Portfolio performance

The JFT Strategies Fund (the "Fund") was up 0.69% in May 2018. The positive performance was mostly the result of winners from our long positions. The biggest contribution for the month came from Great Canadian Gaming (GC), which was up 42% in May after a big Q1 earnings beat. As we mentioned in last month's commentary, GC was one of our bigger positions in the Fund as we believed the recent transformational asset purchases from the OLG were not being properly reflected in the stock price or in analysts' estimates. Another positive contributor was Photon Control (PHO), which increased 25% in May after a strong Q1 result. PHO manufactures and sells optical sensors that are a key component for chip manufacturers. The company has been growing quite fast, and in Q1 they reported 24% sales growth YoY and a 70% increase in net income. Our long position in Organigram's (OGI) convertible bonds was also a big contributor in May, as the bonds increased by almost 12%. We own the bonds because we think Organigram is undervalued relative to others in the sector considering its long history as one of the first licensed producers and the size of its current operations. We also believe it could be one of the next take-over targets in the sector. The Fund also had positive contribution from some of its short positions, with some of the notable wins coming from a short position in the Canadian dollar, and Brazil (EWZ) and Turkey (TUR) ETFs.

Tight labour markets could squeeze profit margins

In previous commentaries we talked about inflation being a potential risk to earnings and markets. We think labour could be one of the biggest drivers of inflation going forward as the U.S. job market remains tight. In fact, the latest data shows that for the first time since records have been kept (2000), there are now more job openings in the U.S. than there are people looking for work (6.3m unemployed vs 6.7m job openings)[1]. Given this backdrop, we think labour costs could continue to pressure profit margins, as companies compete to retain and attract new employees. Commentary from ADP's (one of the largest payroll and HR outsourcing companies) Q1 conference call supports our view as the company said that they are seeing "underlying inflationary trends with labor costs accelerating."

One recent example of labour costs accelerating is Costco's decision to raise its minimum wage to at least US$14/h, which should cost the company US$110-120m this year[2]. Other examples include Cheesecake Factory, saying a competitive staffing environment is leading to wage inflation of around 6%, and Walmart's decision to spend US$300m more on labour by increasing its minimum wage to US$11/hr. These are just a few examples. Other companies to announce pay hikes or call out wage pressures during Q1 reporting include Target, Best Buy, Williams Sonoma, Kohls, Ross Stores, Starbucks, Loblaws, McDonalds, QSR, Dunkin Donuts, Papa John's, Shake Shack, Cracker Barrel, Hershey, Campbell Soup, Colgate and Premium Brands, to name a few.

In addition to the direct costs of having to pay employees more, companies are also feeling the impact of higher labour costs across the supply chain. Perhaps the biggest example of this is in transport and logistics. Freight costs have been increasing rapidly, as transport companies struggle to find enough truck drivers. The latest numbers show that freight costs are up more than 8% YoY, to levels not seen since 2007[3]. More importantly, this is the cost to ship freight excluding fuel surcharges, so when you factor in the increase in oil and gasoline prices this year, it's not unreasonable to see cost increases into the double digits.

Investors appear to be buying companies they like, no matter what the price

The below chart shows Amazon's Price-to-Sales ratio over the past 10 years. From it, we can see that for most of the last decade Amazon's valuation traded in a fairly tight range, around 2.0x. However, since the start of 2015 the valuation multiple has almost tripled to its current level of roughly 4.2x P/S. In our view, this is another indication that investors want to buy businesses they like, no matter what the price. We are not short Amazon, but we wonder whether this big increase in valuation is justified given that competitors like Walmart are also making a big push into e-commerce.

Source: Bloomberg

Tesla – competition in the EV market is heating up

Tesla has established itself as a leader in the luxury EV market with its Model S, and it is now targeting the mass market with the launch of its more affordable Model 3. However, this shift comes at a time when competitive pressures in the market are increasing, which create a new risk for the company. While the Model S has long been the defacto choice at the luxury end, manufacturers like Porsche (Mission E or Taycan), BMW (I8 and IX3), Mercedes-Benz (EQ S), and Jaguar (I Pace) have all recently introduced products that will compete with the Model S.

Tesla's EV competition won't be limited to the luxury market, as a large number of manufacturers have announced plans to launch a full suite of EVs. For example, BMW, Chrysler, Daimler, GM, Hyundai, Jaguar, Kia, Land Rover, and Volkswagen have all announced EV line-ups, some of which are expected to be in the market as early as next year. Moreover, these producers aren't talking about 1 or 2 models, they want to have a full suite of offerings (GM aims to have 20 models by 2023). Based on industry research and OEM announcements, we estimate that there could be more than 300 different EV models in the market within the next decade. We believe this growing competition from profitable, well run car manufactures will present Tesla with a new risk it has yet to face. This could reduce Tesla's ability to maintain its dominance in the EV space.

Jean-François Tardif, President & Portfolio Manager, Timelo Investment Management Inc.

Performance (%)	1 Month	3 Month	6 Month	YTD	1 Year	3 Year	5 Year	SI[1]
JFT Strategies Fund	0.69	0.64	0.92	0.56	0.76	2.44	7.28	7.61
S&P/TSX Composite TR Index	3.12	4.83	1.45	0.25	7.75	5.36	8.05	9.25

Source: First Asset as at May 31, 2018

Inception date: May 18, 2012[1]

Use of benchmark: The S&P/TSX Composite Total Return Index is a capitalization-weighted index designed to measure market activity of stocks listed on the Toronto Stock Exchange. The Index is used as a benchmark to help you understand the Fund's performance relative to the general performance of the broader Canadian equity market.

Sources:

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