Arrow Capital
MANAGEMENT INC.

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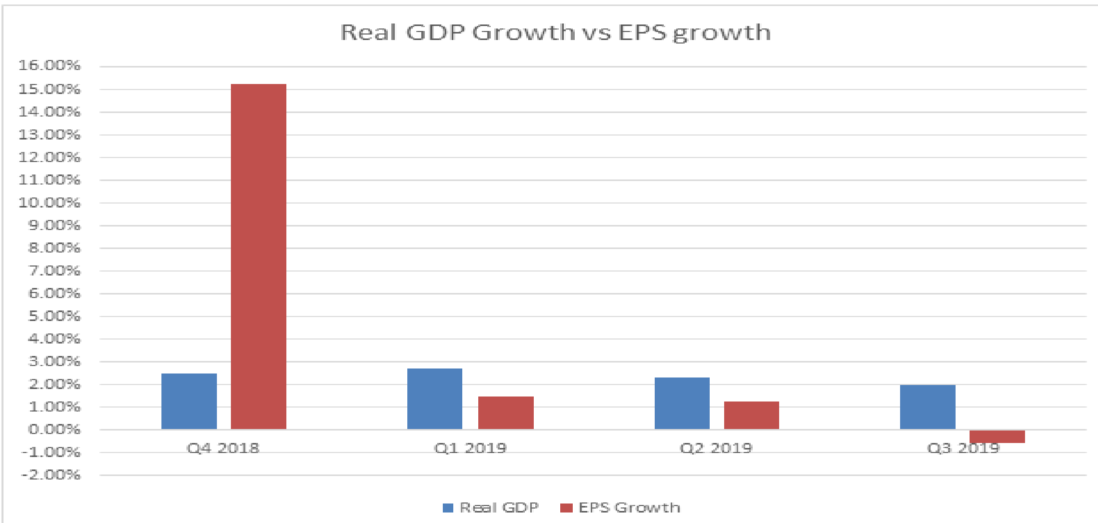
ARROW GLOBAL ADVANTAGE FUND

Q3 2019

The Arrow Global Advantage Fund was down -0.05% for the third quarter and is now down -1.62% for the year.

As we enter the last quarter of 2019 equity markets, particularly in the U.S., continue to perform very well. This is despite any real sector in top corporate earnings. The chart below shows how earnings growth has continued to decelerate in line with our forecasts for U.S. GDP.



Source: Bloomberg

The net result with the S&P 500 20% up YTD is that this is virtually all multiple expansion. That makes some sense given the FED in Q4 2018 was restrictive and is now accommodative. The issue is will further accommodation be effective?

We are forecasting headline CPI (inflation) YoY to head higher in Q4, from a trough low of 1.7% in Q3 to 2.2% by the end of Q1, 2020. That is a big percentage jump (29%). We are receiving a good amount of push back on this but the evidence is clear. For example, energy prices (which make up 9% of CPI) where $45 last year at this time versus $55 today. These are called “base effects” i.e. we are lapping a low point so CPI has to go higher. When looked at in conjunction with other components of CPI (which we measure all the time), this is a high conviction forecast for us. One could also point to higher core CPI (i.e. ex food and energy) currently at 2.4% YoY as a leading indicator. Finally, wages have marched steadily higher and are finally starting to creep into CPI – companies at first resist any price hikes but eventually it is passed on to consumers – ditto tariffs.

So clearly, if the FED continues to lower rates, real interest rates will fall even further in the U.S. This should benefit gold in particular. It should also help reduce the value of the U.S. dollar – giving a lift to EM and dollar linked economies (NB see what the high USD is doing to Chile and their social unrest as costs have escalated).

Source: Bloomberg

36 Toronto Street, Suite 750 • Toronto, Ontario • Canada • M5C 2C5 • Tel: 416.323.0477 • Tel: 1.877.327.6048 • Fax: 416.323.3199 • www.arrow-capital.com

Finally, with the front end of the yield curve coming down and the back end either rising (or remaining the same), this sets up well for financials as they can make more money on their loan spreads. Now the market has "sniffed" this out over the past month or so. What has worked in the past (growth equities, long treasuries, long USD etc.), has been under pressure while value stocks like financials, industrials etc. are now working. So, are we changing our positioning to follow this move? The short answer is "kind of".

We have excited our net short positions in financials, cyclical sectors like industrials and energy, eliminated our long USD position and moved to a more neutral portfolio with plenty of cash. Why? Because while we are confident in our inflation forecast, our GDP forecast is still in limbo.

Source: Bloomberg

We do believe that after the deceleration from 3.2% in Q3, 2018 to our forecasted 2.05% in Q3, 2019 we could "bounce" to 2.2% in Q4 but then flatten to 2.1% in first half, 2020 i.e. very little change in GDP growth. We will get more data at the end of October along with the FED's position. If things change for the better, we will begin a portfolio rotation in earnest with further cyclical/value exposure. Stay tuned.

Yours sincerely,

Jim McGovern

Jim McGovern
Managing Director & CEO

Ted Whitehead
Senior Portfolio Manager

Ahson Mirza
Portfolio Manager

Effective January 1, 2019, the fund was renamed Arrow Global Advantage Fund.

Effective January 1, 2015, this fund was renamed Arrow Global Growth Fund and James McGovern was appointed as the sole portfolio manager. Prior to January 1, 2015, the fund was managed by different teams with substantially different investment parameters. For a complete history of this fund, including returns, please contact Arrow Capital Management Inc. Unless otherwise stipulated returns are net of all fees, in Canadian dollars, reflect class "F" units and assume reinvestment of all distributions.