expansion from the non-prime consumer lender.
The largest equity detractor in 2018 was Champion Iron Ore (CIA) where the Fund gave back what it made on the stock in 2017. The thesis is related to the Fund's investment in Baffinland debt – CIA is a low-cost producer of high-grade iron ore trading at an extreme low multiple with a high cash flow yield. Likely catalysts for the company's stock price include

folding in part of the Province of Quebec minority interest and significant production growth in 2019-2020.

Fund Positioning and Outlook

Looking ahead to 2019 we view the economic and financial market environment as favourable for corporate debt and our style of investing. We view the recent volatility in debt and equity markets as an overshoot of lower growth concerns in 2019 and 2020 with financial markets discounting a significant economic slowdown. This view is inconsistent with the U.S. Fed outlook at low to mid-2% growth in 2019 with no recession in sight. Based on a number of indicators we follow we do expect slower 2019 U.S. economic growth consistent with the Fed in the 2%-2.5% area. This would not be in recession territory and a normal slowdown within the ebbs and flows of the economic cycle. Combined with extremely low interest rates and continued moderate inflation this spells out an environment which remains accommodative for corporate credit and should

facilitate continuation of low default rates. In the fourth quarter of 2018 high yield credit spreads widened by 200 basis points to end at 573 basis points and a yield of 8.23%, the highest yield since April 2016 which was near the beginning of more than two years of strong returns in the U.S. high yield debt market.

While our larger picture view is that the bear market in Treasury bonds began in mid-2016, in the near term there has been respite from higher bond yields due to inflation taking a pause (helped along by lower oil prices). The increased near term supply of U.S. government debt due to large budget deficits will likely be absorbed by households given recent financial market volatility. As financial markets get attuned to the lower growth environment we expect a resumption of higher bond yields in the coming year. Historically high yield corporate debt has outperformed investment grade corporate debt in periods of rising rates – we expect Fund positioning to be consistent with this theme.

Purpose Credit Opportunities Fund	1 month	3 month	6 month	YTD	1 year	3 year	5 year	Since inception
Series F	-2.16%	-6.72%	-5.23%	1.24%	1.24%	8.75%	-	8.34%
Series A	-2.24%	-6.98%	-5.64%	0.39%	0.39%	7.84%	-	7.59%

All performance as at December 31, 2018

All data sourced to Bloomberg.

Redwood Asset Management Inc. amalgamated with its parent company, Purpose Investments Inc,. on March 31, 2018. Purpose is a different kind of investment company, with an unrelenting focus on client-centric innovation. We offer a range of managed and quantitative investment products, with each product designed to have a clear purpose – to meet a specific goal in building resilient portfolios for our clients. Purpose Investments is a division of Purpose Financial, an independent technology-driven financial services company.