2nd QUARTER LETTER 2021

July 21, 2021

CANADIAN EQUITY: A Strong 15-Year Track record

During the 2nd quarter of 2021, the **LAM Canadian Equity Fund** rose **+2.7%** before fees versus +8.5% for the TSX Composite Total Return. Year-to-date, we are up **+11.5%** versus +17.3% for the TSX. While we got off to a very strong start in the first quarter, we lagged in April and May as momentum investors rotated out of last year's winning stocks into more cyclical ones in order to "play the reflation trade". As many of our long time clients know, we are not "momentum chasers" and shy away from cyclical sectors in order to mitigate risk and volatility. Given that the strong return of the TSX during the quarter was mainly driven by the heavily weighted cyclical sectors including a 20% surge in Energy, a 7.4% rise in Financials, and a 6.5% increase in Materials, it is not unexpected that we would underperform the index in such a scenario. Also, Shopify alone contributed +1.8% of the TSX return during the quarter. There have only been a few times where we have lagged to such a degree while the major components of the TSX have surged, and these have tended to be relatively short lived.

Our top contributors included several healthcare related companies such as **CareRx** (Canada's leading institutional pharmacy), **Savaria** (a global leader in home accessibility and patient handling products), **CloudMD** (a North American telehealth services provider), and **Sienna Senior Living** (one of Canada's leading owners of retirement residences and long term care facilities)**.** Our energy infrastructure holdings such as **Altagas**, **Keyera** and **Enbridge** also performed well, as did **Telus** and **Loblaw.** Detractors included some of our previous biggest winners such as **Ag Growth**, **MDF Commerce**, and **Goodfood Market**, as well as **Stella Jones**, **CN Rail** and **Badger Infrastructure**. We have been adding shares of some of these companies as we believe their prices have reached compelling valuations.

As stated in our previous letter, we were "not wanting to be a hero by playing the re-opening trade, but rather holding more stable companies and a larger cash balance even at the risk of lagging the broader market on the upside". This was indeed the case during the 2nd quarter. We also said that stock markets were "defying gravity", as they continue to march upward on easy money and an overly optimistic global economic recovery despite the number of infections rising again in many parts of the world. The reality is that the reopening of economies is very uneven from one region to another, hampering commercial trade, supply chains and consumption, and leading to much continuing uncertainty for many businesses. We therefore continue to be cautious in our investment approach.

The end of the 2nd quarter of 2021 marks the 15-year anniversary since we launched our Canadian Equity strategy. Our cumulative compound gross return over this period is 405% versus 170% for the TSX, meaning that an investment of $100,000 on July 1, 2006 would be worth over $500,000 today (before fees). This strong track record ranks us among only a handful of the top performing money managers in Canada, and validates our disciplined and diversified "all cap" investment strategy.

U.S. EQUITY

During the 2nd quarter of 2021, our US portfolio was up **+7.4%** versus +8.5% for the S&P 500 Total Return. At a high level, our underperformance was mainly due to our underweight position in the Technology sector which rose +11.3%. Regarding specific stocks, **Eli Lilly**, **T-Mobile** and **Microsoft** were strong performers, while **Booking** declined on fears of the Delta variant spreading quickly and causing renewed lock-downs. **NextEra Energy**, one of our top holdings, also declined as the Utilities was the worst performing sector of the S&P 500 as investors rotated into the "reflation trade". However, we still like **NextEra**, as it is one of the largest renewable energy producers in the world. We continued to add high quality large cap companies during the quarter including **Alphabet** (Google), **Analog Devices** (semiconductors), and two consumer products companies: **Colgate** and **Mondelez** (maker of Oreo cookies). We also took advantage of a sharp decline in share price to repurchase **Viacom** whose content library and new streaming service we consider as undervalued assets within the company. We sold **Pinterest**, **Procter & Gamble**, **Walmart**, and **Pfizer** to lock in gains as they no longer met our investment criteria. We also continue to hold an average cash balance of close to 10% and are ready to increase our exposure on market pullbacks, particularly in the Technology sector.

FIXED INCOME

The 2nd quarter of 2021 was beneficial for most bond indices. Yields for most terms except short maturities ended at lower levels than the first quarter. Despite our short duration positioning, the **LAM Canadian Fixed Income Fund** still ended the quarter well ahead of the benchmarks with a gross performance of **+2.8%** versus +1.7% for the Canada Universe Bond Index and +1.8% for the Hybrid Bond Index. On a year-to-date basis, we have generated a gross return of **+2.7%** versus -3.5% for the Canada Universe Bond Index and -0.5% for the Hybrid Bond Index.

There were several events that added to the volatility during the quarter, including a number of economic data releases, but the most notable event was the Fed's update that pointed to an earlier rate hike than the market had anticipated and the beginning of a "discussion" on future "tapering". Although our exposure is mostly Canadian, the influence of the very accommodative measures in the U.S. and its future policies also have an impact on asset volatility in Canada. This change in direction took the market by surprise as the Fed had been reiterating that inflation was transitory and that its mandate was restoring full employment. Consequently, short-term interest rates rose rapidly while 10-year and longer-term yield fell in anticipation of slower economic growth and on the possible negative effects of inflation if short-term rates rise too quickly, combined with a reduction in central banks' balance sheets. Both investment grade and high yield credit spreads tightened during the quarter, aided by positive corporate earnings, which boosted our performance as we continue to have significant exposure to corporate bonds.

