# MULVIHILL PREMIUM YIELD

"The inherent vice of capitalism is the unequal sharing of blessings; the inherent virtue of socialism is the equal sharing of miseries."

— Winston Churchill

## Third Quarter 2020

**The Mulvihill Premium Yield Fund "MPY" returned 7.7% in the third quarter, bringing YTD returns to 4.7%. MPY has outperformed the S&P/TSX Composite Index by 7.8% this year with lower volatility and a higher yield.**

**The third quarterly distribution of $0.125 was paid at the end of September. Total distributions received YTD is $0.375 per unit.**

The stock market, and most other asset classes, continue to be a curious case of contradictions. Stocks seemingly refuse to decline in the face of ever greater hurdles. Deteriorating economic data, declining earnings, record high valuations, a US President that refuses to commit to a peaceful transition of power and a resurgent COVID-19 virus lead a long list of major risks investors digested in the last three months as the S&P 500 Index trucked to new all-time highs. The volume of market moving events continues to impact the performance of every asset class. In the first nine months of 2020, asset classes that historically provided safety in volatile markets have done just that. Long duration treasuries and gold have returned 21.8% and 24.3% respectively. Stock markets extended the rally from the March lows, with the S&P 500 returning 8.9% in Q3 while the S&P/TSX Composite Index returned 4.7% in the quarter and -3.1% for the year.

Figure 1:

| Asset Class | YTD 2020 Total Return |
|---|---|
| Gold ($/oz) | 24.3% |
| Treasuries (Long Duration) | 21.8% |
| IG Corporate Bonds | 7.5% |
| S&P500 | 5.6% |
| HY Corporate Bonds | -1.1% |
| S&P/TSX Composite | -3.1% |
| Emerging Markets | -1.0% |
| EAFE | -6.7% |
| Russell 2000 | -8.7% |
| REIT's | -12.3% |
| Commodities | -12.1% |
| Oil (WTI) | -34.1% |

Source: Bloomberg, Mulvihill Capital

## MPY Income Analysis

**Income Objective:**

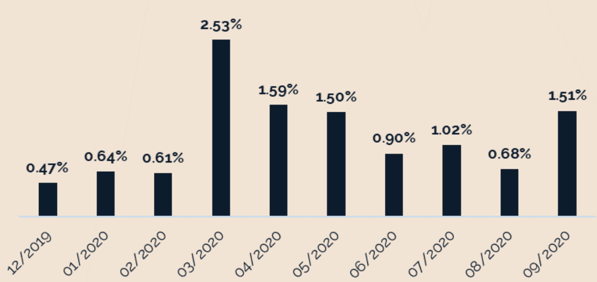
- Achieve 50bps in option premiums per month (6% per year) to fund the targeted 5% distribution per annum

**Option Premium Generated:**

- **MPY has generated 11.1% in option premiums in the ten months since inception.**
- Averaged 1.1% per month in premiums generated.

MPY Monthly Option Premiums Generated

(Since Inception 12/01/2019)




**Option Writing Statistics** (since inception)

| | |
|---|---|
| Total option trades | 118 |
| **% Positive*** | **81%** |
| **% Negative**** | **19%** |
| % of portfolio written (average) | 28.1% |
| Call / Put Trades | 110 / 8 |

*positive P/L or exercised below breakeven price

**negative P/L or exercised above breakeven price

Source: Mulvihill Capital

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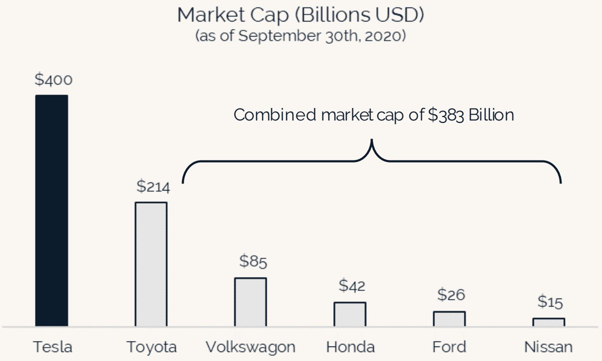
## Robinhood market

Last quarter, we touched on the extreme concentration of the FAANG stocks and their outsized impact on index returns this year. These stocks garnered a lot of media attention given how much market-cap they added in such a short period of time. While the magnitude of these moves has been surprising, and welcome given our exposure in the fund, it was other pockets of the market that resembled a sense of euphoria often associated with market tops. Fintech apps like Robinhood have made trading stocks easier and cheaper for new investors. Combined with COVID keeping people locked in their homes and stimulus checks hitting bank accounts, this new breed of investor had outsized impacts on certain stocks, including those discussed below.

