Significant Challenges Ahead

A. Second Quarter Review

Well, that was historic. The fastest 30% plus drawdown in the history of global equities in the first quarter followed by the largest 50-day advance in market history in the second quarter. The S&P 500 which peaked at 3,393 in late February bounced off a low of 2,192 in late March only to be back above 3,100 on June 3! The technology laden Nasdaq, after dropping 30% from a record high of 9,817 on February 19th to 6,860 on March 23rd hit a new all-time high on June 10 and just keeps moving higher!

The strength of the quarter for both equities and credit was driven by central banks and governments who provided enormous amounts of stimulus as economies started to reopen after forced lockdowns due to the coronavirus. Despite the strong rebound in risk assets, traditional portfolio hedges such as government bonds and gold have performed strongly. US Treasuries are up about 9% year to date, while gold is up close to 20%. As economies have started to reopen, economic data has shown signs of a sharp rebound, albeit off historic lows. For example, US retail sales rose 17% month on month in May, while UK retail sales rebounded by 12%. As impressive as these numbers sound sales are still down 6% and 13% year on year respectively. The speed and magnitude of the bounce back is positive but we have a long way to go.

The S&P 500 looks to be pricing in a V-shaped economic recovery, but it is worth noting that sector performance tells a more differentiated story. For example, online retailers are up very strongly year to date, while department stores are down sharply, along with other sectors that have been most affected by the virus, such as hotels, airlines, retail REITS, energy companies and banks. While most of the worst-performing sectors year-to-date have also lagged during the rally since late March, energy companies have actually been one of the best-performing sectors, as oil prices partially recovered. Some of the best performing sectors year-to-date, such as food retailers and supermarkets, have lagged the most during the rally. So it is important to look beneath the index for both the opportunities and risks, and to be aware that many companies aren't starting the second half of this year where they were at the beginning of the year, even though some stock indices may give that impression.

Value stocks are down 17% this year, while growth stocks (especially technology companies) are up 6%. Overall, the market has rallied on the back of fiscal and monetary stimulus, combined with the reopening of economies. We believe that monetary support (low interest rates and money printing) are here to stay, while fiscal stimulus may become less generous (governments are tapped out) and will certainly differ by country. Meanwhile, rising infection rates of COVID-19 look to be leading to further social distancing measures being imposed or voluntarily adopted along with forcing as many people as possible to run around with masks. Given the draconian response to the coronavirus by governments around the world, we favour a flexible and active approach to investing. We continue to keep some money on the sidelines and invest in companies and sectors that are most likely to survive this round of insanity.

Here are five longer-term implications emanating from the pandemic that we believe are highly likely and are influencing our asset allocation.

1. Low interest rates for as long as the eye can see. The global economy has taken a massive hit from the pandemic and interest rates are being held at near zero or lower by all the

major central banks. Currently, there is a significant amount of economic spare capacity due to the lock downs in the short-run this will keep inflation low for the next year at least. After experiencing zero rates, central banks are likely to keep rates low once inflation rises. They will be reluctant to tighten too quickly especially given the crushing levels of debt around the globe.

2. Less globalization. Globalization and the raiding of Western nations was already in reverse before COVID-19. The backlash in the UK with Brexit, the rise of Donald Trump and the U.S./China trade war have dampened global trade. The virus simply accelerated the anti-globalization trend especially when the world saw the culpability and dishonesty of the Chinese Communist Party. Global supply chains are being unwound and the pandemic has created fears about food security and pressure for domestic production of medical supplies and other manufactured goods.

3. More government debt and a bigger share of government in the economy. The lockdowns have led to the largest rise in government debt levels since World War II and higher levels of government support for industries. Eventually, the political debate will turn to how to pay for the lockdown support measures and how to address the socialist driven inequalities made worse by the pandemic. As government grows, wealth disparities increase and economic growth slows. We need to be in very resilient and defensive industries least impacted by the cancerous growth of the State.

4. Higher inflation, eventually. While inflation should not be a major problem for the next year or two given economic spare capacity, longer-term, inflation could rise by more than expected. It seems almost impossible that our money will not lose significant value in the years ahead. If governments continue to run massive deficits and pile up debt at a record rate and central banks use their power to digitally create trillions of currency units, the value of our paper money can only go in one direction, down! As shareholders, we need to be invested in businesses and assets that will protect our purchasing power from this abandonment of economic and fiscal prudence.

