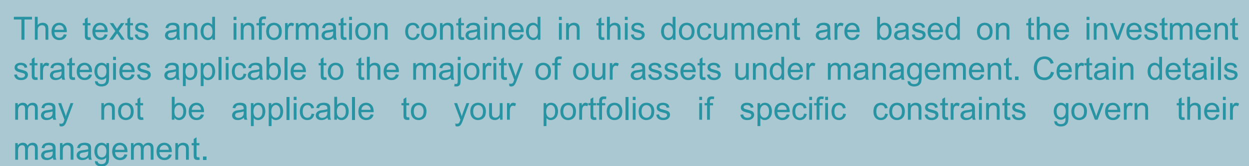
As at March 31, 2023

Quarterly Commentaries

CDSPI

FIERA CAPITAL


The texts and information contained in this document are based on the investment strategies applicable to the majority of our assets under management. Certain details may not be applicable to your portfolios if specific constraints govern their management.

Macroeconomic Landscape

Global

Global growth is holding up reasonably well under the weight of higher interest rates, underscoring the challenge faced by central banks as they look for evidence that monetary policy is sufficiently restrictive to bring inflation back to target.

Canada

The Canadian economy got off to a strong start in 2023, defying expectations for a sharper slowdown in the face of the highest interest rates in 15 years. The labour market is showing few signs of succumbing to the cumulative tightening of the past year. While the latest deceleration in inflation likely supports the Bank of Canada's decision to move to the sidelines, a domestic economy that is proving resilient and still-elevated core inflation may prompt the central bank to end its "conditional" pause and return to the inflation battle.

United States

The US economy has held up remarkably well, thanks to a surprisingly resilient labour market, excess savings, and pent-up demand for services. The stickiness of services sector inflation that is tied to the labour market is particularly worrisome given persistent imbalances, with a strong demand for workers that is far in excess of supply fueling wage gains. This risks keeping inflation above 2% and warrants a higher level of interest rates from the Federal Reserve, challenging the market's expectation for a swift pivot to interest rate cuts.

International

The European economy turned a corner at the beginning of the year. The threat of a severe energy crunch receded and dampened fears of an imminent recession, while the reopening of China's economy also buttressed activity. That being said, robust economic conditions are ultimately an upside risk to inflation. Given that the European Central Bank recently abandoned forward guidance in favour of data dependence, positive economic surprises at a time of record-high core inflation have handed ammunition to officials who say rate increases are not yet complete.

Emerging Markets

The Chinese recovery is gathering pace following the abrupt abandonment of COVID Zero Policy, while the pro-growth stance from policymakers has also lent some notable support. Domestic demand has reaccelerated in response and is driving the economic revival. That said, it may prove difficult to keep up this brisk pace, particularly given that global growth is slowing and pent-up demand is likely to fade over time. Still, with the policy bias leaning decisively towards growth-supportive measures, the recovery should sustain some decent momentum in the near-term.

This document is a marketing communication

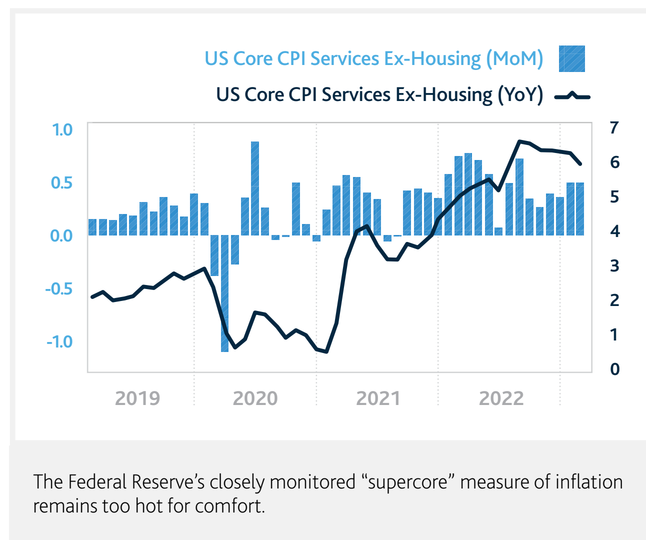
Economic Outlook

Central Bank Outlook: Higher for Longer

In early 2023, the battle against inflation lingered on, with central banks reinforcing their unwavering resolve to tackle inflation regardless of the financial market or economic fallout. However, this task has been complicated by recent signs of distress in the banking sector as the most aggressive tightening campaign in decades takes its toll. These developments have brought into question the ability of central banks to push ahead with their tightening plans as they attempt to weigh the risks associated with unrelenting pricing pressures against the growth-dampening impacts of financial market instability.

A great deal of uncertainty remains as to how tighter credit conditions in the private banking sector may translate into another form of policy tightening that ultimately does central banks' work for them. Tighter credit conditions could potentially equate to anywhere from 25 to 100 basis points of rate hikes. This may impact the trajectory for monetary policy through 2023 and consequently, the outlook for economic growth.