- Few examples better represent the Robinhood market than Hertz. On May 22nd, Hertz filed for bankruptcy after the lockdown and travel freeze crippled the business for rental cars. Hertz shares declined by over 80% the next day as investors, including legendary investor Carl Ichan, liquidated their positions. Apparently blind to the fate of equity holders in a bankruptcy proceeding, the Robinhood crowd smelled an opportunity and began purchasing Hertz, moving the stock from $0.56 on May 26th to $5.53 on June 8th, a gain of nearly 900%. It has subsequently sold off by nearly 80%.
- Eastman Kodak Co, a brand name famous for its pioneering work in film photography, was the next target for this new cohort of investors. Kodak stock surged from $2.62 on July 27th to an intraday high of $60.00 two days later on news it won a government loan to assist in the production of a coronavirus treatment. It declined 85% from the highs to end the quarter at $8.82.
- My personal favourite remains the headscratcher that is Tesla. Tesla sold 367 thousand of the nearly 66 million cars sold globally in 2019, a whopping 0.5% of total global production. Despite this miniscule market share and the fact they have no operating profit, Telsla's market value was $400B at quarter end. To put this in context, the five largest auto companies globally sold over 22 million vehicles last year and have a combined market cap that is $383 billion (see figure 2).

While these are the stories that occupy the headlines, our investment philosophy steers us away from these euphoric opportunities and into high quality names with favourable long-term dynamics. Even as markets sit near record high valuations, we are finding numerous opportunities both in Canada and the US. More now than ever it seems apparent stock selection will be more important going forward than simply indexing.

Figure 2:




Source: Statista 2020, Forbes, Bloomberg, Mulvihill Capital

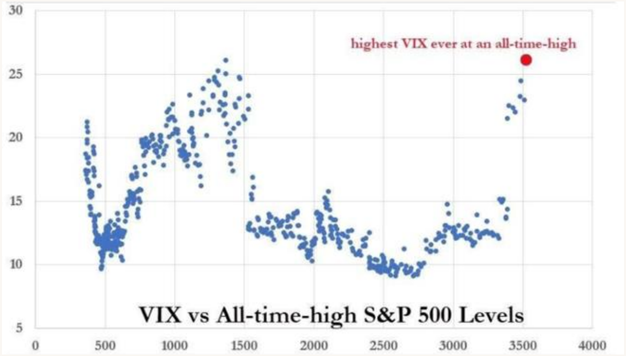
## Positioning

September marked the biggest shift we have seen in our thinking since we launched MPY in November 2019. As we discussed in previous quarterly updates, the portfolio was tilted away from traditional dividend stocks towards mega-cap growth names that paid low or even no dividends. Our option writing expertise provide us this flexibility as we don't need to chase yield via dividends, but rather generate income via option strategies. The rapid price appreciation, extreme valuations and bullish sentiment around this positioning became too worrisome as the quarter wore on and the fund exited names like Netflix Inc and Electronic Arts Inc. that benefited from the stay at home trade. Names that we continued to hold we wrote options on aggressively to mitigate downside (APPL, AMZN, MSFT). To reduce overall risk in the portfolio, this money was redeployed in Canada into more defensive sectors (Utilities, Consumer Staples). These new additions including Northland Power (+10.5% in September) and Metro (+5.9%) had positive attribution to the overall portfolio as markets declined in September.

The fund generated approximately 3.2% in option premiums in the last three months, more than enough to cover the third quarter distribution of $0.125 that was paid at the end of September. We continued to focus the option writing on holdings with high volatility, particular gold stocks and some of the larger cap technology holdings including Shopify Inc.

We believe we are in the early innings of what is ultimately setting up to be a secular tailwind for our strategy. Elevated volatility has adequately compensated us for writing options while positive price momentum in many of the companies held in the portfolio has contributed to capital appreciation in excess of the yield. To this point, one of the better charts received in the quarter was from Michael Gayed at Toroso Asset Management. As the S&P 500 broke out to new all time highs in August, he looked at what the level of the VIX Index (volatility) was during previous all-time highs (see figure 3). **Simply put, volatility has never been higher when the S&P 500 reached new highs.**

Figure 3:




Source: Toroso Asset Management

## Final Thoughts

Risks to the economic outlook remain the same.

- Resurgent COVID-19 cases
- US Presidential election
- Dwindling relations between US and China
- High valuations
- Social unrest fueled by race and inequality

The good news is that market participants appear to be aware of these risks and one way or the other have priced them into the market. Our best estimate for the near term is that any of these may provide a sudden dip in equity prices that will be ultimately met with more buying. As the FED continues its financial shenanigans and the political landscape pushes people and countries further apart, it is the potential for a more sustained sell-off that concerns us. Having said that, we remain flexible in our approach and have many tools at our disposal to mitigate portfolio risk should these events unfold.

## Disclosures