5. Pressure on profit margins. Slower economic growth due to the crippling levels of debt and government intrusion in the economy, inefficient capital allocation, weakening just-in-time inventory management, higher taxes and higher labor costs will put downward pressure on profit margins.

B. North American Equity Market Statistics

During the second quarter, the Canadian equity market as measured by the S&P/TSX increased by by 16.7%, and year over year decreased by 3.0%, including dividends. The S&P/TSX index has lagged most of the world's major stock markets over the past 15 years and over the past 5 years has only generated returns of 3.7% per year! Despite this underperformance, ROCKLINC has successfully generated returns over the past year and for longer periods that have trounced the overall Canadian market index. We have managed to do this by avoiding many of the weaker performing stocks and minimizing our exposure to some of the underperforming sectors.

During the second quarter, our basket of Canadian companies outperformed the index by approximately 10.4% and over the last twelve months we were ahead of the Canadian index by approximately 27.9%! This is another reason why we love active investing over passive index

investing! Our overweight position in the gold and silver royalty companies, along with our infrastructure holdings and technology stocks, added significant value during the quarter and over the past year. Our underweight position in banks, energy and materials helped us avoid some of the weaker sectors in the S&P/TSX during the quarter and over the past year. Despite these very strong numbers, our focus remains on the long run and on the economic fundamentals.

In terms of the S&P/TSX, all the sectors except for one turned in positive returns during the second quarter! In the first quarter all the sectors were negative! Here are their returns from best to worst: Information Technology +68.2%, Materials +41.6%, Consumer Discretionary +32.0%, Industrials +12.8%, Consumer Staples +11.4%, Real Estate +10.2%, Health Care +9.6%, Energy +9.3%, Financials +4.8%, Utilities +2.7%, and Telecommunications -2.1%.

Pertinent market action during the second quarter of 2020 and during the last 12 months is captured in the following table.

	June 30, 2019	March 31, 2020	June 30, 2020	3 Month	1 Year Return
CAD/USD	$.7637	$0.7128	.7366	3.33%	-3.55%
Oil WTI (US $)	$58.47	$20.31	$39.27	93.40%	-32.80%
Gold (US $)	$1,413.70	$1,590.20	$1,783.40	12.20%	+26.20%
Silver (US $)	$15.34	$14.14	$18.20	28.70%	18.64%
S&P/TSX	16,382	13,379	15,515.20	15.96%	-5.29%
S&P 500	2,942	2,585	3,100.29	19.90%	5.38%
Cdn 10 yr.	1.47%	.73%	.52%	-21 bps	-95 bps
US 10 yr.	2.01%	.73%	.66%	-7 bps	-135 bps

Source: Bloomberg

The Canadian dollar regained some of its losses in the first quarter by increasing 3.33% against the $USD during the second quarter but is still down 3.55% over the last year. Over time the best way to mitigate currency risk is to buy strong and growing businesses that generate revenue in numerous currencies and as a result, create a natural currency hedge in your portfolio. At the time of writing this report our Federal government has just released its estimated deficit for 2020. The number is mind boggling and is expected to exceed $343 billion. At the beginning of the year, our total federal debt was approximately $750 billion. This means that in one year we will increase our national debt by almost 50%! This underscores our basic thesis of buying hard assets along with precious metals to protect us from our government which is determined to trash the value of our money with their grossly immoral economic policies.

Oil continued its volatile ride during the quarter! After a disastrous first quarter oil rebounded by 93.4% but is still down 32.8% year over year! Fortunately for our investors, our exposure to the oil and gas sector remains miniscule and our interest in the sector remains muted. Commodities in general are very volatile and lack predictability making them poor long-term investments. To add further pain to the oil trade in Canada, we have the added complexity of having political leaders (at the federal level) who are more interested in sabotaging the resource sector (especially the oil and gas sectors), rather than leaving it alone to prosper and create significant wealth for all Canadians.

