Third Quarter 2021

The Mulvihill Premium Yield Fund "MPY" returned 2.2% in the third quarter of 2021 vs the S&P/TSX Composite Index return of 0.2%

The third quarterly distribution of $0.125 was paid at the end of September. Total distributions paid since inception are $0.875 per unit.

Macro Thoughts

As the saying goes, we have a lot to unpack these days. The pandemic and its effect on the economy and society, the outlook for inflation, and Federal Reserve Board policies are three that come immediately to mind as having potentially meaningful repercussions on financial markets. Each is worthy of serious analysis to have an intelligent investment plan, but in my opinion the most critical question that needs to be addressed is where China is headed, as an economy and as a political entity. Obviously as the world's second largest economy and major trading partner of many countries, slower growth in China would have a significant negative impact on global growth. Already this year pandemic controls and government regulations have resulted in construction investment being down 3.2% as of the end of August and year over year retail sales in August came in at only 2.5% versus estimates of 7%. In addition, China's second largest property developer Evergrande Group is in default and facing bankruptcy which can't be good for the economy at large. If the Government or the Central Bank come to the rescue it will be a positive for markets not just locally but globally as well. President Xi Jinping might, however, see the bankruptcy as an opportunity to reduce risk taking by investors and to provide an excuse to consolidate his control over the country. Which brings us to a more significant and longer-term consideration; what is Xi's plan for the future of China. In 1972 President Richard Nixon made his famous trip to China to try and rekindle relations post the isolation that had resulted from events like the Korean War, the Vietnam War and Mao's cultural revolution. In the ensuing decades China gradually became more westernized, adopting a more democratic and capitalistic approach to government and the economy.

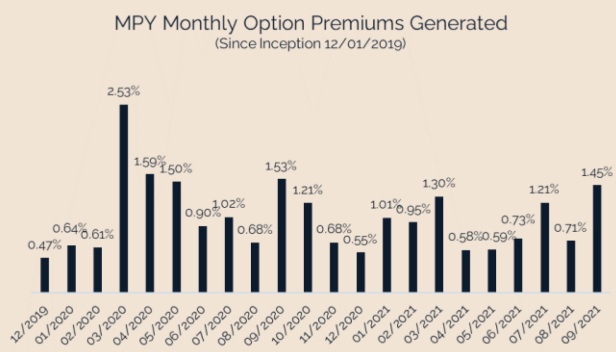
MPY Income Analysis

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 11.8% in option premiums in the last twelve months.**
- Averaged 1.0% per month in premiums generated.



Option Writing Statistics (since inception)

Total option trades	267
% Positive*	**79%**
% Negative**	**21%**
% of portfolio written (average)	25%
Call / Put Trades	247 / 12

*positive P/L or exercised below breakeven price

**negative P/L or exercised above breakeven price

Source: Mulvihill Capital

Today there is a strong sense that is about to change. Xi has become much more authoritarian, has cracked down on companies and entrepreneurs like Alibaba and its founder Jack Ma, and is proposing what appears to be a return to a stronger socialist state under the heading "common prosperity". It is difficult to know where this will all lead, but such a path for China would add to an already deteriorating relationship with the U.S. and other Western countries and raise concerns about global economic growth.

On this side of the Pacific Ocean the questions of leadership are much more up in the air. Canada has elected another minority government and in the U.S. hope for stability in Congress has vanished despite the Democrats owning a narrow majority. President Biden finds himself fully aware of the number of Republican votes against his legislative proposals, but is forced to beg and cajole to find support within his own party. The debt ceiling will be raised, (the government can't go on without money) but it's almost a tradition for the party not in power to squeeze as much of its own agenda in to the legislation as possible. It is beyond strange that a politician can vote for spending that requires borrowing and the next day vote against that borrowing. The infrastructure bill is even more contentious, as both the size of the bill and how to pay for it are up for serious debate. The U.S. economy would benefit from the fiscal spending the bill will provide, but the increase in taxes will have a reverse effect. Everyone seems to forget taxes don't need to be increased; the government has the power to allocate the funds without needing to balance any budget.

Which brings us to the spectre of high inflation. There is a compelling argument that the Fed's easy monetary policy over the past decade, which involved injecting liquidity into the system by buying bonds, did not in fact increase the amount of money in the system since more cash but less bonds left the system flat overall and hence didn't precipitate inflation. Fiscal stimulus such as this infrastructure bill and the support payments made during the pandemic are a whole other kettle of fish. They definitely involve injecting new money into the system and heighten the inflation risk. The CFO of Costco summed up the current environment rather well: "inflationary factors abound, higher labour costs, higher freight costs, higher transportation demand, along with container shortage and port delays and higher commodity prices". Of course, he is rationalizing his own price increases but he's not wrong. I am still of the belief that there will be reversion to the mean as the pandemic forces ease, but the energy crisis developing in Europe is another example that this is no time to relax.

