BOYLE CAPITAL

October 9, 2019

Dear Investor,

Portfolios were up modestly for the quarter and appear poised for sizeable upside as housing finance reform moves forward in the months ahead.

In early September, Treasury released the much-anticipated plan for reforming housing finance. The plan contained both administrative and legislative recommendations for achieving the Trump administration's housing finance reform goals; though as we have stated before, the likelihood of legislative action is remote. The number one goal highlighted in the plan is "ending the conservatorships of the Government-sponsored enterprises (GSEs) upon the completion of specified reforms." Central to that goal is building capital at the entities. On September 30th, in the first step toward increased capital levels, Treasury and the Federal Housing Finance Agency (FHFA) announced it will now allow Fannie and Freddie to retain up to $45 billion in combined capital as they begin to prepare to exit conservatorship. On October 4th, the FHFA issued a notice that it was seeking a financial advisor responsible for creating and implementing a road map "to responsibly end the conservatorships" of the GSEs. According to the notice, the financial advisor would work with the FHFA on "capital raising options, timing and feasibility." In the coming months, we expect the FHFA to announce the selection of a financial advisor as well as the final capital rules for the entities. Both are critical milestones that need to be achieved before a grand bargain with Treasury can be negotiated on its senior preferred stock and a settlement with shareholders can be reached.

On the legal front, the negotiating leverage of the shareholders received a substantial boost in September when the Fifth Circuit Court of Appeals issued its *en banc* opinion in the Collins vs. Mnuchin case. In the ruling, the Court found that the net worth sweep exceeds FHFA's statutory authority as the GSE's conservator. It also found that the FHFA's structure-led by a single director appointed for a five-year term and removable only "for cause," not at the president's discretion-is unconstitutional. The Court did not go so far as to invalidate the net worth sweep, instead choosing to remand the case to district court to decide if issues of fact require a trial or if summary judgement should be granted. Given the irrefutable facts (e.g. Treasury has taken all profits since 2012) and the strongly worded majority opinion criticizing the net worth sweep, the probability is high the plaintiffs will eventually win the case and the net worth sweep will be invalidated.

A few days after the court ruling, Treasury Secretary Mnuchin stated during a **Fox Business** interview that "we're not going to let this ruling stand in the way one way or another, with housing reform….regardless of that case, we will restructure Fannie Mae and Freddie Mac so that they have private capital in front of taxpayer risks." In a separate interview, FHFA Director Mark Calabria told **Bloomberg** that "once they end