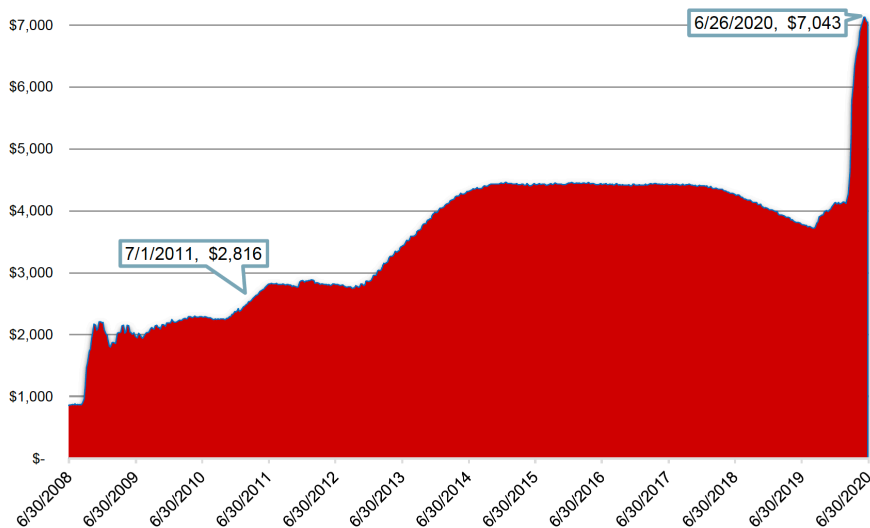
During the first quarter, interest rates collapsed in the face of the economic turmoil resulting from the policy decisions to shut down the global economy in response to the coronavirus. What is particularly interesting is that interest rates continued to fall in the second quarter even as economies began to reopen. This trend reinforces what we have been telling our investors for almost ten years, **we do not expect interest rates to increase significantly for a long time! How could they? With global debt at levels never before seen in world history the global economy could not even absorb an increase of 200-300 bps without sinking into a depression!**

Low interest rates, coupled with fears of a global depression, continued to propel the price of precious metals and gold jumped to its highest level in eight years (gold as measured in Canadian dollars is now approaching $2,500 per oz. which is an all-time high). Year over year gold is now up over 26%. Our expectation is that this is just the beginning for gold and its lagging counterpart silver. With interest rates approaching zero and, in many geographic regions, negative, coupled with record amounts of money printing globally, it's a safe bet that monetary substitutes, like gold and silver, will experience substantial upside in the years ahead. The bottom line is that currencies, whether US dollars, pounds or yen are based on nothing more than trust. Precious metals have a 5000 year history as money and represent a dependable store of labour and real value. Trust is not required to hold gold and silver because they have no counterparty risk and are not another person's liability.

With governments around the world coupled with their central banks destroying trust in the financial system with their profligacy, it's not difficult to understand why investors should maintain a portion of their portfolios invested in the precious metals. The image below reflects the balance sheet of the Federal Reserve which is another way of saying the money that is being pumped into the economy. In 2008 US money supply was approximately $800 billion. Today it is over $7 trillion!

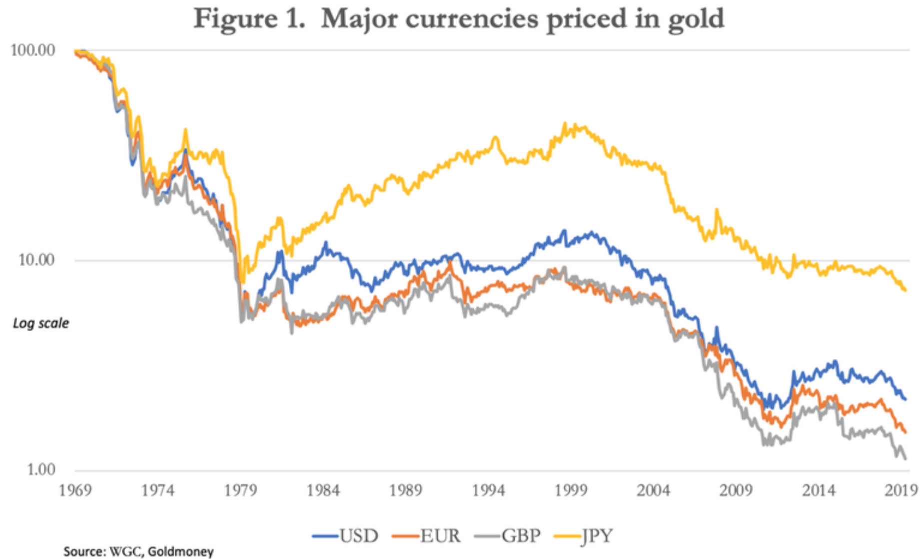
Fed Balance Sheet

- At $7.043 trillion, the U.S. Federal Reserve Balance Sheet is 150% higher than it was in 2011, and still growing



Source: Sprott Investments

Figure 1 below shows that all major currencies have lost more than 90% of their value against gold since 1969! Note that the chart below is using a logarithmic scale. We believe the loss of value of paper or digital fiat currencies will only accelerate over the next 3-5 years! When gold is headed up the value of your currency is heading down! Don't be fooled by the politicians. There is no such thing as free money!



