2022 YEAR END LETTER

January 27, 2023

During 2022, both equity and fixed income markets were at their most volatile since the pandemic outbreak and Global Financial Crisis in 2008-2009. A rapid fire series of interest hikes by central banks to combat inflation not seen in over 40 years, caused bond prices to plummet and valuation multiples of stocks to compress. As usual, investor panic and extreme pessimism set in, leveraged funds were forced to unwind positions, short sellers appeared in droves, and momentum-driven strategies took over capital markets, all of which caused volatility to be magnified. Major popular stock indices such as the S&P 500 and NASDAQ were down -18.1% and -32.5% respectively, while large North American bond indices and ETFs were down between -13% and -18%.

As per our previous commentary, we had been of the view that the current inflationary pressures would soon begin to subside, as much of it was due to supply-demand imbalances caused by the pandemic, supply chain bottlenecks, and the Russian war on Ukraine, and that central banks would then ease off raising rates. We also believe that any economic slowdown caused by the rapid rate hikes would be mild given the strong employment levels in Canada and the U.S. This is proving to be the case as the Bank of Canada (BOC) has now put rate hikes on hold and the Federal Reserve (Fed) is expected to gradually follow suit. As a result, both equity and fixed income markets have responded positively, with large gains in both asset classes so far in 2023. Investors who panicked have thus far missed a strong rebound since the mid-October 2022 lows. As we have seen over many decades of ups and downs in the markets, it was important for investors to keep their cool and stay the course.

The high inflation environment has created an attractive opportunity for investors to take advantage of still elevated yields on fixed income securities caused by the aggressive rate hiking cycle of central banks. Of note, is that our Canadian Fixed Income strategy, after our LAM Canadian Bond Fund L.P. received a *Top Performer Award* in 2021 by Global Manager Research (GMR) for the best 1-Year Annual Return in the Canadian Fixed Income Universe category, ranked in 6th place in 2022 in GMR's Canadian Fixed Income Plus Universe category*. As well, the *Quebec Emerging Managers Program* continues to award additional institutional funds for us to manage in Canadian bonds.

Despite lingering market uncertainties, we are confident that both our equity and fixed income portfolios are well positioned to deal with higher inflation and higher interest rates than we have seen in the recent past, as well as with any economic slowdown. Our investment strategies remain focused on navigating short-term volatility and generating strong long-term risk-adjusted returns. As always, we owe our success to our loyal clients and wish to express our sincere thanks for allowing us to work for you.

All our best wishes for a healthy and happy 2023,

Stephen Takacsy
President & CEO

Tony Boeckh
Chairman

CANADIAN EQUITY

For the 4th quarter of 2022, the **LAM Canadian Equity Fund** produced a gross return of **+4.8%** versus +6% for the TSX Composite Total Return including dividends. Our slight underperformance was entirely due to our lack of exposure to the Gold sector which rose +13.9% and to oil & gas producers which drove the Energy sector up +12.9% during the quarter. Outside of the volatile resource-based sectors, we would have outperformed the TSX. Our top contributors included e-commerce solutions provider **MDF Commerce** which rose 64% on the sale of its Intertrade B2B platform**,** and asset manager **Guardian Capital** which rose 45% on news that it was selling its life insurance and fund distribution business. In both cases, each business is being sold for an amount that represents nearly the entire market capitalization of each company. This illustrates how inefficient the stock market can be, as these underlying businesses were being significantly undervalued by investors. Detractors included natural gas distributor **Altagas** and renewable power producer **Boralex**, both safe and growing companies in the Utility sector, which was the second worst performing sector during the quarter, down -8.4%.

For 2022, the **LAM Canadian Equity Fund** was down **-11.2%** versus -5.8% for the TSX Composite Total Return including dividends. Our underperformance was mostly due to our lack of exposure to oil & gas producers which helped boost the TSX Energy sector by over +48% and contributed roughly +3.7% to the TSX return. Our top contributors included many long-term core holdings such as **Ag Growth**, **Stella Jones**, **Boralex**, and **Dollarama**, as well as new additions such as **WSP Global**, **Pet Value** and **Definity Financial**. Detractors included certain healthcare-related stocks which we exited due to chronic cost pressures from labor shortages affecting the sector, as well as small and mid-cap stocks which were down more than the broader market. Core holdings such as supply chain solutions supplier **Tecsys**, funeral services provider **Park Lawn**, and accessibility equipment manufacturer **Savaria**, were down significantly despite generating strong results. The shares of one of our favorite companies, **Pollard Banknote**, got hit particularly hard when it reported lower profit margins despite record sales. Pollard is one of only three North American companies that supply instant tickets for government lotteries. Unexpected increases in the cost of specialty paper, ink, and foil impacted gross margins for all three industry players who generally have long-term contracts based on fixed prices. As these contracts are renewed at higher prices and as input costs decline, margins should return to previous levels and even exceed them.