For now, strains in the banking sector appear to be contained as the authorities have taken extraordinary measures to shore up confidence and limit concern about financial system contagion. With inflation running hot and a global economy that is proving surprisingly resilient, we expect central banks will opt to prioritize fighting inflation and push forward with their tightening plans. Moreover, in early April, the Organization of Petroleum Exporting Countries and allies (OPEC+) unexpectedly announced an output reduction of more than 1 million barrels a day, reviving concerns about elevated inflation that may force central banks around the world to push interest rates higher and keep them there for longer.



The Federal Reserve's closely monitored "supercore" measure of inflation remains too hot for comfort.

Source: Bloomberg, as of March 31, 2023.

Investment Strategy

Our high probability scenario that calls for a "Deep Recession" remains intact. This scenario is predicated on our expectation that central banks have more work to do in the fight against stubbornly elevated inflation and will prioritize doing so regardless of the economic fallout. Should banking stress dissipate without a severe tightening of credit conditions, a backdrop of firm inflation will keep the Federal Reserve on the path to higher rates and could even spark a significant hawkish surprise to get the fight against inflation back on track. At the same time, tightening credit conditions that equate to approximately 100 basis points of rate hikes would ultimately do the Fed's work for them, which would intensify headwinds for the global economy and result in the same recessionary outcome.

The growing risk of a "Deep Recession" warrants a defensive stance from an asset allocation perspective. In this environment, we maintain an underweight allocation to both stocks and bonds, with a sizeable overweight allocation to cash and non-traditional income.

That being said, the risk of prolonged financial instability stemming from the latest banking woes has increased the probability that the Federal Reserve will shift gears. In this less challenging "Stagflationary" scenario, well-anchored long-term inflation expectations allow the Federal Reserve to prioritize financial stability and live with above-target inflation for longer, with the central bank abandoning its tightening campaign at levels that would avoid an outright contraction in growth. In a less-likely recovery scenario ("Disinflation"), an economy that proves to be much weaker than perceived combined with the disinflationary forces from cumulative tightening to date sends inflation spiraling lower to levels that allow central banks to begin cutting interest rates later this year, also averting a hard landing scenario and initiating a new economic cycle in the process.

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Economic Scenarios

Main Scenario | Deep Recession

Probability **55%**

In our high probability scenario, stubbornly elevated inflation that proves increasingly entrenched triggers the continuation of aggressive monetary tightening that inevitably sparks a recession. The depth and magnitude of the recession ultimately hinges on how persistent inflation proves to be, and on how much pain policymakers are willing to inflict on the economy in order to bring inflation down to levels deemed acceptable. While goods prices peak and begin to roll over, underlying "core" inflation proves to be more sticky and entrenched, with wages, services inflation, and shelter costs all remaining uncomfortably elevated. Inflation expectations de-anchor and spiral higher, which forces central banks to prioritize tackling inflation in order to restore their inflation-control credibility, regardless of the economic fallout. As a result, central banks tighten monetary policy much more assertively and keep rates in restrictive terrain for longer. Policymakers are unlikely to pause the rate hike cycle until they see convincing evidence that inflation is coming down, which ultimately means that central banks will be hiking interest rates well into economic weakness, making way for a "Deep Recession."

Scenario 2 | Stagflation

Probability **30%**

As policymakers are unable to simultaneously achieve their inflation and growth targets, they are forced to choose between the two and opt to prioritize the economy and live with above-target inflation. In this "Stagflationary" scenario, well-anchored long-term inflation expectations lower the risk of a wage price spiral and allow the Federal Reserve to prioritize financial stability and live with above-target inflation for longer, with the central bank abandoning its tightening campaign at levels that would avoid an outright contraction in growth. Global growth slows to below-potential levels, but global inflation remains elevated and above target. This economic scenario is reinforced by the growth dampening impact of banking sector stress and tighter financial conditions as the emergence of financial stress challenges the Federal Reserve's ability to keep raising rates, with the lingering risk of prolonged financial instability increasing the likelihood that the Federal Reserve will pivot.

Scenario 3 | Disinflation

Probability **15%**

In the "Disinflation" scenario, the economy proves to be much weaker than previously thought, which when combined with the disinflationary forces from cumulative monetary policy tightening sends inflation spiraling lower. While the banking crisis raises the risk of a recession, it also accelerates the disinflationary impulse in a meaningful way and prompts central bankers to pause their tightening campaign and eventually cut interest rates. Consequently, the economy averts a hard landing scenario, and a new economic cycle begins by the middle of 2024.

