# Invesco Canadian Fund / Class

**Quarterly review |** As at June 30, 2022

## Investment philosophy

Invesco Canadian Fund seeks to provide strong capital growth over the long term. The Fund invests primarily in common shares of Canadian and global companies.

## Performance summary

- Invesco Canadian Fund, Series I generated a return of -10.70% over the second quarter of 2022 versus its benchmark, the 65% S&P/TSX Composite Index/35% MSCI World Index, which returned -13.27% (C$) over the same period

## Key contributors to performance

- The Fund's relative performance versus the benchmark benefited from investments in the information technology and materials sectors, which outperformed those of the benchmark. The two most significant individual contributors to Fund performance over the quarter were **Cenovus Energy Inc. (CVE)** and **Northrop Grumman Corp. (NOC)**
- Cenovus is the third-largest Canadian oil and natural gas producer and the second-largest Canadian-based refiner and upgrader, combining high-quality and low-cost oil sands and heavy oil assets with extensive midstream and downstream infrastructure.[1] Their strategy focuses on cost leadership and realizing the best product margins. Oil prices remained elevated over the period reflecting improved demand as the global economy recovered from the pandemic, especially with limited new supply coming online. CVE has high operating leverage to higher oil prices given their low cash operating costs. At recent oil prices, the portfolio management team (the "team") believes its free cash flow generation is exceptional and that this will result in meaningful deleveraging and returns to shareholders
- Northrop Grumman is a leading U.S.-based aerospace and defense company. Defense company valuations benefited from improving market sentiment following the invasion of Ukraine. While only a small portion of its earnings come from outside the U.S., recognition of escalating geopolitical risks, particularly involving Russia and China, were expected to provide greater bipartisan support for growth in the Department of Defense's budget

## Key detractors from performance

- The Fund's relative performance versus the benchmark was hurt by investments in the communication services and financials sectors, which lagged those of the benchmark. The Fund's underweight exposure to energy names also had a negative impact as the energy sector declined less than the broader market The two most significant individual detractors over the quarter were **Brookfield Asset Management (BAM)** and **Bank of Nova Scotia (BNS)**
- BAM is a global alternative asset manager with over US$700 billion[1] of assets under management. The company's investments are focused on real estate, renewable power, infrastructure, private equity and credit. Despite reporting solid quarterly results and record fundraising, BAM's share price has likely been impacted by rising rates. Higher interest rates negatively impact asset values through higher discount rates, and funding costs on debt. While acknowledging these factors, the team believes the majority of BAM's high-quality long-life assets should be fairly recession-resistant and offer a good level of inflation protection. The team views BAM as being well-positioned to deploy capital opportunistically in a downturn – as it has demonstrated many times in the past – given the significant amount of liquidity it currently enjoys

- BNS is one of the largest banks in Canada. BNS declined over the quarter, along with the other Canadian banks, amid concerns of an economic slowdown. Fears have also been mounting that rising interest rates will cause weakness in the mortgage market and strain borrowers who may struggle under the increased cost to service their debts. The team believes that BNS is well-capitalized and has been relatively conservative with respect to their lending practices, so they should be able to weather an economic slowdown without too much difficulty. Additionally, BNS has a solid banking presence in Latin America that provides long-term growth opportunities. As well, the Canadian banking industry enjoys an oligopolistic market structure, which has helped to generate strong returns on invested capital. In the team's view, the bank continues to be an attractive investment on a risk-reward basis

## Portfolio activity

- During the period, Texas Instruments Inc., Richelieu Hardware Ltd. and Starbucks Corporation were added to the Portfolio at a discount to the team's estimate of intrinsic value. Texas Instruments (TI) is the world's largest manufacturer of analog semiconductors. The team views analog semiconductors as an attractive business for many reasons; these products are difficult to produce, they are a critical component in the end-use application yet represent a small cost, the customer base is highly fragmented, and the switching costs are high. The team believes TI is particularly well-positioned in the market given its dominant scale, which allows the company to offer a broad portfolio of products, insource most of its manufacturing and deal directly with its customers. These competitive advantages together with an outstanding management team have allowed TI to consistently take market share in an industry that enjoys long-term secular growth. Concerns over a potential slowdown in demand resulted in the opportunity to acquire TI at a discount to the team's estimate of intrinsic value
- Richelieu Hardware is a market leader in the distribution of specialty hardware products for the kitchen cabinet and furniture markets across North America. Richelieu has experienced strong growth through innovation, value-added service strategies, and acquisitions. Recent market volatility provided an opportunity to purchase Richelieu at what the team considers an attractive level
- Starbucks is a multi-national coffeehouse with approximately 34,000 stores globally. The company's immense scale allows it to secure convenient locations to capture habitual coffee drinking and control its supply chain to ensure consistent, sustainable products. Starbucks also has a unique culture that is focused on maximizing the benefit for all members of its ecosystem, including its employees, customers, suppliers and community. The outcome of this model is high-quality, personalized customer service, a unique in-store experience, good quality coffee and sustainable products, resulting in high returns on capital. In the team's estimation, very few competing players, if any, can do all these things well and at scale. Recent issues including unionization efforts, management changes and the COVID lockdowns in China allowed the team to establish a Fund position in Starbucks at a discount to their estimate of intrinsic value
- Northrop Grumman was sold over the period as shares had reached the team's estimate of intrinsic value. The team redeployed the proceeds into other investment ideas where they see the potential for better risk-adjusted returns
- In terms of positioning, the Fund is most overweight the financials and consumer discretionary sectors. In contrast, the Fund is most underweight energy, consumer staples and materials. Sector weights are a function of the team's bottom-up, fundamental investment approach and are not a top-down call on the attractiveness of any given sector

## Investment outlook

The second quarter was a very difficult period for global markets given the challenging economic environment. Inflation remained problematic, and many developed economies experienced a slowdown as central banks continued to normalize monetary policy. In addition, China's economic growth experienced a serious negative impact from further COVID-related shutdowns.

In this environment, global equities posted significant declines. Canadian stocks, which fared better than U.S. stocks in the first quarter, were hit hard in the second quarter on rising recession fears. Global fixed income also posted substantial declines. Not only did high yield and investment grade fixed income post negative returns, but so did government bonds as expectations for the number of rate hikes in the U.S. and other developed countries increased.

In the team's view, the long-term value proposition for equities has become more attractive as near-term pessimism has increased and valuations have decreased.

## Important information

Sources: Invesco Canada Ltd., Bloomberg L.P., FactSet Research Systems, Inc., Morningstar Research Inc., as at June 30, 2022. Data expressed in Canadian Dollars.

[1]Bloomberg L.P.

The above securities were selected for illustrative purposes only and are not intended to convey specific investment advice.

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Performance† of Invesco Canadian Fund, Series I, as at June 30, 2022:

| | 1-Year (%) | 3-Year (%) | 5-Year (%) | 10-Year (%) |
|---|---|---|---|---|
| **Invesco Canadian Fund, Series I** | **0.67** | **11.09** | **8.68** | **7.62** |
| 65% S&P/TSX Composite Index/35% MSCI World Index (Net) C$ | -6.28 | 7.56 | 7.66 | 9.64 |

† Performance is gross of fees.

The views expressed above are based on current market conditions and are subject to change without notice; they are not intended to convey specific investment advice. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations.



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