For clients who know their history, money printing and governments that steal and pillage from their own population is nothing new. The chart below shows the watering down of Roman coinage based on the percentage of pure silver. As Roman culture collapsed morally their money was not far behind. **The value of a country's money cannot rise above the values and ethics of its citizens.** As Western civilization turns its back on its history and Judeo-Christian foundation, it should not surprise us to see our money being destroyed and devalued by a thoroughly corrupt political class. What's even worse is a citizenry that is too envious and greedy (driven by socialism) to even notice or care.

This is why we continue to build substantial positions in the precious metals sector. Our top five precious metals investments are listed below. In aggregate they represent 18% of our total assets and given our total equity exposure across all our client accounts is 68% our precious metals exposure is now over 25% of our equity weightings. Given that all the major indexes are negative during the first half of 2020, with the exception of the NASDAQ you can see how these companies added substantial value to your portfolios with an average six month return of approximately 33%! Their outperformance has continued into the third quarter!

	31-Dec-19	30-Jun-20	% Change
Franco-Nevada	$134.09	$189.69	41.5%
Wheaton Precious Metals	$38.64	$59.71	54.5%
Royal Gold	$122.25	$124.32	1.7%
Sandstorm Gold	$9.84	$13.03	32.4%
Pan American Silver	$30.76	$41.23	34.0%

Lastly, as we have communicated to our clients for many years, gold tends to act as a hedge to weak capital markets. The chart below illustrates the value gold can provide in a negative market environment.

Gold as a Hedge

Date of Market High	Date of Market Low	S&P 500 Return	Gold Return	Gold Relative S&P 500
16-Sep-1929	1-Jun-1932	-86.19%	+0.29%	+86.48%
2-Aug-1956	22-Oct-1957	-21.63%	-0.11%	+21.52%
12-Dec-1961	26-Jun-1962	-27.97%	-0.06%	+27.91%
9-Feb-1966	7-Oct-1966	-22.18%	0.00%	+22.18%
29-Nov-1968	26-May-1970	-36.06%	-10.50%	+25.56%
11-Jan-1973	3-Oct-1974	-48.20%	+137.47%	+185.67%
28-Nov-1980	9-Aug-1982	-27.27%	-45.78%	-18.51%
25-Aug-1987	20-Oct-1987	-35.94%	+1.38%	+37.32%
16-Jul-1990	11-Oct-1990	-20.36%	+6.81%	+27.17%
17-Jul-1998	8-Oct-1998	-22.29%	+1.71%	+24.00%
24-Mar-2000	10-Oct-2002	-50.50%	+11.18%	+61.68%
11-Oct-2007	6-Mar-2009	-57.69%	+25.61%	+83.30%
21-Sep-2018	26-Dec-2018	-20.21%	+5.59%	+25.80%
19-Feb-2020	23-Mar-2020	-35.41%	-3.63%	+31.78%
	MEAN	**-36.65%**	**+10.28%**	**+45.85%**
	MEDIAN	**-27.97%**	**+1.38%**	**+27.54%**

Source: Cornerstone Macro, FactSet, Bloomberg. Gold performance is measured by Bloomberg XAU Curncy (Spot Gold). The S&P 500 is measured by the Bloomberg SPX Index.

C. ROCKLINC Investment Update

In terms of our ROCKLINC portfolios, with a 68% equities and 32% short-term bonds mix, they increased by 15.1% during the second quarter and by 15.9% during the last 12 months (period ending June 30, 2020).

More importantly, our average annual compound rate of return over the past 3 and 5 years is clocking in at approximately 10.5% and 9.5%, respectively. Returns are after all fees, and are based on an asset mix of approximately 68% invested in equities, with the remainder invested in short-term deposit accounts, bonds and preferred shares. This asset mix has varied over the past five years but in general we have averaged approximately 65% invested in equities. Please note that the performance we are disclosing is our **aggregate performance** across all our accounts. Each client's portfolio is unique, and performance will vary, based on your risk tolerance and your specific asset allocation.