Portfolio Strategy

Matrix of Expected Returns (CAD)

SCENARIOS	DEEP RECESSION	STAGFLATION	DISINFLATION
PROBABILITY	**55%**	**30%**	**15%**
TRADITIONAL INCOME			
Money Market	5.0%	4.5%	4.0%
Canadian Bonds	-10.9%	-7.1%	2.3%
NON-TRADITIONAL INCOME			
Diversified Credit	6.0%	8.0%	7.0%
Diversified Real Estate	4.0%	9.0%	8.0%
Infrastructure	5.0%	8.0%	7.0%
Agriculture	5.0%	8.0%	7.0%
TRADITIONAL CAPITAL APPRECIATION			
Canadian Equity Large Cap	-22.4%	8.2%	23.4%
U.S. Equity	-28.0%	-13.6%	14.1%
International Equity	-29.3%	-9.7%	16.7%
Emerging Market Equity	-28.8%	-8.6%	19.1%
NON-TRADITIONAL CAPITAL APPRECIATION			
Private Equity	5.0%	12.0%	15.0%
Liquid Alternatives	0.0%	5.0%	7.5%
CAD/USD	0.75	0.85	0.80

Source: Fiera Capital, as of March 31, 2023.

Discussions regarding potential future events and their impact on the markets are based solely on historical information and Fiera Capital's estimates and/or opinions, and are provided for illustrative purposes only. Expected returns are hypothetical estimates of long-term returns of economic asset classes based on statistical models and do not represent the returns of an actual investment. Actual returns will vary. Models have limitations and may not be relied upon to make predictions of future performance of any account. Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.

Portfolio Strategy

Current Strategy[1]

TRADITIONAL AND NON-TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
Money Market	0%	5%	30%	30%	+25%
Canadian Bonds	5%	25%	45%	5%	-20%
Canadian Equity Large Cap	10%	20%	40%	20%	0%
U.S. Equity	0%	10%	20%	0%	-10%
International Equity	0%	10%	20%	0%	-10%
Emerging Market Equity	0%	5%	15%	5%	0%
Non-Traditional Income	5%	25%	45%	40%	+15%

TRADITIONAL PORTFOLIOS

	MINIMUM	BENCHMARK	MAXIMUM	STRATEGY	+/-
TRADITIONAL INCOME	**20%**	**40%**	**60%**	**60%**	**+20%**
Money Market	0%	5%	30%	30%	+25%
Canadian Bonds	5%	35%	55%	30%	-5%
TRADITIONAL CAPITAL APPRECIATION	**40%**	**60%**	**80%**	**40%**	**-20%**
Canadian Equity Large Cap	5%	25%	50%	25%	0%
U.S. Equity	0%	15%	30%	5%	-10%
International Equity	0%	15%	30%	5%	-10%
Emerging Market Equity	0%	5%	15%	5%	0%

Evolution of Value-Added[1]

Source: Fiera Capital, as of March 31, 2023.

1 Based on a 100 basis point value added objective. The benchmark employed here is based on a model portfolio and for illustrative purposes only. Individual client benchmarks are employed in the management of their respective portfolios. Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.

Fixed Income Outlook

Fixed Income Review

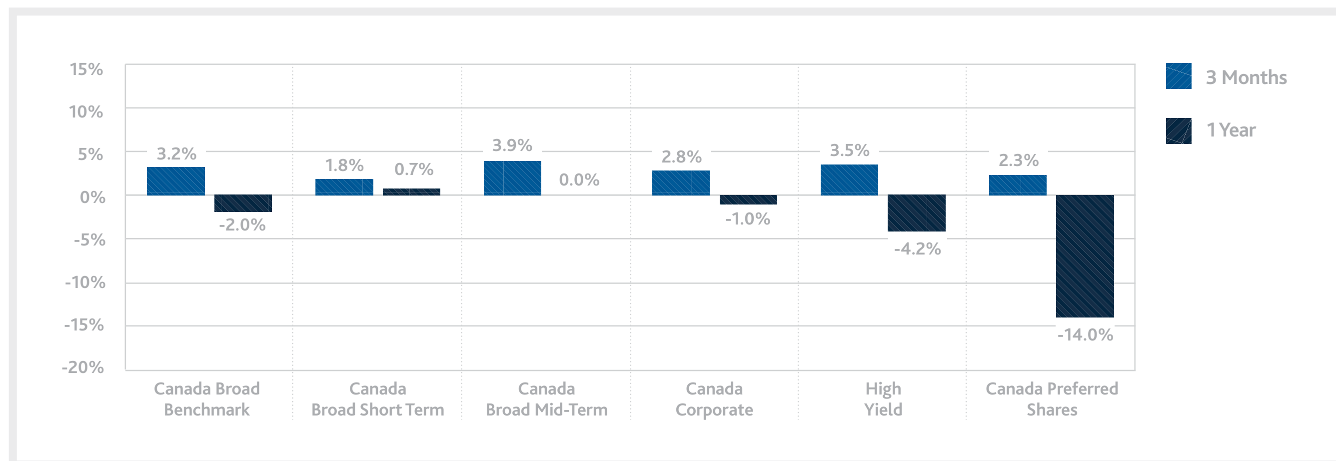
Fixed income markets fluctuated in the first quarter as investors weighed the outlook for interest rates in light of still-elevated inflation and lingering stresses in the banking sector. In the end, bond markets generated positive results as investors wagered that policymakers would have to pivot their focus to financial stability from fighting inflation, which prompted a massive re-pricing of monetary policy expectations and sent bond yields spiraling lower.

