MULVIHILL PREMIUM YIELD

"Markets can influence the events that they anticipate."

— George Soros

First Quarter 2020

Mulvihill Premium Yield Fund "MPY" completed its first full quarter on March 31, 2020. It is hard to envision a three month span where more market moving events have taken place. Just days into the new year Qassem Suleimani, Iran's most important general, was killed by an American drone. This was just the tip of the iceberg as that was followed by an OPEC induced 66% collapse in the price of oil, US 10 Year Yields near 0.50%, the Federal Reserve effectively cut the policy rate to zero, a $2 Trillion fiscal stimulus package, Joe Biden emerged as the Democratic front runner, 6.8 Million Americans filed jobless claims in one week, volatility reached record levels, and a global rout in stocks, We ended the quarter with half the world collectively working from their couches as the global economy has been shut down to deal with the spread of COVID-19.

Performance of every asset class was impacted in the quarter led by stocks (S&P 500) which reached all time highs on February 19th only to find itself in a bear market (down 20%) by March 11th , down 35% by the March 23rd and ended the quarter down 19.6%. The S&P/TSX Composite Index fell -20.9% over the same period. **MPY returned -13.3% for the first quarter, capturing approximately 63% of the market decline.** While we don't like losing money we are pleased with how the strategy performed in the first quarter given the large negative returns seen across asset classes. Aspects of our investment philosophy were essential in navigating these volatile markets.

Figure 1:

Asset Class	Q1 2020 Total Return
Treasuries (Long Duration)	21.5%
Gold ($/oz)	3.9%
IG Corporate Bonds	-3.2%
HY Corporate Bonds	-12.0%
S&P500	-19.6%
S&P/TSX Composite	-20.9%
EAFE	-22.7%
Commodities	-23.3%
REIT's	-23.4%
Emerging Markets	-23.6%
Russell 2000	-30.6%
OIL (WTI)	-66.5%

Source: Bloomberg, Mulvihill Capital

Investment philosophy contributed to the outperformance in the period.

ACTIVE MANAGEMENT:

- **Believe in actively managed portfolios**
- Large market drawdowns, like the one just experienced, highlight that passive strategies are benchmarked to the downside as well as the upside.

FLEXIBLE MANDATE:

- **Flexibility to position the portfolio**
- Ability to invest outside of Canadian stocks, across all sectors and actively manage option writing exposure.

INCOME ORIENTED:

- **Utilize experience in options market to earn consistent tax-efficient income.**
- Ability to enhance income through selling options offers an alternative to popular dividend strategies.

LARGE CAP BIAS:

- **Invest in established companies**
- Large cap companies offer a level of safety during volatile markets, often declining less than small cap stocks.

FULLY INVESTED:

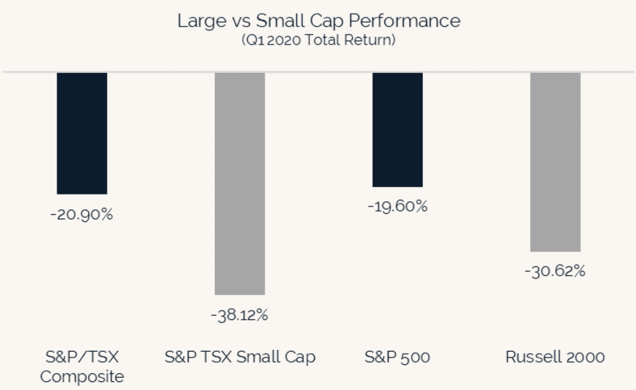
- **Believe investors in the fund make their own allocation decisions.**
- Investors choose MPY for a combination of income and equity exposure. Cash provides neither of these attributes.

Investment Philosophy Impact

In the first quarter the portfolio was positioned to differentiate itself from the S&P/TSX Composite. Our **actively managed** process and **flexible mandate** provide the ability to be unconstrained across geographic and sector exposures. MPY took full advantage of this by allocating approximately 47% of the portfolio outside of Canada. This decision impacted performance in several ways.

