1st QUARTER LETTER 2022

April 26, 2022

The 1st quarter of 2022 was marked by extreme volatility with both global stock and bond markets suffering sharp declines. As the world emerged from the aftereffects of the pandemic, high rates of inflation have taken a firmer hold than anticipated due to supply-demand imbalances, supply chain disruptions and labor shortages causing central banks to take an aggressive stance in raising interest rates. Supply chain disruptions and product shortages have been further exasperated by the tragic events of Russia's brutal invasion of Ukraine.

As a result of the above, the S&P500 and NASDAQ equity indices plunged -5.9% and -10.1% respectively in Canadian dollars, while the MSCI Europe, Far East and Emerging Market indices were down -8.3% and -8% respectively. Bonds, normally seen as a safe haven for conservative investors, faired just as poorly, with the Canadian Universe Bond Index down -7% and the U.S. bond index benchmark also down -7% in Canadian dollars. While markets remain volatile and momentum-driven, we believe that we are well positioned in both equities and fixed income securities to weather a likely economic slowdown and generate attractive long-term returns.

CANADIAN EQUITY

During the 1st quarter, the **LAM Canadian Equity Fund** was down **-0.6%** before fees versus a rise of +3.8% for the TSX Composite Total Return. The positive return of the TSX was driven by the Energy and Gold sectors which were up +36% and +20% respectively. As a reminder, we do not invest in highly cyclical businesses such as gold or mining and metals stocks, and our investments in energy are primarily in infrastructure companies that gather, process, store, and transport fossil fuels, and are less volatile than exploration and production companies that assume the commodity risk. Considering our low exposure to the "commodity complex", we are relatively satisfied with our return, particularly given that many of our holdings are reporting record results.

Our top contributors included **AG Growth International**, a global manufacturer of agricultural equipment used for grain and fertilizer handling and storage and food processing, which rose +36% on record financial results and a record backlog. Strong returns were also generated by our energy infrastructure holdings such as **Enbridge**, **TC Energy** and **Gibson Energy**, as well as renewable power producer **Boralex**. Various other stocks such as **CP Rail**, **Dollarama** and **Telus** contributed positive returns during the quarter.

Among our detractors were not surprisingly several of our technology holdings such as supply chain management solutions provider **TECSYS**, e-commerce and government e-procurement platform **MDF Commerce**, and IT consulting firm **CGI Group**. Also, **Pollard Banknote**, whose instant lottery ticket business is generating record sales, nevertheless dropped -32% on higher input costs for specialty paper and ink, despite being an oligopoly with high barriers to entry and having attractive profit margins and strong free cash flow.

Given the volatility and economic uncertainty going forward, our strategy is to remain highly diversified by company in non-cyclical and non-economically sensitive sectors that are fairly recession resistant. These include several newer holdings such as vitamin manufacturer **Jamieson Wellness**, P&C insurance company **Definity**, retailer **Pet Value**, and renewable power producer **Northland Power**. We are also well positioned to benefit from the continuation of many powerful trends such as aging demographics, the digitization and automation of businesses and optimization of supply chains, and the reduction of the world's dependence on fossil fuels.

U.S. EQUITY

During the 1st quarter, our U.S. portfolio declined **-4.9%** versus -4.6% for the S&P 500 Total Return. Our small underperformance was due to a strong rebound in low-quality yet still expensive companies at the end of the quarter, which we suspect was mostly due to short covering. As we invest almost exclusively in high quality reasonably valued companies, we did not participate in this short-lived rebound which has since reversed.

Natural gas infrastructure leader **Williams** was our top performing stock with a +28% return driven by the energy sector, which was the best performing sector. Energy prices and other commodities got a big boost fueled by Russia's invasion of Ukraine as these two countries are key commodity producers on the world stage. **Arch Capital** also did very well with a +9% return as property & casualty insurance companies are in a strong pricing environment and the stock is still relatively cheap at around 10x earnings. **T-Mobile** was also a positive contributor due to its defensive nature as a wireless carrier and the strongest 5G player in the U.S.

On the flip side, our biggest detractor was **Meta Platforms** (formerly Facebook) which was down sharply as the number of new users has slowed considerably. The company is also investing billions of dollars in its "Metaverse" without any foreseeable return on investment, as a result of which we sold our shares. **Lowe's**, the hardware giant, got hit as the rising interest rate environment could deter demand for home improvement products. **Ross Stores**, a retailer, was also down as inflation is expected to cut into consumer discretionary spending. We still like both companies as they are leaders in their fields with excellent return profiles.

We took advantage of the market decline to add some new names such as the fast-growing cybersecurity provider **Crowdstrike**, digital payment leader **PayPal**, and **Charles River Labs**, the world's largest non-clinical drug research company. As we are in an environment where the Federal Reserve is withdrawing liquidity, we expect continued volatility in the markets and are keeping some cash for further opportunities.