The Federal Reserve raised rates to a target range of 4.75% to 5.00% in March. However, officials appear to be buying some time in order to assess the fallout from the banking crisis. The statement was adjusted to say that policymakers anticipate "some" additional tightening and omitted prior language that forecasted "ongoing increases" in the fed funds rate, while the peak rate for 2023 was unchanged between 5.00% and 5.25%. However, Chair Powell sounded unimpressed by progress on inflation that is still running too high and said the process of getting inflation back down to 2% has a long way to go. More recently, several officials have expressed their unwavering resolve to restoring price stability despite banking strains.

The European Central Bank followed through with another 50-basis point rate hike in March. Given recent financial market volatility, President Lagarde refrained from providing any explicit forward guidance about the path for rates and instead highlighted that the uncertain environment warrants a data-dependent approach, underscoring that officials are willing to hike further if conditions warrant. The acceleration of core inflation to a record high reinforces that further rate hikes are likely forthcoming.

The Bank of Canada held rates steady at 4.5% in March, maintaining its earlier guidance to pause and assess the impact of cumulative tightening. The Bank of Canada reinforced the conditional nature of its decision, warning that either stronger growth or stickier inflation could pull it off the sidelines. Here, the latest data shows the economy running north of 2% (annualized) in the first quarter, far exceeding the Bank of Canada's 0.5% forecast when they signaled the pause – while core inflation measures are hovering just below 5% year-over-year (well above the targeted 1% to 3% range).

Canadian Fixed Income Market Returns



Source: Fiera Capital, as of March 31, 2023. Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.

Investment Strategy

Expectations for a dovish pivot from central banks are premature, in our view. We anticipate that banking turmoil will ultimately subside and attention will revert back to the environment of elevated inflation, leading investors to recalibrate their expectations for interest rates higher. This has created a near-term risk to the latest bond market rally.

The path of least resistance for bond yields should be higher from here. The market continues to underestimate central banks' resolve in fighting inflation, in our view. We expect short-term rates to rise by much more than the consensus view in response to inflationary dynamics that prove extremely difficult to bring back in line, while longer-term yields should also push higher. Meanwhile, given our high probability scenario calls for a recession, we see limited scope for spread compression in the corporate and high yield space. This unappealing outlook underpins our underweight allocation to traditional fixed income.

