CAPSTONE MORTGAGE POOL

Q3 Commentary

CAPSTONE ASSET MANAGEMENT™

AT A GLANCE

SEPTEMBER 30, 2023

- Construction and development mortgages in Canada
- Diversified by developer and development type
- Mortgage terms are 3 to 36 months
- Low to no correlation to bond and equity markets
- Liquidity is accommodated monthly with one month's notice
- $395 MM AUM
- Current price: $9.8173 (Series I)

MARKET & POOL UPDATE

Over the past quarter, the Capstone Mortgage Pool (Series I) returned 2.36%. This portfolio is now beginning to reflect the higher interest rates in a real estate environment that has had to rapidly adjust to significant changes over the past year and a half. The most recent interest rate policy change occurred in July, and this has brought the Bank of Canada rate to an even 5%: the highest interest rate policy set in Canada in well over 20 years.

Through the first half of 2023, the Canadian real estate market has remained surprisingly robust as a result of Canada's expansive immigration policy. Supply remained low, by historical standards, while demand surged. This combination produced stable, if not increasing, housing prices across Canada right through the spring market. However, the July increase in interest rates caused the tide to turn through the summer. Listings steadily increased while demand for homes dropped. While interest rates remain high, most pundits expect a significant slowdown in the real estate space for at least the next 6 months. While higher interest rates may push some buyers to the sidelines, we are of the opinion that Canada's housing supply will not keep pace with demand and that this will assist in mitigating a significant, prolonged real estate correction.

A significant occurrence over the summer was the acquisition of the majority of the value of Capstone Mortgage Opportunity Fund LP (MOF) by Capstone Mortgage Pool. This added approximately $101MM of Net Asset Value to Capstone Mortgage Pool. Because these two strategies had evolved to a point where they contained nearly identical mortgage holdings, it no longer made sense to maintain them as separate fund offerings. Clients previously invested in the MOF LP will now experience simplified tax reporting and more flexible redemption parameters with the Capstone Mortgage Pool, a mutual fund trust.

Since the adoption of the IFRS 9 accounting standard in 2018, interest distribution fluctuations are more common. For that reason, Capstone requires mortgage portfolios to include a loan loss provision (bad debt allowance) to mitigate default risk. While higher interest rates are likely to reward investors over time, they are punitive to developers and may cause some to experience credit challenges. Therefore, in high interest environments, Capstone increases the loan loss provision to ensure that the mortgage portfolio is valued fairly for the given period. If the market outlook becomes worse, investors should expect a higher percentage of interest income to be directed to this bad debt fund. Conversely, market improvement will lead to a portion of the reserve being directed back to investors. This mechanism ensures that the valuation of the portfolio is current throughout the year, but it can cause additional distribution fluctuations that the Pool did not experience in prior years.

With the expectation that the Canadian real estate market could correct at any time, we at Capstone have spent the past few years expanding our due diligence procedures while being conservative in the ongoing development of our lending criteria. We believe that our prudence will provide excellent value to our investors in both the long term as well as during shorter periods when the real estate market may be more volatile.

For more information on this Pool, please contact your Portfolio Manager.

PERFORMANCE (Gross of Fees)

Performance figures are those of Series I units as of September 30, 2023. Performance is annualized for periods longer than one year.

1 MO.	3 MO.	6 MO.	1 YR.	3 YR.	5 YR.	10 YR.	INCEPTION*
0.68%	2.36%	4.67%	8.57%	8.52%	8.90%	9.00%	8.98%

** Annualized as of first trade date April 30, 2012*