2021 YEAR END LETTER

January 27, 2022

Once again, we would like to express our sincere hope that you and your loved ones have remained in good health and been able to weather this lengthy pandemic. On our end, the LAM team is healthy and strong, continuing to alternate between working from home and the office as needed and depending on government restrictions. We have also continued to renew the team with the addition of Kate Passingham and Elisa Stawnyczy to our client services and portfolio administration functions, supporting Lorie Hache and Marc Dansereau in providing seamless service to clients, smooth operations, and support to our portfolio management team.

In Canadian Fixed Income, we are proud to have maintained our long track record of positive returns despite a challenging environment of rising interest rates, ranking us in the 1st quartile of Fixed Income managers in the country*. The addition of Olivier Tardif-Loiselle in 2020 as Lead Manager of Fixed Income has greatly strengthened our team. Olivier had worked for 7 years at Industrial Alliance, Canada's 4th largest life insurance company, as portfolio manager, senior bond trader and credit analyst. The launch of the **LAM Canadian Fixed Income Fund** in January 2021 has been a success with assets under management approaching $50 million. As well, the **Quebec Emerging Managers Program** awarded us additional funds to manage for institutional investors in bonds, now totalling $40M.

Regarding Canadian Equity, it was a humbling year for us and the first time in 16 years that we lagged to such an extent. While we significantly outperformed the TSX Composite in 2020, the converse was true in 2021. Our portfolio has proven to be fairly pandemic proof; however, it was not so inflation proof. While our approach to having a diversified portfolio had served us well in the past, 2021 was a year to be heavily concentrated in two sectors: oil & gas and banks. Although we definitely learned a few lessons as all managers do in their careers, the massive move up in these two sectors is unlikely to repeat itself to such an extent again in 2022.

Despite a plethora of uncertainties in the markets these days, we believe that our portfolios are well positioned for 2022 and beyond. In Fixed Income, we have proven that we can navigate a rising rate environment and generate positive performance. In Equity, our long-term track record gives us the confidence that we have the right strategy to continue generating strong risk-adjusted returns over the long run. As always, we owe our success to our loyal clients and again express our sincere appreciation for allowing us to continue enjoying the work we do for you.

Our best wishes for a healthy and happy 2022.

Stephen Takacsy
President & CEO

Tony Boeckh
Chairman

CANADIAN EQUITY

For 2021, the **LAM Canadian Equity Fund** produced a gross return of **+5.4%** versus +25.1% for the TSX Composite Total Return including dividends. Our underperformance was due to our lack of exposure to oil & gas producers which helped propel the TSX Energy sector by a staggering +85%, and our low weighting in the Financial sector which rose +37% mainly driven by banks. These two sectors alone, which represent a 41% weighting in the TSX, contributed +20.5% of the TSX Return. In other words, about 80% of the +25.1% Total Return of the TSX was derived from Energy and Financials.

Admittedly, we could have and should have done a lot better, and are disappointed with our return, especially after such a strong outperformance in 2020, and what was a good start to 2021. However, our investment strategy has several key tenets which we have followed closely for over 15 years. Among these is diversification by industry in order to mitigate sector risk. Another is maintaining low cyclicality by minimizing exposure to commodities in order to help mitigate volatility. These two investment principles have served us well in the past and have allowed us to outperform the TSX over the long run, but were a detriment to our performance in 2021.

While we do own a few banks such as TD and BMO, the Global Financial Crisis of 2008/09 taught us not to put all our eggs in one basket of stocks, and therefore we hold other businesses in the Financial sector. We also have exposure to the Energy sector; however we generally avoid investing in oil & gas exploration and production companies due to their high volatility and unpredictability of earnings. We prefer owning energy infrastructure stocks such as pipelines which have more stable cash flows and growing dividends. However, these did not rise as much, yet should not fall as much when the price of oil declines. Despite its 85% rise in 2021, the Canadian Energy sector is still down nearly 50% over the past 15 years, equivalent to a loss of -2.6% annually. Finally, we have always taken Environmental, Social and Governance (ESG) issues into consideration as well when investing in the Energy sector.

Our top contributors for the year were a diversified group of companies including **Blackberry**, **CareRX**, **Altagas**, **Park Lawn**, **TD Bank**, **Savaria, Enbridge**, and **Loblaw**. The strong returns generated by these investments were partially offset by a significant decline in our renewable energy holdings which included **Boralex**, **Innergex**, and **Algonquin Power** (ironically, momentum investors switched out of renewable energy and into oil & gas stocks). As well, certain technology-related stocks that had risen on brighter prospects due to the pandemic, such as **MDF Commerce**, pulled back sharply.