Equity Outlook

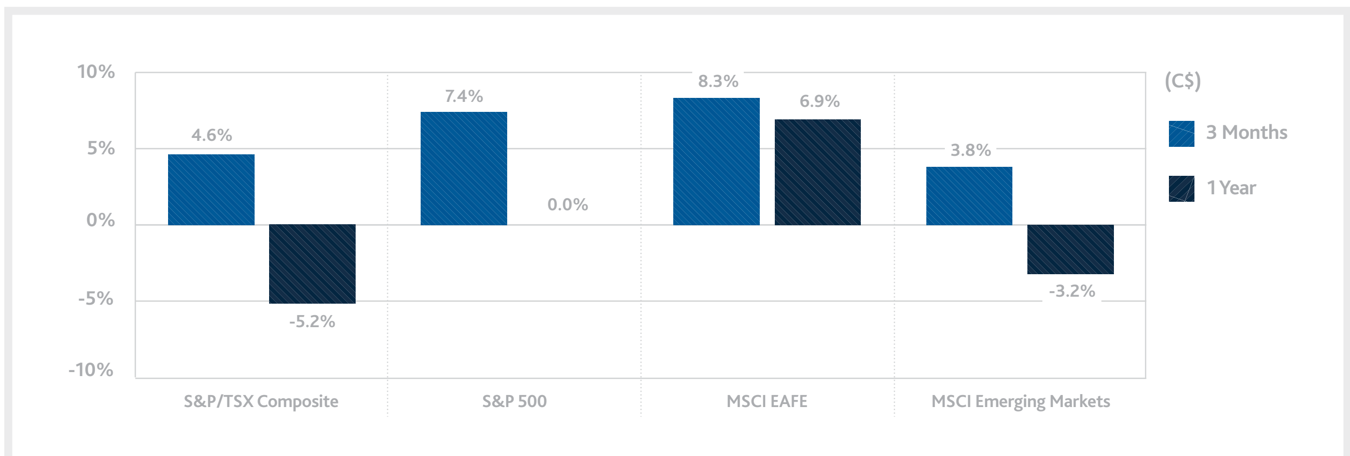
Equity Review

Global equity markets were whipsawed at the beginning of 2023 but managed to end the first quarter with a solid gain. Initially in January, stocks roared higher on hopes for a soft economic landing as inflationary pressures showed signs of abating, while China's reopening also fueled investor optimism at the beginning of the year. However, a wave of risk aversion swept up the financial markets in February. Hopes for an imminent end to rate hikes and a dovish policy pivot were dashed in the wake of unrelenting signs of resilient growth, an overheated labour market, sticky inflation, and some hawkish central bank rhetoric that prompted a shift in investor expectations towards higher interest rates for longer. Then in March, stocks propelled higher on growing speculation that policymakers may have to abandon their tightening plans in response to the banking crisis, which boosted investor optimism late in the quarter. The MSCI All Country World advanced over 7% in the first quarter, with all major regional benchmarks contributing to the quarterly gain.

There was very little in the way of fundamental underpinnings that drove the latest rally in global stock markets, in our view. Expectations for a dovish pivot in the monetary tightening cycle saw bond yields tumble lower and price-to-earnings multiples re-rate higher. However, the recent bout of multiple expansion remains at odds with limited evidence in terms of progress on the inflation front, with inflation still a far cry from central bank targets. From a valuation perspective, this leaves stock markets vulnerable after the profound first quarter rally – particularly should investors recalibrate their expectations for interest rates in response to inflation that fails to show any meaningful signs of subsiding. Should investors price out the discounted interest rate cuts as we expect, bond yields would ultimately revert higher and weigh on price-to-earnings multiples.

Meanwhile, earnings expectations have not yet adjusted to reflect the looming risk of recession and economic realities are bound to catch up to corporate earnings. From a fundamental perspective, should the equity market be disappointed by either hawkish central banks (declining price-to-earnings multiples) or a deteriorating economic backdrop (earnings contraction), equity prices are likely to trend lower.

Equity Market Returns



Source: Fiera Capital, as of March 31, 2023. Past performance is not a guarantee of future results. Inherent in any investment is the potential for loss.

Investment Strategy

Taken together, there is very limited scope for further multiple expansion as interest rates rise by more than markets generally expect. Furthermore, our expectations for an economic and earnings recession are expected to weigh on stocks in the coming year. An aggressive monetary policy trajectory against a backdrop of sticky inflation and deteriorating growth prospects emboldens our defensive stance. In this environment, we maintain an underweight stance on equities over our tactical 12-18-month horizon.

Private Markets Outlook

The Case for Private Markets

Global stock and bond markets have been moving in tandem by the most in nearly three decades, which limits the ability to diversify the risk exposures within a traditional 60-40 equity-bond portfolio. The merits of the traditional 60-40 portfolio were challenged in 2022 after both stock and bond markets capped a year of unprecedented and historic losses, with a traditional 60-40 portfolio generating some of the worst returns in decades.

Here in 2023, public markets are pricing in the best of both worlds. While bond prices have been pricing in a recession and are thriving in response, stock markets have shown resilience on hopes for a dovish pivot from central banks that ultimately averts a contraction in corporate earnings. We are skeptical, however, and believe that both stocks and bonds look expensive at current levels. We expect that rising interest rates and still-elevated inflation will come up against a backdrop of stagnating growth and possibly recession, which would undoubtedly result in sub-par expected returns for public market asset classes in a notoriously volatile trading environment. As such, a traditional portfolio of stocks and bonds may once again prove inadequate in satisfying investor objectives.

There are growing reasons to believe that we are embarking on a period of structurally higher inflation (and accordingly, interest rates) versus the post-2008 era.

These inflationary forces include:

> **Demographics:** Ageing populations are set to temper labour force growth, keeping wages elevated. The pandemic exacerbated these labour market shortages, with participation still below pre-COVID levels.

> **Deglobalization:** The disinflationary impulse from globalization is expected to subside given that the COVID crisis and persistent geopolitical tensions have sparked a move towards onshoring supply chains and bringing production closer to home.

> **Global Climate Change:** The transition towards a lower carbon world implies that governments will be ramping up spending on green energy initiatives, with the potential for supply-demand imbalances in the energy space along the way.

> **Debts & Deficits:** The buildup in government debt will keep rates above the lower levels that prevailed since the global financial crisis as investors demand compensation for holding long-term government bonds.

These developments require an expanded set of investment opportunities in the construction of a properly diversified portfolio, including private credit, real assets, and private equity. These asset classes are uncorrelated with public markets, are less susceptible to wild gyrations in a potentially more volatile market, and have differentiated sensitivities to inflation.

As such, the inclusion of private markets strategies can prove instrumental in enhancing a portfolio's risk-adjusted performance.