First, it helped accomplish the **large cap bias** we aim to have in the portfolio. The average market capitalization of stocks in the S&P/TSX Composite is $9.2 Billion, with the largest being Royal Bank of Canada ($124 Billion). The average market cap of the holdings in MPY at quarter end was $221 Billion, 24x larger than the average index constituent. Large cap stocks have historically outperformed small caps in volatile markets. This was the case in the first quarter (Figure 2).

Figure 2:



Source: Bloomberg, Mulvihill Capital

Second, the fund was able to avoid the high sector concentration within the S&P/TSX Composite. The top three sectors, financials, energy, and materials, make up nearly 60% of the index. The exposure to these three sectors within MPY was just 32% in the quarter. Utilities was the largest overweight as the fund looked to benefit from segments of the market that traditionally outperform when interest rates decline.

Third, the allocation to US equities provides exposure to the US Dollar which historically appreciates in turbulent markets, especially relative to commodity based currencies like the Canadian Dollar. MPY remained unhedged on the currency throughout the quarter, fully benefitting from the 8.3% advance in the greenback in Q1.

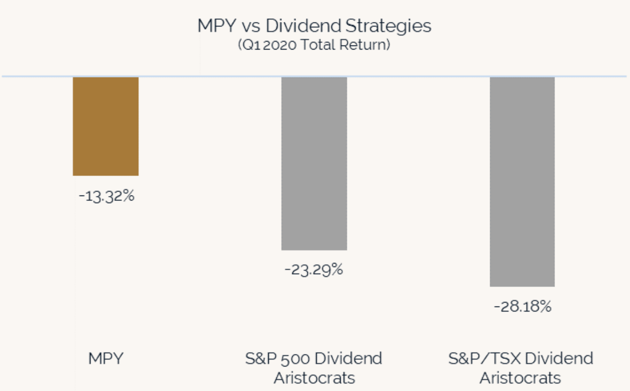
The fund is intended for investors looking for alternative sources of equity income outside of traditional dividend strategies. Our **income oriented** approach has evolved over two decades of experience in the options market to efficiently write options (covered call and cash covered puts) to generate tax-efficient income while balancing the need for capital growth. This approach has numerous benefits over dividend strategies;

- Generate income between dividend dates
- Option premiums receive preferential tax treatment vs other sources of income
- Customize amount of income generated in any month
- Not exposed to dividend cuts
- Capitalize on market events (elevated volatility, earnings)
- Premiums received preserve capital in a down market

Dividend strategies, specifically the S&P/TSX Canadian Dividend Aristocrats Index, are concentrated in the financial (37%) and energy sector (12%) where long-term headwinds may lead to dividend cuts for a number of companies. While dividend investing is usually synonymous with a level of safety, both the S&P/TSX and S&P 500 Dividend Aristocrats Indices underperformed the broader markets in the first quarter.

MPY has a distinct advantage of being able to avoid these stocks while using option writing to enhance yield in more attractive areas of the market. The fund utilized these tools to greatly outperform dividend based strategies (Figure 3) while also offering a yield advantage, currently at 5.9% (indicative) vs 5.3% for Canadian Dividend Aristocrats and 2.9% for US Dividend Aristocrats.

Figure 3:

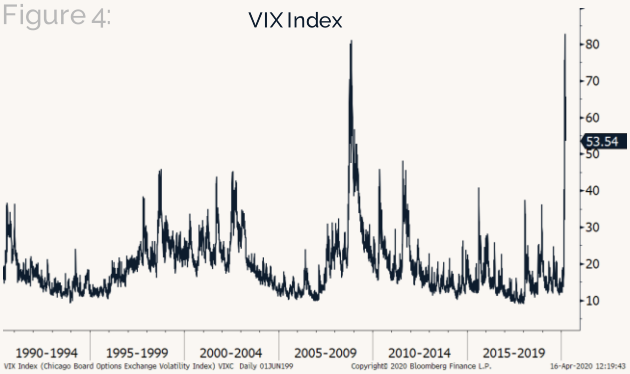


Source: Bloomberg, Mulvihill Capital

Option Writing

As uncertainly spread rapidly throughout global markets, volatility (VIX Index) reached levels only seen during the depths of the financial crisis (Figure 4) The fund was active in the first quarter as significant opportunities presented themselves in the options market. The fund was written on just 5.7% of the portfolio in mid January but increased this meaningfully to as much as 51.4% by mid March.