Once again, our exposure to preferred shares with "floors" contributed greatly to our performance. The lack of new issues in this sub-asset class combined with the movement in interest rates have pushed investors to look for safe securities with higher yields which such preferred shares provide. In fact, the Preferred Shares Index was up +5.7% for the quarter. Positive contributions to our outperformance also came from our exposure to high yield corporate bonds and some REITS.

For the next few quarters, volatility in the bond market will certainly increase, as risky assets will remain sensitive to any regime change. However, we believe that the market in general is too pessimistic about central bank speeches. In our opinion, it is normal that the Fed is starting to discuss future monetary policy changes, given the extremely accommodative measures deployed last year and the strength of the economic recovery. Secondly, 10-year interest rates for many developed countries are trading at levels lower than prior to the pandemic and real yields are now even more negative after inflation. Therefore, it is not abnormal to think that interest rates may still rise. It will be interesting to see if inflation data remains elevated, which will largely dictate monetary policy actions of central banks. Overall, we remain positive on the corporate credit market, preferred shares and high dividend stocks given the good results posted by companies and the favorable environment for commodity prices that should continue to benefit the Canadian economy.

MACROECONOMIC OUTLOOK

The big media story for many months has been about high sustained inflation. The hype has been supported by many well-known economic gurus and has been playing nervously with investor expectations for stocks, bonds, and currencies. There are obvious distortions in prices due to several factors. These would include unfair comparisons between current prices and the low prices a year ago affected by the pandemic, and faster than expected economic recovery due to massive but temporary stimulus, combined with bottlenecks and shortages which are already starting to be resolved. The underlying picture is remarkably different than what the headlines are telling us.

Using U.S. data, the core measure of inflation (excluding food and energy) is currently showing a year-over-year increase of 4.5%, more than double the Fed's target. This is what the media is fixated on. However, when prices affected by reopenings, shortages, and bottlenecks are considered, the adjusted core CPI is currently only running at slightly over 1%, which is half of the Fed's target. Fortunately, the bond market has the sense to see through this with 10-year government bond yields in the U.S. and Canada dropping significantly. There has been some flattening in the yield curve (long rates falling relative to short rates), due in good part to two concerns. One is that the very rapid economic recovery will inevitably normalize as it always does, to a more normal growth rate of 2% to 2.5%, along with a significant reduction of fiscal stimulus. The second concern is that central banks may start to raise interest rates too soon. The Bank of Canada has already cut back its purchases of Government bonds (QE) and the Fed has hinted at doing the same in due course. Also, fears of renewed lockdowns and other restrictions due to the Delta variant's spread have picked up steam.

Our view continues to be that the bump in reported inflation, as well as the rapid post-pandemic recovery, will normalize over the next 6 to 9 months. Central banks will also need to normalize their highly stimulative operations as the need for such action has diminished. This will help reduce inflation expectations. Nevertheless, liquidity by any measure remains abundant. The savings rate is extremely high and fiscal drag means that government fiscal policy will, in itself, add to that. The world has been plagued by excessive savings for two decades and this is what lies behind the tendency towards deflation and near-zero (or even negative) interest rates. Global excess savings will re-emerge as an issue when the global economy normalizes, which will be bullish for higher yielding fixed income securities of sound quality. However, volatility will persist in the short term as markets swing between fears of inflation on one hand and the re-emergence of a slowing economy on the other.

Strong liquidity and low interest rates are positive factors for capital markets, both stocks and bonds. Corporate earnings are a third key factor, and should continue to recover and remain healthy. Globally, the Canadian stock market, currency adjusted, has been outperforming global markets. While the Canadian dollar has recently given back a part of its recent gains, due to a more hawkish Fed and a recent flight to quality, Canada's fundamentals remain strong. Commodity prices, particularly oil, should remain buoyant on the back of the global economic recovery, though we expect this to moderate. Foreign investors are likely to continue being attracted to Canadian stocks as they are relatively cheap, and prospects are good for a strong Canadian economy and currency.

BUSINESS UPDATE

We are pleased to announce the appointment of two new members to our portfolio administration and client services team: Kate Passingham and Elisa Stawnyczy. Both are recent graduates of the John Molson School of Business at Concordia University and both were working for Maples Group, one of the world's largest fund administration and service providers. We are also proud to announce that Lester Asset Management has become a signatory to the United Nations' Principles for Responsible Investing (PRI). In our fiduciary role to act in the best long-term interests of our clients, we believe that environmental, social, and governance (ESG) issues should be taken into consideration when investing, and that these can contribute positively to the performance of investment portfolios and to the betterment of society. While we have often considered ESG factors in our investment process, signing the PRI formalizes our commitment to consistently do so.

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