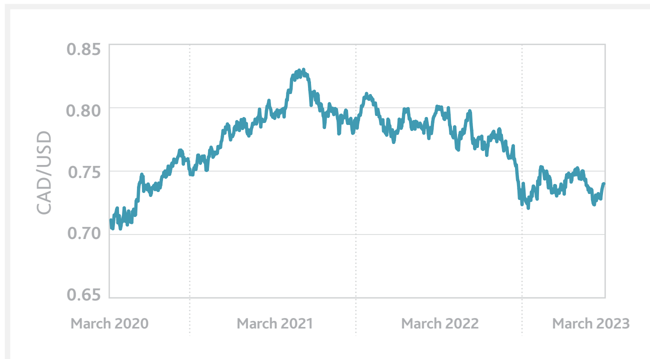
Portfolio Resiliency & Private Market Strategies

Private Market strategies continue to be instrumental in the construction of a resilient and well-diversified portfolio. Optimizing a portfolio to include private credit, real assets, and private equity may enhance both the performance and durability of a total portfolio, including maximizing the potential for an increase in its reward per unit of risk.

Source: Fiera Capital, for illustrative purposes only.

Commodities and Currencies

Currency Markets



The US dollar retreated in the first quarter as financial instability risks sparked a profound re-pricing in expectations for the fed funds rate. The yield advantage narrowed amid mounting speculation that the Federal Reserve may be nearing the end of its tightening cycle and will begin cutting rates later this year. By contrast, the euro strengthened given a relatively more hawkish-leaning stance from the European Central Bank, with President Lagarde reinforcing her unwavering commitment that getting inflation back on target is "non-negotiable." The Canadian dollar edged modestly higher alongside a broadly weaker US dollar, even despite the sharp retreat in crude prices at the beginning of the year. Looking forward, the US dollar should strengthen versus its global peers as the Federal Reserve ultimately pushes ahead with additional rate hikes. Favourable rate differentials, elevated risk aversion, and global growth uncertainty may help to place a floor under the counter-cyclical greenback in the coming year.

Oil

Crude oil retreated in the first quarter as global growth expectations faltered and weighed on the outlook for demand, which overshadowed a generally restrained supply backdrop. However, oil prices shot higher in early April after the Organization of Petroleum Exporting Countries and its allies surprised the market and pledged to cut production by over 1 million barrels per day beginning in May, which threatens to restrain an already tight market. We remain bullish on oil prices. While some demand destruction in developed markets is inevitable in a recessionary environment, the reopening and subsequent rebound in China may help to cushion the blow. Moreover, supply-side restraints including low spare capacity and continued production management by OPEC+ and US shale producers may ultimately place a floor under prices and will limit the extent of price declines during the next recession, while prolonged underinvestment and regulatory restraint in the energy space has also contributed to supply deficits.

Gold

Gold rallied in early 2023 as the banking crisis prompted a downshift in expectations for the Federal Reserve's policy path. In response, both treasury yields and the dollar spiraled lower and boosted the appeal of bullion. We expect gold to trade in a narrow range given some conflicting forces at hand. While bullion's appeal as an inflation hedge and a safe haven given lingering recession risks should underpin prices, the prospect for an aggressive path of rate hikes should limit any notable upside for the non-interest-bearing metal.

Copper

Copper soared higher following China's move to relax virus controls and Beijing's efforts to stimulate the domestic economy, which drove optimism for a recovery in the top metals-consuming nation. While copper is at risk of some demand destruction in a recessionary scenario, China's pro-growth policy stance aimed at infrastructure spending and aid to the property sector may counteract some of that weakness in developed markets. Longer term, copper stands to benefit in the global effort to scale up in green infrastructure spending and expand the electric-generation grid.

Source: Bloomberg, as of March 31, 2023.

Forecasts for the Next 12-18 Months

SCENARIOS	MARCH 31, 2023	DEEP RECESSION	STAGFLATION	DISINFLATION
PROBABILITY		55%	30%	15%
GDP GROWTH				
Global	2.10%	1.00%	2.50%	3.50%
Canada	0.50%	-1.00%	1.00%	2.00%
U.S.	0.30%	-2.00%	0.50%	2.50%
INFLATION (HEADLINE Y/Y)				
Canada	5.20%	4.00%	4.50%	3.00%
U.S.	6.00%	4.50%	5.50%	3.00%
SHORT-TERM RATES				
Bank of Canada	4.50%	5.50%	4.50%	3.50%
Federal Reserve	5.00%	6.00%	5.00%	4.00%
10-YEAR RATES				
Canada Government	2.90%	5.00%	4.50%	3.00%
U.S. Government	3.47%	5.00%	4.50%	3.50%
PROFIT ESTIMATES (12 MONTHS FORWARD)				
Canada	1503	1300	1500	1600
U.S.	226	200	240	260
EAFE	157	125	155	165
EM	80	65	80	85
P/E (12 MONTHS FORWARD)				
Canada	13.4X	12.0X	14.5X	15.5X
U.S.	18.1X	15.0X	17.0X	19.5X
EAFE	13.3X	12.0X	14.0X	16.0X
EM	12.4X	11.0X	13.0X	15.0X
CURRENCIES				
CAD/USD	0.74	0.75	0.85	0.80
EUR/USD	1.08	1.00	1.15	1.12
COMMODITIES				
Oil (WTI, USD/barrel)	75.67	90.00	130.00	100.00
Gold (USD/oz)	1969.00	1900.00	2100.00	2000.00

Source: Fiera Capital, as of March 31, 2023.