The pandemic and resulting government restrictions have encouraged a massive shift by consumers into buying more goods and less services. This has created a large imbalance between supply and demand causing dislocations in supply chains around the world, which, along with higher oil prices, has led to high rates of inflation. While we had been leery of high valuations, the anticipated rise in interest rates by central banks to combat inflation has created market volatility, and is helping to deflate a bubble that had formed in certain technology stocks and other risky assets. A healthy correction was overdue and should create some good investment opportunities.

We believe that the pandemic is a “wake-up call” to accelerate the digitization of businesses and institutions, be it for e-commerce, e-learning, supply chain management, or telehealth. The Technology sector will continue to be the growth leader, and we are maintaining exposure to this sector despite the increased volatility. We remain well diversified by industry, holding companies that have pricing power or are able to protect margins in an inflationary environment. We also highlight that most companies in our portfolio are trading at reasonable valuations and are expected to generate record results this year, which bodes well for 2022 and beyond.

U.S. EQUITY

For 2021, our U.S. portfolios were up **+18.1%** versus +28.7% for the S&P 500. Our underperformance was mainly due to large cash balances held throughout the year, as well as a lower technology weighting and our lack of “momentum stocks” trading at high multiples which helped drive the S&P 500’s return. These types of stocks don’t ascribe to our mostly large cap value strategy. We tend to look for companies with strong cash flows and sound business models trading at reasonable prices.

According to Goldman Sachs, from April 2021 to mid-December 2021, only 5 stocks accounted for over half or 12% of the S&P 500 return of 24% during that period (Microsoft, Nvidia, Apple, Alphabet, and Tesla). Suffice it to say that “the market” is very narrowly represented. In fact, Tesla and Nvidia alone contributed more than +9% during that period. These stocks present a massive overvaluation in the index, and not owning most of them in our portfolios explains a large part of our underperformance.

Furthermore, the Information Technology (IT) sector being very expensive, we were underweight IT throughout the year as we could not get our heads around valuations, which also caused us to lag. Both **Activision Blizzard** (due to bad corporate culture and product delays) and **Splunk** (difficult transition to the cloud) were drags on our performance. Conversely, **Microsoft**, **Eli Lilly**, **UnitedHealth**, and **CVS** were strong contributors during the year.

As seen so far in 2022, the pendulum is shifting to more value investing, as a rising interest rate environment and a less accommodative central bank are a negative for very expensive stocks. Case in point is the rapid downward spiral in Tesla’s share price (-21% from its peak), as well as Nvdia’s (-30% from its peak). Even with these declines, these stocks are still expensive. At the risk of lagging, we still need to be disciplined and not chase momentum or highly valued stocks. We have cash to redeploy and are waiting for opportunities as the market digests the Federal Reserve’s change in rate regime.

FIXED INCOME

We are very pleased with our Fixed Income strategy’s strong performance in 2021. The **LAM Canadian Fixed Income Fund** generated a gross return of **+4.6%** for the year, well ahead of the -2.5% for the Canada Universe Bond Index. As previously mentioned, this extends our track record of consistent positive annual returns since inception in 2008. Our outperformance was mainly due to our weighting in “rate-reset” preferred shares with “floors”, as well as shorter duration higher yielding corporate bonds. In fact, the Canadian Preferred Shares index was one of the best asset classes in 2021, with a return of more than +23%. We also benefited from positive returns of our high yielding dividend stocks like **BCE**, **Enbridge**, and **AltaGas** (which we limit to 5% of the Fund), as well as several new issues and high yield bonds such as **Fairfax 3.95%** and **Nuvista 7.875%**.

Towards year-end, volatility in the bond market rose substantially, as the Bank of Canada abruptly announced the end of quantitative easing and faster rate hikes, mainly due to rising inflation. In the U.S., the FED Chairman dropped the word "transitory" causing the market to anticipate faster tightening as well. This caused bond yields to rise and bond prices to fall. Shortly afterwards, the outbreak and rapid spread of the Omicron variant created economic uncertainty, and bond yields swiftly reversed course and declined causing bond prices to rise. This has since reversed once again, as fears of faster and more numerous rate hikes have gripped capital markets on strong inflation data.