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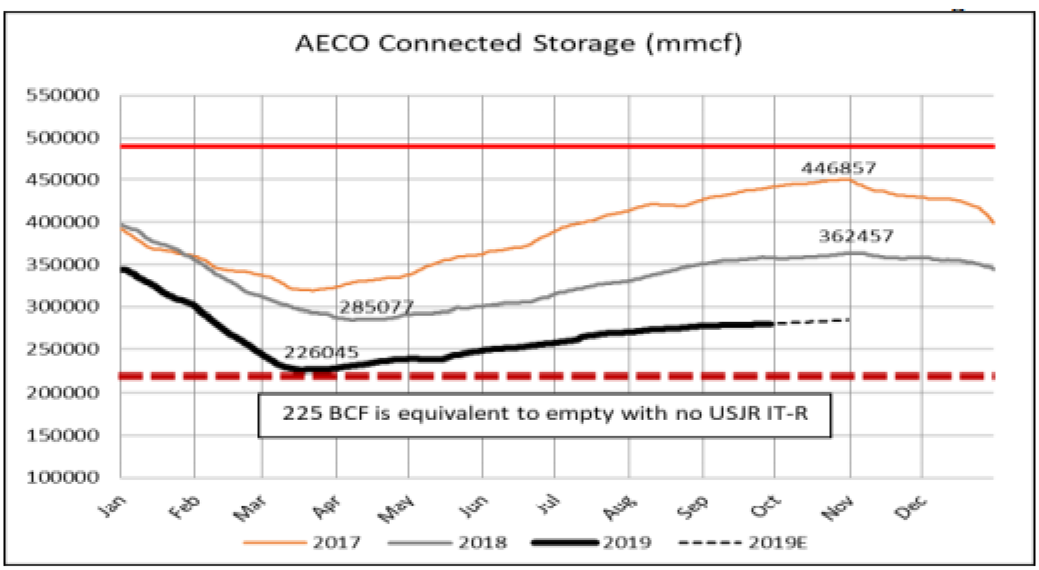
the net worth sweep, which is part of our plan anyways, I think a lot of the suits go away." As we have highlighted before, the plaintiffs will not drop their lawsuits until Treasury ends the net worth sweep AND declares that it has been fully repaid. The Fifth Circuit's ruling would likely lead to this outcome in the end, however, Treasury and the FHFA have an incentive to settle with shareholders prior to the election in November 2020. For starters, the soon to be hired financial advisor will have an impossible task of raising third party capital until these legal issues are resolved. Settling with shareholders not only clears the path for a successful capital raise, but also makes permanent the changes made to the senior preferred stock agreement (SPSA), thereby preventing a new administration from undoing the plans of the Trump administration. Treasury also has an asset in the form of Fannie and Freddie warrants that could be worth as much as $100 billion for taxpayers. It cannot monetize on this until the legal issues are resolved. The Fifth Circuit ruling also means that a change in the administration next November could mean the removal of Mark Calabria as director of the FHFA in early 2021. As a result, both Treasury and the FHFA have a motivation to implement permanent and lasting changes prior to the election next fall. The best way to do that is through a global settlement with plaintiffs and the recent Circuit decision gives them the political cover necessary to do so. On the other side of the negotiating table, and emboldened by the recent Fifth Circuit ruling, plaintiffs have considerable leverage that makes a conversion of the junior preferred shares into common at or near par value appear to be a matter of ***WHEN***, not ***IF***. Around 50% of par value presently, shares remain heavily discounted from likely final outcomes.

Energy is another heavily discounted sector right now. Despite oil prices rebounding more than 30% from last December, many energy names are hovering near all time lows. As we wrote last quarter, "if something cannot go on forever, it will stop." Signs continue to emerge that production growth is slowing dramatically at nearly every major oil and gas basin in North America. Combined with significant depletion rates, the fundamentals are improving by the day and excess inventories are being drawn down. As it relates specifically to Birchcliff Energy, the AECO connected storage levels are historically low heading into the winter season.



Source: TC Energy

Despite the low inventory level, prices remain too weak to incent producers to substantially alter capital expenditure plans heading into 2020. Consequently, AECO prices are likely to see a lift this winter and could surge during cold snaps. Among Canadian energy producers, Birchcliff has some of the most significant torque to AECO movements and thus would benefit appreciably from a lift in AECO prices this winter.

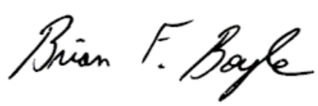
The upcoming national election in Canada also has the potential to provide a boost to Canadian stocks. A dead heat in most polls right now, a win by conservatives would light a match under the Canadian energy sector which is at historic low valuations. On the other hand, a loss by conservatives would likely accelerate industry consolidation. Beyond 2020, significant new take away capacity will come online from TC Energy's planned Nova Gas Transmission (NGTL) expansions and the current under construction LNG Canada terminal. With Birchcliff shares at just 1.6 times cash flow (five-year average is 6.1) and 0.3 times book value (five-year average is 0.9), investors remain apathetic despite signs of a turn ahead and substantial free cash flow.

Remaining portfolio positions possess strong balance sheets, substantial buyback programs and valuations well below market averages. We also maintain some dry powder to take advantage of opportunities afforded by market volatility, which has picked up recently and is likely to continue given political and trade headlines.

In closing, economic and market cycles are long in the tooth and portfolios look nothing like the broad market averages. We are positioned for the eventual recapitalization of Fannie Mae and Freddie Mac and expect further gains as it does.

If you have any questions about your account or pertinent financial information has changed, please reach out.

Best Regards,



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