When we dig further into our numbers, we find that our basket of equities increased by 22.8% during the second quarter and by approximately 21.6% during the past 12 months. Our equities have been compounding by approximately 13.2% per year over the past 5 years and outperforming their relevant indexes. We like to point out the significant difference in performance between Canadian and US equities. Over the past five years, our Canadian equities have been compounding at 11.7% per year (compared to the index at 3.7%), while our US equities have been growing at 15.4% per year (compared to S & P 500 index at 10.7%)! This points to both the greater investment opportunities outside Canada and the strong US stock market. We continue to allocate capital into global businesses and glean the benefit of global growth and diversification in our portfolios.

Although the markets were very volatile during the first half of 2020, our focus did not change. We continue to rivet our attention on the economic fundamentals! This means that we **first,** selectively add companies as our research team ferrets out new opportunities. **Second**, prune underperforming businesses. **Third**, take advantage of market swings and add to our outstanding companies at better prices! Whether the markets are woozy or exuberant, there are always opportunities we can seize upon. The key is that we must be prepared and focused on the playing field.

D. Company Update

As Covid-19 spread across the globe, hygiene and health protection was top of mind for both consumers and businesses. Companies that were prepared to address the health and safety needs that quickly arose performed strongly in the quarter and are now well positioned to grow for years to come. One company that is a leader in hygiene, food safety, clean water and infection prevention is Ecolab. Whether you have been to a grocery store, restaurant, public washroom, hospital or hotel, chances are you have benefitted from one or more of Ecolab's products and services and not even known it. Ecolab's products play a critical role in its customer's daily operations. As health and hygiene become a top priority, Ecolab captured a larger mindshare of its 3 million customers. Ecolab provides services to many of the largest corporations in the world, such as Costco, Chic Fil A, Four Seasons, McDonalds, PepsiCo, Marriott, Nestle, Starbucks, Walt Disney and Walmart.

Ecolab offers a unique value proposition in that it creates customized solutions to address its customers' challenges, while also helping its customers save money on water and energy in the

process. For instance, in 2019, Ecolab helped its customers save 206 billion gallons of water, conserve 28 trillion BTUs of energy, eliminate 113 million pounds of waste and avoid 1.5 million metric tonnes of greenhouse gas emissions. Ecolab incorporates predictive data-analytic technology across its core products to automate and enhance the efficiency of customer's operations. Ecolab's main mission is to help its customers create a safer, cleaner and more efficient operation. It does this by employing a strategy called "Circle the Customer, Circle the Globe" to grow its business. To "circle the customer", Ecolab offers a comprehensive set of solutions that address more than one of its customers' needs. As its customer's business expand, Ecolab "Circles the Globe" and moves with its customers across different geographical regions. This has enabled Ecolab to become a global leader in many geographical markets.

Many different industries depend on Ecolab for their daily operations. In the Food and Beverage industry, the prevention and elimination of foodborne illness and contamination is critical. Ecolab offers a comprehensive suite of customized food safety solutions used across the food and beverage production cycle. In the Food Retail sector, Ecolab provides products and personalized services to clean and sanitize grocery stores and restaurant kitchens. In the Energy industry, Ecolab offers on-site solutions to prevent corrosion and improve the useful life of petroleum, petrochemical and natural gas operators' assets. In the Healthcare industry, companies are required to meet strict regulatory compliance and sanitized environment. Pharmaceutical, life sciences, medical device, hospital and biotechnology companies rely on Ecolab as part of their cleaning and disinfection programs to prevent infections, improve hospital room turnover and create sterilized environments. In long-term care facilities, Ecolab offers cleaning, disinfection and hand hygiene programs to help to eliminate and prevent the spread of pathogens. Across different industries, companies rely on Ecolab to address many of their water challenges. Ecolab offers clean water technology that not only helps treat water, but also help customers save money by reducing overall water usage.