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Portfolio Management Team: Charles Lefebvre, Luc Bergeron, Tan Vu Nguyen, Olivier Audette Génier, Nicolas Vaugeois, Alexandre Cousineau, Kon-Yu Lau, Imran Chaudhry, Sapan Sheth and two analysts

STRATEGY OVERVIEW

Our investment philosophy relies on a multi-strategy approach whereby duration management, portfolio positioning on the yield curve, sector selection, and the active management of corporate bonds all constitute opportunities for adding value versus the benchmark. Our corporate bond approach is conservative and focuses on high quality securities.

The objective is to outperform the benchmark, to a reasonable extent, at every stage of the credit cycle. Long-term returns are therefore generated through a combination of interest income and a moderate capital gain.

QUARTERLY COMMENTARY

The annual inflation rate was down once again in the first quarter. In Canada and the United States, it continued to move slowly back toward the central banks' target of 1% to 3%. Even so, the looming recession helped keep volatility high on the bond market. The inverted yield curve and banking sector stress on both sides of the Atlantic also supported the recession scenario.

The Bank of Canada paused its key rate hiking cycle. At the end of the first quarter, bond investors were expecting the Canadian key rate to decline by 0.5% by the end of 2023. In the United States, the markets were pricing in a possible decline from 5.0% to 4.25% by year-end.

During the quarter, we kept the duration longer than that of the index, a decision that contributed to the portfolio's return.

At the end of the first quarter, the segment of the curve from 2 to 10 years was inverted by 84 basis points (bps). At the end of December, the slope was negative by 75 bps. As for the segment from 2 to 5 years, it is now inverted by 72 bps. During the quarter, we kept a portion of the portfolio in securities maturing in more than 5 years.

In the first quarter, spreads for corporate securities with 5-year and 10-year maturities widened by 12 bps. Provincial bond spreads were stable in the short- and medium-term segments of the yield curve. As for municipal spreads, they were unchanged at 95 bps in relation to Quebec bonds. We increased our corporate holdings to a slightly overweight position.

The markets expect key interest rates to decline. As a result, the slope of the yield curve should steepen. The slowing economy calls for caution. With a combination of corporate, provincial and municipal bonds, our exposure is generally lower than our benchmark index. We have an overweight in good-quality corporate bonds but an underweight in provincial bonds. Lastly, we maintained our overweight in non-rated Quebec municipal bonds, which were trading at very attractive prices.

Portfolio Management Team: Nessim Mansoor, Nicholas Smart and Tony Rizzi

STRATEGY OVERVIEW

We focus on owning high-quality businesses trading at attractive valuations, with a significant focus on capital preservation. We want to own good businesses that have demonstrated an ability to build intrinsic value over time for our investors. We have found that this approach has outperformed over time, and with lower risk.

QUARTERLY COMMENTARY

MARKET UPDATE

In the first quarter of 2023, the rally that began at the end of last year continued as the "January effect" compounded improving sentiment even with continued recession fears. Despite the consistent hawkish tone from central banks and the emergence of the US regional banking crisis, the Canadian index showed positive returns across most areas of the market. The strongest performing sectors were Information Technology (26.5%) and Consumer Staples (7.9%), with Energy (-2.3%) and Health Care (0.9%) the biggest laggards.

PERFORMANCE

In the first quarter of 2023, the strategy had an absolute return of 6.58%, whereas the S&P/TSX Composite Index had a return of 4.55%.

Among the leading contributors to performance over the quarter were Constellation Software and Thomson Reuters. Constellation Software offers software and systems that are narrowly focused on solving a problem for a specific market or industry and are typically core to an end customer's operations, making them utility-like and difficult to replicate. Constellation, a business we have long admired, has a number of strong attributes including one of the best decentralized business models we have come across, modest capex requirements, and an exceptional founder (and senior executives) with plenty of skin in the game. Following the sector-wide pullback that affected higher multiple technology companies during past of last year, the company performed well the first three months of the year as they continue to focus on deal sourcing, execution and integration across various verticals. Thomson Reuters is a leading provider of information-enabled software solutions. They have these industry-leading digital tools to help professionals in the legal, tax, accounting and compliance fields. The company has a strong balance sheet, consistent pricing power and a resilient profile from the critical products and services they provide to their clients.