Figure 4: VIX Index

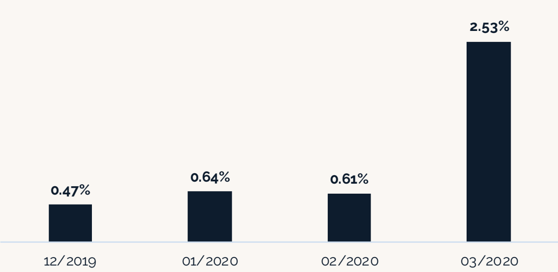


Source: Bloomberg, Mulvihill Capital

One intriguing observation was the rapid rise in shorter dated volatility vs longer dated volatility. The fund was able to capitalize by writing 1 to 2 week options out of the money, receiving elevated option premiums while also preserving some upside participation should the sell off be short lived, Given the short time horizon to expiration, these options eroded in value very quickly allowing them to be re-written multiple times during the month of March. The window to do this was brief, and the fund began to limit call writing activity towards the end of March anticipating a market bounce. MPY ended the quarter with 22% of the portfolio subject to option related strategies.

To fund the targeted 5% distribution per annum we aim to achieve 50bp in option premiums per month (6% per year). **In the first quarter MPY generate 4.4% in income, 3.8% from option premiums. The first quarterly distribution of $0.125 was paid at the end of March.**

Figure 5: MPY Option Premiums Generated (Since Inception 12/01/2019)

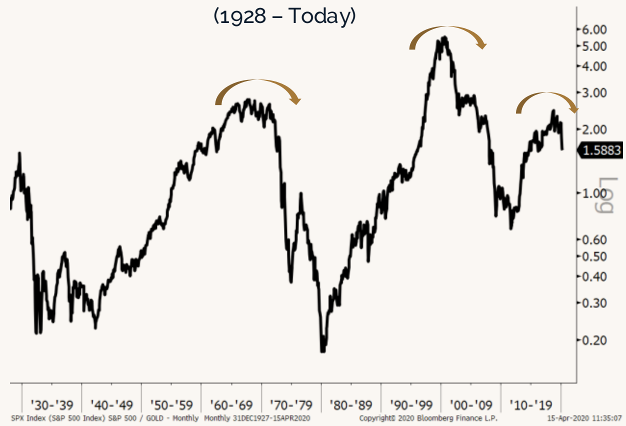


Source: Bloomberg, Mulvihill Capital

Final Thoughts & Positioning

At quarter end the fund remained conservatively positioned with a bias towards large cap US technology, utilities, and health care. Gold stock positions have been increased in the portfolio as we see few scenarios playing out in the current macro backdrop in which gold isn't a beneficiary (Figure 6). The belief is currently that a fairly meaningful rally has the potential to develop off the March 23rd lows that could extend for sometime. However, we remain hesitant to reconfigure the portfolio into more cyclical areas such as financials and energy at this time in an attempt to catch this bounce. We remain near fully invested in large cap, quality names that meet our investment criteria. This provides us with a sense of comfort in participating in a market move higher while maintaining a defensive posture should we see another wave of selling.

Figure 6: S&P 500 / Gold Ratio (1928 – Today)



Source: Bloomberg, Mulvihill Capital

Overall we think the market is getting ahead of itself with the "all clear" message from risk assets. Market typically don't bottom until the main issue that caused the selling (in this case the virus) is resolved. We haven't seen that yet and anticipate this may play out longer than most people believe. We look for concrete messages from market internals such as value outperforming growth stocks, small caps outperforming large caps, and high beta outperforming low volatility to give us comfort in a more durable move higher. This hasn't occurred yet. In the mean time we follow our process, generate consistent income and aim to deliver long-term returns for our investors.

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