EFG Canadian Dividend Strategy

Second Quarter Commentary – July 17, 2024

Don Simpson BBA, CFA
Vice President & Portfolio Manager

Rory Ronan, CFA
Vice President & Portfolio Manager

Eric Mencke, CPA, CA, CFA
Vice President & Portfolio Manager

Q2 2024 Quarterly Commentary

The second quarter continued the trend we witnessed in the U.S. equity markets, with a lot of momentum in a small segment of the market. The U.S. equity markets continued to rally, after posting some impressive returns in the first three months of the year. In the second quarter, the S&P 500 Index (C$) returned 5.5% while the S&P/TSX Composite Index was down in the quarter, with the index declining 0.5%. Year to date, the TSX is up 6.1% and the S&P 500 is up an impressive 19.6% both in Canadian dollar terms. Consistent with our earlier commentaries, we find ourselves in a position where valuations are elevated, especially in the U.S. where the returns have been primarily concentrated around a few equities. In Canada, valuations look more reasonable and stock market returns have been more broadly based. While participation has widened out in the U.S. market, a material amount of the returns has continued to come from the technology sector and is mostly related to the potential growth opportunities from Artificial Intelligence. We see Artificial Intelligence as an important innovation for mankind and our funds have some exposure to this theme. However, we are careful when managing investment exposure as we want to be diversified by idea and sector. Historically, when investors start chasing returns around a certain theme, that leads to a crowding effect with elevated valuations and the risk of a fair amount of downside, which makes us more cautious about the U.S. market.

The initiatives put forth by the central banks have taken hold as inflation has come down, but we could be moving into a situation where the monetary policies between Canada and the U.S. could differ. For the U.S., some areas of the economy have seen inflation come down, but other areas have remained high. With inflation still pacing ahead of the 2% target level, coupled with a decent jobs market and healthy consumer spending, it would seem there is little room for the U.S. central bank to start cutting interest rates as aggressively as the market is discounting. Further, if there is a change in the government in this upcoming U.S. election that could bring further concerns that inflation could be reignited due to tax cuts and higher import tariffs. However, that is not necessarily the case for Canada, as we have started to see the economy slow, with lower productivity rates and job creation falling below expectations. This will be further impacted by a clamp down on immigration levels and a highly indebted customer. We believe our banks are in great shape to weather this storm and have provisioned conservatively. However, there is a strong argument that the Canadian central bank will be forced to cut interests more aggressively than our trading partner to the south. While this will translate into lower interest payments for Canadian citizens, it is likely to result in a weaker Canadian dollar and make imports more expensive for the consumer.

As we stated earlier this year, we believe there are reasons to be cautious as the economy is softening. The unknowns related to the economy and the potential for a recession, due to higher interest rate levels, stubborn inflation, and a highly indebted consumer. Couple that with elevated equity valuations and sadly the ongoing geo-political instability globally with several conflicts and tensions escalating in other areas, leads us to be cautious and conservative in our approach. This is being further compounded, as several government elections are occurring globally and bringing with it a change in the ruling party's political ideology. However, based on this backdrop, it is setting up to be an ideal market for stock pickers and investors looking for more value-oriented companies. This is a positive for the Canadian market, due to our high composition of commodities and value-type sectors.

Despite our cautious stance, we continue to believe that on a relative basis, the Canadian market remains attractive. Looking back over the last decade, it has been a great run for the U.S. market, while Canada has shown strength in certain periods. This has been partially offset by a couple of very tough years. As active managers looking for opportunities, Canada stands

out as one of the better places, for several reasons. First, the Canadian market trades at a discount to its peers, the TSX at 15x forward price to earnings looks much more reasonable when compared to the S&P at 21x, and the MSCI World at 19x. Second, we have a very solid banking system in Canada. Our banking system has shown its stability in prior financial crises including the regional bank crisis earlier last year, and it accounts for 20% of the TSX index. Third, our large exposure to some of the leading material and energy operators provides a solid inflation hedge. Fourth, we live in a very stable political environment, which is even more appreciated with the ongoing and escalating political instability in the world. And finally, we have a healthy and welcoming immigration policy, which is driving population growth and bolstering the Canadian economy.

Our primary focus is always on the long term, but we will make tactical adjustments to the portfolio as valuations quickly change. With that in mind, we have taken profits in some companies by either exiting positions or trimming the weight where we felt prices had moved out of step with valuations. We would highlight that we are finding more opportunities in Canada versus the U.S. where we feel we are getting better compensated for risk.

In conclusion, we believe markets are emotional and volatile, especially in the short run, but our process is not. We continue to be patient and adhere to our discipline, which is to build a concentrated portfolio of high-quality businesses that will grow over the long term and generate compelling risk-adjusted returns through a variety of business cycles. We continue to be on the lookout for opportunities to invest in high-quality companies where we will be paid for risks in the portfolio. We want to reiterate a very important point: we don't view volatility as risk. We define risk as a permanent loss of capital, which is why we are always focusing on the preservation of capital through constructing a well-diversified portfolio of leading businesses with strong balance sheets. We believe if you do your research, you can construct a diversified portfolio of businesses that can be owned through different economic cycles.

We thank you for your continued support.

Don Simpson
Vice President & Senior Portfolio Manager

Eric Mencke
Vice President & Portfolio Manager

Rory Ronan
Vice President & Portfolio Manager

GenerationalWealthManagement.ca

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Views expressed regarding a particular company, security, industry or market sector are the views of the writer and should not be considered an indication of trading intent of any investment funds managed by 1832 Asset Management L.P. These views should not be considered investment advice nor should they be considered a recommendation to buy or sell. These views are subject to change at any time based upon markets and other conditions, and we disclaim any responsibility to update such views.

The information provided is not intended to be investment advice. Investors should consult their own professional advisor for specific investment and/or tax advice tailored to their needs when planning to implement an investment strategy to ensure that individual circumstances are considered properly and action is taken based on the latest available information.

™Trademark of The Bank of Nova Scotia, used under licence. 1832 Investment Counsel is a business name is a business name used by 1832 Asset Management L.P., a limited partnership, the general partner of which is wholly owned by Scotiabank.

1832
INVESTMENT COUNSEL™