Significant detractors over the quarter were Metro and Intact Financial. Metro distributes food and pharmaceutical products through an expansive network of grocery and drug stores in Quebec and Ontario. The company benefits from the natural attractive industry structure of the Canadian grocery sector, strong pricing power and a top tier management team with a track record of efficiency and operational excellence. After showing strong resilient performance during the volatility of last year, the stock experience slight pullback during the quarter. Intact Financial is the largest Property & Casual (P&C) Insurer in Canada, with significant scale advantages further enhanced by acquisitions over recent years. In the current rising interest environment, P&C carriers face increased product pricing challenges because the generally shorter-term nature of P&C coverages means although they will be able to raise premiums to a certain extent, they'll need to rely more on underwriting efficiency and investment earnings to minimize any shortfalls between premium revenue and claims payouts. For Intact, as the largest P&C player in Canada, they have significant scale advantages including vast amounts of data that they use in customer pricing as well as a strong history of underwriting and investment discipline. This scale has allowed them to manage the current environment incredibly well and maintain organic growth across product lines. Following last year in which the company was one of the best performing stocks in the Canadian Financial sector, it experienced slight pullback during the quarter as the market favoured other areas of the industry.

MAJOR TRANSACTIONS

We did not initiate or exit any positions during the first quarter of this year.

OUTLOOK

The portfolio continues to be composed of high-quality businesses that can withstand tough times and is currently trading at an attractive discount to its intrinsic value. Both of these should position the portfolio well for long-term compounding of returns.

Portfolio Management Team: Marc Lecavalier and an analyst

STRATEGY OVERVIEW

This strategy employs a fundamental bottom-up investment approach to constructing portfolios which focuses on identifying the leaders of tomorrow and long-term strategic investment themes or trends that are expected to exert a positive influence on small-cap equity securities. Small Cap companies demonstrating balance sheet strength and offering growth opportunities available at a reasonable price are selected across all sectors to diversify our sources of added value while paying special attention to the preservation of capital. This approach aims to generate consistent added value at a risk that is below that of the market.

QUARTERLY COMMENTARY

Canadian small-cap equities, like all equity markets, experienced a period of high volatility in the first quarter of 2023. In January, inflation was declining and investors believed central banks would moderate interest rate increases. As a result, the markets rose strongly. In March, investors were concerned about the collapse of two U.S. regional banks. The entire financial services sector suffered as a result of the contagion of this crisis. Gold stocks were used as a safe haven. Our underweight position in gold companies and overweight position in financial services detracted from the portfolio's quarterly performance.

Our management continues to focus on owning well-capitalized businesses, with a focus on growth through acquisitions in fragmented markets. Rising interest rates and relatively scarce venture capital positions these companies well to make acquisitions at reasonable prices.

In fact, during the first quarter, one of our Uni-Select securities was the target of an acquisition.

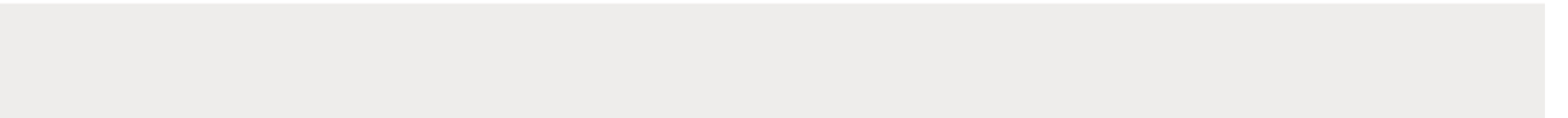
Many of our holdings continue to benefit from some key trends. This is the case for ATS Automation, a leader in robotics. The repatriation of foreign production activities and labour shortages support the need to robotize production lines. The same is true for Savaria, the leader in home accessibility. This manufacturer of residential elevators and lifts is benefiting from an aging population. In the first quarter, both companies reported better-than-expected financial results.

One of our holdings, Trisura Group, faced an exceptional loss that negatively affected its results. The stock's decline affected our performance.

During the quarter, several new names were added to the portfolio. Agricultural infrastructure provider AG Growth International. Its new management team has already begun to reduce debt and increase profit margins. AG Growth has a strong backlog, not only in North America but also in India and Brazil. We purchased Lumine Group, a company spun off from Constellation Software. Lumine Group offers software services to media companies. Like Constellation, it generates cash flow and targets growth by acquisition in a fragmented market.

Two U.S. companies, NV5 Global and CBIZ Inc. were also added. In return, we sold AutoCanada and Sangoma Technologies, two companies that we believed were more vulnerable to the current environment.

The prospects for recession, labour scarcity and fragile supply chains are challenges for businesses. However, we are confident in the quality of the companies held in the portfolio. Their balance sheets are strong and their valuations are attractive. This puts them in an excellent position to be acquired by competitors or to make acquisitions to ensure their future growth.



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Unless otherwise indicated, all dollar figures are expressed in Canadian dollars.