We continue to apply key tenets of our investment strategy that we have followed for 17 years. These include industry diversification in order to mitigate sector risk, and maintaining low cyclicality by minimizing exposure to commodity and resource-based companies in order to mitigate volatility. These two investment principles have allowed us to outperform the TSX over the long run. And, more than ever, we continue to take into account Environmental, Social and Governance (ESG) issues when making investment decisions. Our portfolio remains well diversified in recession-resistant businesses with pricing power. Most of our holdings continue to report record results and are trading at reasonable valuations. Finally, we continue using volatility to invest in high quality companies at attractive prices which should provide the portfolio with strong long-term returns.

U.S. EQUITY

During the 4th quarter of 2022, our U.S. Equity strategy returned +**9.1%** versus +7.6% for the S&P 500 Total Return. We are pleased with the result and attribute our outperformance to individual stock selection, with notable performances from **Arch Capital, JP Morgan, Mastercard, Mondelez** and **Cisco.** For 2022, our U.S. Equity strategy was down -**12.7%** versus -18.1% for the S&P 500 total return. While it was a challenging year in absolute terms, our relative outperformance was driven by a diversified set of quality companies, overweight in healthcare, lower exposure to technology, and high cash balances. Our top individual performers were not surprisingly in more defensive sectors like healthcare (**Eli Lilly)**, insurance (**Arch Capital**), communication services (**T-Mobile**), and our sole exposure to energy (**Williams)**. As the Fed aggressively raised interest rates throughout the year, it had a pronounced impact on technology companies, particularly those trading at extreme valuations. Our largest detractors were not surprisingly technology-related companies such as **Amazon**, **Microsoft,** and **Alphabet**, however we viewed and continue to view their valuation as reasonable considering their long-term growth prospects, high-quality attributes, and competitive advantages. In fact, we added to our Amazon position in the fourth quarter.

During the 4th quarter, we added **Jacobs Solutions**, one of the largest engineering and design companies in the world which provides professional services to governments and the private sector. Jacobs has experienced growing client demand most notably in infrastructure, ESG, cybersecurity, automation/reshoring, and defense, which has resulted in the company reporting a record backlog throughout 2022. With more U.S. government spending programs expected in 2023 and beyond, there's a strong visible trajectory for accelerated earnings potential and increased free cash flow to sustain share repurchases and dividend growth. With a challenging 2022 in the rear-view mirror, our approach to 2023 has not changed from previous years. We continue to hold a diversified portfolio and evaluate opportunities as markets digest elevated inflation and higher interest rates. While holding cash was beneficial last year, we plan on reducing cash levels by deploying capital opportunistically in high-quality companies that operate in growing sectors having sound fundamentals, have management teams with strong track records, and are reasonably valued relative to their growth profile.

FIXED INCOME

The 4th quarter of 2022 was another volatile one for Fixed Income assets, which nevertheless ended with a positive performance, as all eyes were on inflation data, employment data and central bank speeches. This explains most of the movements in yields and credit spreads, and the different monthly performances in the fourth quarter. These can be summarized by higher than expected inflation data in October which pushed yields higher, followed by weaker than expected data which reassured markets in November and boosted investor sentiment across all asset classes. However, in December, the Fed returned with more restrictive rhetoric and re-emphasized its 2% inflation target which is a far cry from the current inflation rate, leading to the possibility of an even higher than expected final policy rate to achieve that target. In the end, yields for most maturities ended the year at the same levels as at the beginning of the quarter, while investment grade and high yield corporate credit spreads tightened during the quarter which helped our results.