I found it interesting that, as John Mauldin points out, the three expansions in U.S. GDP of the last 20 years prior to the decline and subsequent rebound caused by the COVID pandemic look like this:

1991 – 2001	3.6%
2001 – 2007	2.8%
2009 – 2019	2.3%

It can be argued that once the economy normalizes, this longer-term trend of slower growth will reappear. Something I hadn't thought of, again from Mr. Mauldin, is the effect on the labour force participation rate in the U.S. of the large number of men incarcerated or with criminal records compared to the rest of the world. This group consists mostly of men, African American men, and men with low education and amount to 20 million persons who are largely precluded from joining the work force and are a wasted potential asset.

Asset Class Returns

Stocks	Q3 Return
S&P 500	0.6%
S&P/TSX Composite	0.2%
MSCI Emerging Markets	-8.0%
MSCI EAFE	-0.3%
Bonds	
US Aggregate	0.1%
US Treasuries	0.1%
US Corporate	0.0%
US High Yield	0.9%
Commodities	
Gold	-1.0%
Copper	-4.5%
Oil (WTI)	4.0%

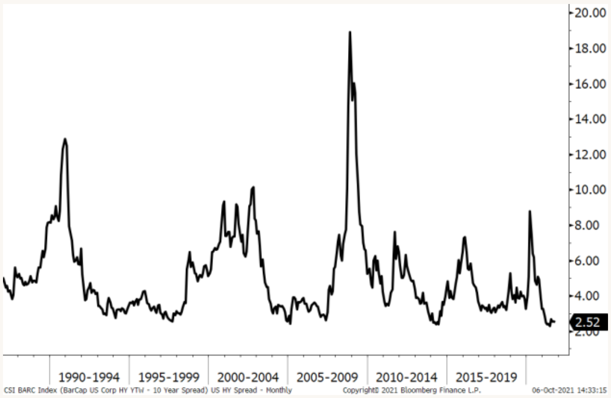
Source: Bloomberg, Mulvihill Capital

Asset class returns were broadly uneventful in the the third quarter. The S&P 500 and S&P/TSX Composite Index were able to eke out small gains up 0.6% and 0.2% respectively. Emerging market equities, led by the rapid decline in Chinese stocks, declined -8% in the past three months.

Rising interest rates have been a popular topic as of late. The US ten year yield traded as low as 1.17% and as high as 1.54% in Q3. It ended at 1.49%, marginally higher than the 1.47% at the start of the quarter. This flat interest rate environment was reflected in fixed income returns with US treasuries and Investment Grade bonds essentially flat for the quarter. US High Yield bonds returned 0.9% and remain an area worth watching as HY spreads sit near record lows (Figure 1).

Figure 1:

US High Yield Spread



Source: Bloomberg, Mulvihill Capital

Commodities remain an area of interest for investors as the inflation narrative has spurred moves in the industrial metals and energy reminiscent of the early 2000's bull market. Gold appears to be the odd man out in the commodity complex with a -7.9% return in 2021, vs WTI up 58% and copper up 16%.

Portfolio Positioning

We remain of the view that the prospects of an imminent recession or aggressive bear market in equities are unlikely at this point.

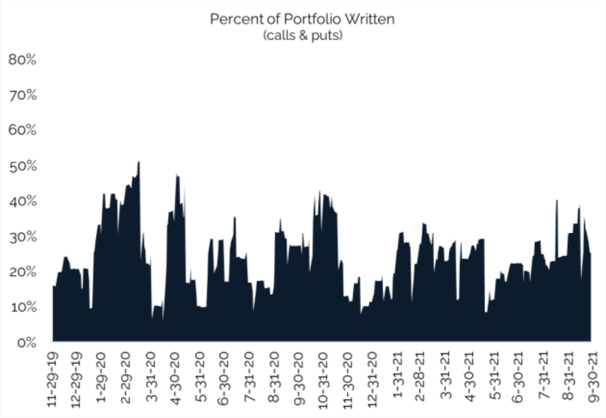
While several indicators are starting to flash caution, overall we remain positive on the outlook for stocks. However, given where valuations are today, the "easy" money has likely been made at this point in the cycle. We anticipate markets will be in a muddle through period where we see limited upside in the near term for stocks and potentially elevated risk for a modest and healthy correction before year-end. The portfolio is positioned for such an environment by remaining invested in cyclical sectors (higher beta) and using these names to implement our option strategies. The higher beta exposure should provide adequate upside participation should markets continue to climb into year end, while the option overlay strategies (both call and put writing) work to reduce downside. At this time, we view this trade-off as a more productive use of clients capital than tilting the portfolio to traditionally more defensive sectors like utilities and consumer staples in an attempt to time a pullback.