As a vital part of its customer's daily operations, Ecolab has created a predictable and stable business model that benefits from long-term growth trends. Many of its products are consumable products, which means customers continue to go back to Ecolab for replenishment. Over 90% of Ecolab's revenue is recurring, which gives Ecolab a very stable stream of revenue over time. Ecolab also has a diversified customer base across different industries, which helps dampen any losses when one or more industries struggle. The company is a prudent allocator of capital that strategically invests in areas with high return on investment. For instance, in 2011, Ecolab acquired Nalco Holding, which has become one of the leading providers of water treatment technology. Ecolab's stable business model, differentiated value proposition and strategic capital allocation also translates into strong financial results. For instance, free cash flow growth is one financial metric that we carefully examine. Free cash flow is the amount of cash that a company can produce after subtracting the purchase of assets, such as property and equipment. From 2010 to 2019, Ecolab generated a free cash flow compound annual growth rate of 11%, which helped contribute to the over 300% return in stock performance over that same period. As companies become more conscious of creating a cleaner and safer operations, Ecolab is well positioned to benefit from this demand for many years to come! Ecolab is a company we have owned in many client portfolios for over 9 years. We suspect that it will remain a major holding for at least another 9 years given its market position and the importance of their products and services to the global community.

E. Moving Forward – Turning Challenges into Opportunities

Our focus has not changed. We continue to keep our eyes riveted on the fundamentals of the businesses we invest in, within the context of the global economy. **We will do our best to take advantage of sharp moves in the market!** As investors, volatility and turbulence are our friends and we will use them to your advantage. During this quarter we had the opportunity to add to many of our favourite positions at wonderful prices but the quick snap back in prices limited our buying opportunities. It is important that we remain vigilant given the massive challenges ahead. Anyone who believes that the market cannot drop sharply going into the Fall is mistaken.

As a result, the investment team at Rocklinc is working hard to make sure our existing companies are performing as expected or better and searching for new companies that we can add to your portfolios. Over the past year we have added several new companies to our mix including Abitibi Royalties, Algonquin Power, Northland Power, Pan American Silver and ThermoFisher Scientific. During the same period we eliminated a couple of positions including Oracle and First Capital, along several smaller positions. Our most significant asset allocation change over the past 12 months is our increased weighting to the precious metals sector primarily through the streaming and royalty companies but also through a couple of mining companies. Given the global monetary recklessness we are engulfed in, we view this allocation as a strategic hedge to protect the overall value of your portfolios as discussed earlier in this update.

Our basic strategy has not changed although we are sharpening our thoughts and processes to deal with these extraordinary times we are living in. Here is a summary our thoughts.

1. Patience – we need to wait for the “fat pitch”. We will only swing at stocks when they are compelling opportunities. We are in uncharted waters. We have never shut down/locked down large swaths of our economy before. We do not know when this will end so we will not rush into the market without some clarity.

2. Watch the world’s leading Central Banks. The level of money printing is already historic and it is just beginning. **Our collective profligacy will make the Roman Empire in its dying and most decadent years look vibrant and prudent!** The only solution central bankers know is to try and reflate the economy with unlimited digital money.

3. Pay attention to the irresponsible decisions of governments around the world. Governments are now running massive deficits that are larger as a % of GDP than during WW2. For example, the US deficit could exceed $5 trillion this year and stay in the multi trillion dollar range for many years. **Canada’s federal government deficit will exceed $450 billion!** These numbers are beyond shocking and they will be devastating to the finances of our country.

4. Diversify across asset classes, sectors and geographic regions. At the current time we are focusing on nine sectors. These are agriculture, consumer staples, financial, healthcare, infrastructure, manufacturing, precious metals, technology and water.

5. Minimize our exposure to the Canadian dollar. Unfortunately Canada is suffering under the most incompetent leadership in the history of our nation. Investment monies have been leaving Canada over the past five years at a record rate and at the same time our politicians, particularly our federal politicians, are increasing our national debt at a speed that is beyond any sort of rational comprehension. To top it off, our Bank of Canada has agreed to monetize these massive deficits with almost unlimited money printing.

6. Invest in businesses with strong balance sheets, backed by hard and tangible assets with limited counterparty risk.

7. Invest in firms that produce essential products and services, in growing industries, with well-established long-term secular growth trends. Our highlighted company this quarter Ecolab is an excellent example.

8. Avoid/minimize highly leveraged financialized firms that have incomprehensible balance sheets, loaded with risky derivatives. Recently, we have reduced our position in banks, which have always been very low and we continue to avoid life insurance companies even more than the coronavirus!

9. Maintain liquidity in our portfolios, in order to take advantage of significant moves in the stock market. **Cash is not trash** when the markets become irrational! We expect our cash allocation to be put to work during 2020!

10. Remain optimistic and opportunistic without being gullible to the risks all around us. **Investing in turbulent times can be rewarding, with the right investment philosophy and prudent execution.**

If you have any questions pertaining to your account please call or email for an appointment.

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