For the 4th quarter, the **LAM Canadian Fixed Income Fund** generated a gross return of **+0.8%** compared to +0.1% for the FTSE Canada Universe Bond Index. Our corporate bond holdings such as **Air Canada 4.625% August 2029**, **Videotron 3.125% January 2031** and **Bell Canada 3% March 2031**, contributed positively during the quarter, as did some of our high dividend yielding shares like **Enbridge**. Although preferred shares as an asset class had another difficult quarter, some of our preferred shares with rate resets and floors (as explained in previous letters), performed well such as those issued by **Altagas** and **Pembina** which were subject to an early redemption at par. Among detractors were high dividend yielding common shares like **Altagas**, which came under pressure following lower than expected quarterly results, although it has been rebounding since.

For 2022, the **LAM Canadian Fixed Income Fund** posted a return of **-8.1%** versus -11.7% for the FTSE Canada Universe Bond Index, representing an outperformance of **+3.6%**. The negative return, our first ever in 15 years, was unavoidably due to central banks' swift interest rate hikes which caused yields to rise and bond prices to fall. In fact, it was the worst performance in recent history of the Canadian bond market and likewise in the U.S. Widening credit spreads and sharp declines in the price of preferred shares also contributed to our negative return. There were a few bright spots however, such as high yield bonds in the energy sector like **Nuvista 7.875% July 2026** and high yielding energy infrastructure stocks like **Enbridge**.

For 2023, we will again need to watch various economic data, especially inflation, which seems to be the focus of central banks and dictate how aggressively they will tighten monetary policy. The Fed often talks about the labor market imbalance, but this appears to be more difficult to control as the gap between labor supply and demand seems large. Labor shortages can lead to more permanent wage inflation; however this could be offset by higher productivity. Investor sentiment remains quite negative, leading to quick reversals as the market perceives the end of the rate hike cycle, as was observed in November. Wide credit spreads and high interest rates make Fixed Income assets very attractive on a current yield basis, with the **LAM Canadian Fixed Income Fund** now offering an average yield to maturity of over **6.25%** with a duration of less than 4 years.

MACROECONOMIC OUTLOOK

Markets have entered 2023 on a much better note on the back of falling inflation expectations. There are early signs of an easing of labour force tightness and price declines in the overvalued housing market that should lead to a reduction in shelter costs which are a large component of reported inflation measures. Inflation expectations have thus fallen sharply over all time frames to levels close to central bank targets of around 2%. This has been the key factor in driving bond yields lower in recent weeks leading to significant gains in bond prices. This should continue as signs of an economic slowdown and the lagged effect on labour markets, wage inflation and housing costs become more evident to policy makers, which will cause both the BOC and the Fed to end the tightening cycle. As the economy and inflation soften further, monetary policy should eventually shift to lowering short-term interest rates and injecting liquidity into the financial system. This is all part of the regular business cycle, and will provide a much friendlier environment for financial asset prices.

There are two other positive developments for Canadian markets. The U.S. dollar, which had become as much as 30% overvalued, has begun to normalize, which is bullish for the Canadian dollar, and Canadian stocks and bonds. The other positive factor is the reopening of China. The economy has performed below normal for two to three years. It should now play catch up which would be bullish for commodities, and thus for Canada.

While the big picture is developing positively for financial markets, there remains lingering short-term risks. The first is that liquidity, a prime driver for markets, is still tight. Central banks continue to focus on coincident and lagging indicators because of an excessive fear of inflation. The unemployment rate, reported inflation indices, and shelter costs, will eventually respond but only after the economy has already weakened. Markets focus on the future which is why longer term interest rates have already started falling and stock prices have stabilized. Central banks have raised rates a lot and quickly, and the concern is that they may maintain a tight policy for too long, which could cause a more pronounced economic slowdown and greater than anticipated short-term weakness in corporate earnings. However, a weaker than expected economy would also mean a bigger than expected drop in interest rates, which should, in due course, outweigh the short-term impact of weaker corporate earnings. Relatively cheap valuations in many sectors should also provide some resilience for stock prices, however in the near term, bonds should outperform stocks. As the year progresses and central banks begin cutting interest rates on the back of falling inflation, leadership should shift to the equity market.

Stephen Takacsy **Matthew Kaszel** **Olivier Tardif-Loiselle** **Tony Boeckh**

*The LAM Canadian Fixed Income Strategy ranked 6th in the Canadian Fixed Income Plus Universe for 2022 and also ranked in the 1st quartile for the periods 1 Year, 2 Years, 3 Years, 4 Years, 5 Years, 7 Years and 10 Years, in the Global Manager Research Institutional Performance Report dated December 31, 2022.

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