In an environment were we see a higher probability for near term volatility, there are a few levers we can pull within the option strategies to better balance the trade-off between risk and reward.

1. **Write a larger percentage of portfolio**
2. **Write options closer to the money (more premium)**
3. **Write put options to enter new positions**
4. **Purchase put options / put spreads**

Over the course of the last three months we have utilized all of these. As of September 30th ,the fund had 25% of the portfolio written (calls and puts) towards the highest levels we have had since the first quarter. As we head into October, we anticipate this written percentage to continue to climb.

Figure 2



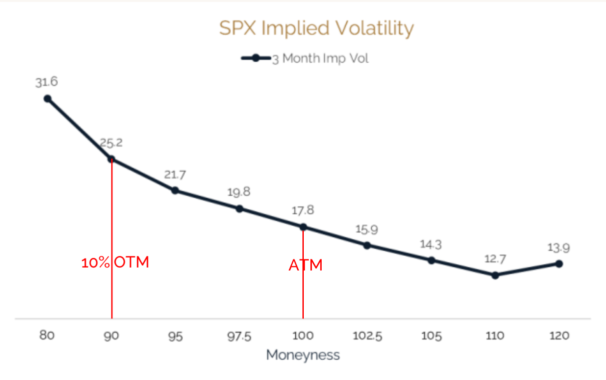
Source: Mulvihill Capital

While the fund continued to write call options on names, a greater emphasis was placed on put writing. This has been in response to dynamics playing out in volatility markets The elevated downside skew in the market (downside volatility higher than ATM volatility) combined with our overall constructive view of markets has lead us to see more value in put writing than we have since inception.

Another way to take advantage of this Skew dynamic is through a put spread. We have implemented a small position on the SPY ETF where we purchased an ATM put and sold 10% OTM puts to help offset the cost of the "hedge". Given the view we don't see a large market correction on the horizon we felt the 10% level was adequate for this trade (Figure 3).

Figure 3:

For much of the third quarter, downside skew on the S&P 500 was at or near the highest levels over the past 10 years. Investors paid a premium to hedge against a sharp decline in the market.



Source: Bloomberg, Mulvihill Capital

Final Thoughts

Traditional equity and fixed income investing have unique challenges in the current market environment. Equity valuations sit near all-time highs on most popular metrics (Cyclically Adjusted PE Ratio, P/Sales etc.) while elevated duration in fixed income portfolios leaves investors exposed to a rising rate environment. Both offer little in the way of yield to compensate investors. Option-based strategies provide an alternative for investors looking for enhanced income with lower risk. However, these strategies come with there own set of concerns for investors. One of the often-cited problems with call writing strategies is they give away too much upside in exchange for lower volatility and enhanced yield. We would broadly agree with this assessment as many managers of covered call funds utilize a passive approach to implementing option strategies. If you refer to the table below, covered call strategies have returned 6.7% annualized vs 14.7% for the S&P/TSX Composite Index, approximately 45% of the return of the index. These results have been achieved with only slightly lower volatility than the market (18.3 vs 19.0).

The active approach of the Mulvihill Premium Fund extracts the benefits of option strategies (higher income, lower risk) while still providing adequate participation in bull markets. MPY has been able to achieve an attractive balance, generating market like returns with lower risk and higher tax-efficient income. **Since Inception MPY has returned 12.5% annualized, capturing approximately 85% of the move in the market with less than 2/3rds the volatility, beta and drawdowns, while providing a 5% tax-efficient yield to investors.**

	Return	Income	Risk		
	Total Return (SI annualized)	Yield (after-tax estimate*)	Sharpe Ratio	Std Dev (annualized)	Beta (toTSX)
Mulvihill Premium Yield Fund	**12.5%**	**5.0%**	**0.87**	**12.9%**	**0.60**
Covered Calls	6.7%	4.2%	0.29	18.3%	0.92
Stocks	14.7%	1.5%	0.65	19.0%	1.00
Dividend Stocks	12.0%	2.5%	0.42	23.5%	1.16
Real Estate (REIT's)	5.2%	2.3%	0.12	26.3%	1.25
Bonds	1.6%	0.8%	0.32	5.1%	0.12

Data from inception of MPY on 11/29/2019 to 10/14/2021

*MPY 100% ROC distributions, Equity investments taxed at dividend tax rate of 39%, Fixed Income investments taxed as interest income 53%

Mulvihill Premium Yield Fund (Class F), S&P/TSX Composite Index, Bloomberg Barclays Canada Aggregate Index, S&P/TSX High Dividend Yield Index, BMO Cdn Covered Call ETF, S&P/TSX REITS Index

MPY Target yield based on initial NAV of $10.00

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