FIXED INCOME

The 1st quarter of 2022 was historic for global bond indices, and not in a good way. The quarter ended with one of the worst performances in over 40 years. The Canada Universe Bond Index ended the quarter with a return of -7% and the Hybrid Bond Index was down -5.3%. We were also impacted, but to a lesser extent, as the **LAM Fixed Income Fund** finished with a gross return of **-3.1%**. We are pleased with this relative outperformance given the very difficult rising rate environment we are currently navigating.

Yields rose considerably during the quarter, which explains the poor performance of the bond index. As yields rise, the value of bonds decline. Our large weighting of short maturity bonds, resulting in low portfolio duration, helped cushion the blow as these then to be less sensitive to rising rates than long maturity bonds. Higher commodity prices fueled by the war in Ukraine, combined with already persistent inflation, left central banks with no choice but to adopt a more aggressive tone regarding future monetary policy tightening. Consequently, short term interest rates have risen dramatically, and the yield curve has flattened to the point where yields on government bonds maturing in 2 years are trading at almost the same level as those maturing in 30 years.

Corporate credit spreads were also volatile during the quarter. Investment grade spreads widened by about 30 basis points which hurt our performance due to our high weighting in corporate bonds. However, high yield bonds such as **Secure Energy 7.25%** and **Nuvista 7.875%**, given their shorter duration and exposure to the energy sector, were resilient, with credit spreads barely impacted. Our exposure to rate-reset preferred shares with "floors" and high dividend yielding stocks such as **Enbridge** and **TC Energy** also contributed to our outperformance. We have also been taking advantage of rising rates to reinvest cash at higher yields. Our **Canadian Fixed Income Fund** is now yielding over 5% with a duration of just over 4 years, which should be very attractive going forward, particularly if inflation rates begin to decline and eventually get back below 3%.

MACROECONOMIC OUTLOOK

The April 13 monetary policy report from the Bank of Canada (BoC) was an unusually clear and unequivocal message to Canadians that interest rates are going to rise further. The report stated that inflation is too high and the BoC is committed to reducing it back to the 1% to 3% target range. Interest rates will rise but how high and for how long will depend on how inflation responds to its tightening policies.

The backdrop to BoC policy is that the economy is strong and has moved into the area of excess demand that must be reduced. Policy is focused on moving the overnight rate above the so-called "neutral rate", which, according to BoC calculations, is well above the current rate, even after the recent increase of 50 basis points. The removal of excess demand is a necessary condition to bring inflation down and the BoC is clear that there is considerable uncertainty as to how long that will take. But the key takeaway is that it is committed to make that happen. That is both good and bad news. In the short term it means that there will remain headwinds for stocks and bonds (and the risk of recession), yet we believe that financial conditions will return to normal, and investors should look through this period of uncertainty and volatility and focus on a longer horizon.

From a broader perspective and in the near term, there are a variety of factors that are complicating investors' ability to time the peak and decline of inflation and interest rates. The Canadian economy is very exposed to the U.S. and to commodities. The U.S. has higher inflation than Canada and the policy tone of the Federal Reserve (FED) has become more hawkish. Commodity prices have risen sharply, driven by supply shortages, strong demand, Russia's invasion of Ukraine and the global response to it. Strong commodity prices support Canadian incomes, economic growth and the Canadian dollar which is fundamentally good for Canada.

On the other hand, it is important to keep in mind that Japan, China, and the European Union are experiencing very weak economic conditions which bodes well for an easing of inflation pressures in the coming months. Moreover, as the data shows, inflation expectations beyond two years remain well anchored at close to pre-pandemic levels, reflecting the commitment of the BoC and the Fed to push inflation down. This suggests that the period of monetary restraint acting against excessive inflation may well abate by year-end.

Broad stock market indexes were initially holding up relatively well in the face of the developing monetary tightness for two reasons. First, the North American economy has been quite resilient and hence expectations of corporate earnings and growth remain supported. Second, a large portion of the rise in inflation has been caused by supply disruptions and temporary shortages due to supply-demand imbalances resulting from the pandemic. Supply side pressures should ease later this year, in good part reflecting lower demand caused by high prices and higher rates, but the consequences of the Russian war on Ukraine remain a wild card.

The bottom line for investors is that there will continue to be uncertainty and volatility in both equity and bond markets until data supports the view that inflation and interest rates have peaked, and that the BoC and the Fed can declare victory. Until then, a focus on quality is appropriate. In the longer run, Canada will remain in a strong position due to the ongoing technology revolution and strong demand for its natural resources as the world lessens its dependence on Russia. The undervalued Canadian dollar and cheap stock market relative to the world will continue to make Canada an attractive place for domestic and foreign investors.

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