For 2022, several themes will be interesting to watch. Inflation and various economic data will remain hot topics, as they will dictate the evolution of monetary policy tightening by central banks. Despite high vaccination rates, we have seen that variants can significantly disrupt the return to normalcy, and can quickly change central banks' views on future monetary policy. As we still hold a significant amount of cash due to continued bond and preferred shares redemptions and new client inflows, this allows us to invest at opportune times as rates rise and to adjust the portfolio according to the evolution of monetary policies and the macroeconomic environment.

MACROECONOMIC OUTLOOK: The Inflation Scare

Despite geopolitical tensions in the Ukraine and the imploding Chinese real estate market, it is the inflation scare closer to home that is most on people's minds, having intensified recently with price measures increasing to near 40-year highs. The U.S. headline CPI number recently hit 7%. The Canadian CPI is also strong but is considerably lower at 4.8%. Inflationary expectations have also risen significantly but primarily over the one and two-year periods ahead. Further out in time, expectations are much lower at closer to 2%, indicating that the market believes the recent rise in prices is "transitory", in the sense that it primarily reflets supply chain problems which will not be long lived. However, because wage inflation has picked up, the Bank of Canada and the Federal Reserve have had to tighten policy in order to pre-empt a potential wage price spiral. However, it is important to keep in mind that supply-induced price increases do not last long in a free market economy. There is an old saying that "the best solution to high prices is high prices".

There are clearly increased risks for financial markets while central banks are trying to bring inflation down. Already the 10-year Government bond yield has risen significantly in both countries. Stock markets never like tightening monetary policy and shrinking liquidity in an inflationary environment. Hence, the increased volatility in capital markets. Investors, however, should assess these risks in the context of both cyclical and secular trends. From a cyclical perspective, high inflation should give way, with a time lag, to lower inflation. The recent sharp rise in prices has a lot to do with the dramatic rebound in the economy following the pandemic low and oil prices. It has also been driven by supply shortages as consumers shifted consumption from services to goods, but excessive fiscal support in both the U.S. and Canada has also played an important role. This is reversing as there is little support for more fiscal largesse. Countries like Japan and China that had almost no fiscal support for workers and businesses have not experienced inflation, a good lesson for North American policy makers.

For the bond market, interest rates at the longer end are probably significantly higher than their long-term equilibrium rate which has been falling over time. It is driven principally by excess savings, long run deflationary tendencies, and slowing structural growth. While upward pressure on interest rates will likely remain for a few months, further sell-offs in bonds would represent great buying opportunities. The stock market is at risk during this confrontation between hawkish central banks and high inflation. However, that risk is short term and limited because interest rates are already above their equilibrium level, and leading indicators of inflation are already softening. The main risk is in very high P/E, long duration, and speculative stocks. They never do well in a period of tight money and rising rates. The areas of the market that have avoided speculation and are reasonably valued will remain solid long-term investments. Since there are already early signs that inflation will soften in the next 3 to 4 months, the window of increased risk is limited and a correction to the recent speculative activity is healthy for the markets. When central banks can declare victory on inflation, the long-term upward secular trend should resume. It is driven, not by fluctuations in monetary policy but by new technologies and innovation that are changing the world and that are still in their early stages.

Canada has three additional factors going for it. The market is relatively cheap by international standards and has not experienced anything like the speculation and over-valuation that the U.S. has. Second, the death of fossil fuels, widely forecast, has been premature to say the least. Green energy is great, but ramping up enough production to cut fossil fuel demand is a problem for the here and now. The high cost of capital of fossil fuel producers and political pressures has seriously limited production during the transition to a much greener world (some may have noticed the irony in this situation as the very green President Biden is imploring the Saudis to increase oil production). Canada is, of course, a huge beneficiary of the current high prices for fossil fuel via rising domestic incomes and improving balance of payments. A third important factor for Canadian investments is the very cheap but rising Canadian dollar, supported by rising oil prices. While the higher price of energy is a relative price shock, the stronger Canadian dollar will help to reduce inflation in Canada which is much lower than in the U.S., while at the same time making Canada an increasingly attractive destination for foreign investors. In short, the near-term environment is not friendly for investments in general, but it will prove to be transitory. Great opportunities and healthier markets will emerge, as they always do, and the long run secular trend will continue to be up, with Canada being a big beneficiary.

Stephen Takacsy **Martin Gagné** **Olivier Tardif-Loiselle** **Tony Boeckh**

*The LAM Canadian Fixed Income Strategy is in the 1st quartile of the Canadian Fixed Income Plus Universe for the periods Year to Date, 1 Year, 2 Years, 5 Years, 7 Years and 10 Years in the Global Manager Research Institutional Performance Report, December 31, 2021.