LESTER ASSET MANAGEMENT

RESPONSIBLE GROWTH

2023 YEAR END LETTER

January 26, 2024

2023 was another volatile year for both Equity and Fixed Income markets, as investor sentiment swung from deep pessimism about stagflation and recessionary fears to euphoria that central banks might start aggressively cutting rates as soon as March 2024. Investors who once again panicked during the October lows, as in 2022, missed a powerful rebound in both Equity and Fixed Income markets during the last 2 months of the year. This reinforces one of the most important principles in investing: staying invested. Trying to time the market is a losing proposition, since missing powerful short term rallies can materially affect long term returns.

As per previous comments, we have always believed that inflation was “transitory” caused by supply/demand imbalances and supply chain disruptions post-pandemic, combined with a spike in commodity prices fueled by Russia’s war on Ukraine. In fact, the rapid rise in interest rates by central banks contributed to inflation through rising shelter costs. The rate of inflation, which ever way you measure it, has declined naturally as these anomalies normalize, not because of the rate hikes. This is why the head of the U.S. Federal Reserve (Fed) Jerome Powell and the head of the Bank of Canada (BOC) Tiff Macklem have “pivoted”. It was only a question of time before bonds would rally strongly on lower inflation data, and that stocks would follow suit. The North American economy is indeed slowing because of the rate hikes, and if it slows down too much, “bad” economic news will be seen as “good” news by the bond market as yields would decline, which would also benefit stocks. Yet, since the job market remains strong and savings rates are still high, a “goldilocks” scenario is possible where disinflation or even deflation occurs along with a sound economy (the opposite of stagflation).

We therefore see a very positive environment for both stocks and bonds in 2024. As mentioned at this time last year, the high inflation environment has created a uniquely attractive opportunity for investors to benefit from elevated yields on Fixed Income securities because of the aggressive rate hikes by central banks. This remains the case today with yields on short-term corporate debt securities still in the 6% to 8% range, representing equity-like returns with very low risk. After receiving a *Top Performer Award* in 2022 by Global Manager Research (GMR) for the best 1-Year Annual Return in 2021 in the Canadian Fixed Income Universe category, LAM received two more GMR *Top Performer Awards* in 2023 for the best 5-year and 10-year returns in the Canadian Fixed Income Plus category for the period ending December 31, 2022. And once again in 2023, we finished in the 1st quartile for the LAM Canadian Bond Fund that we manage for Quebec pension funds as part of the *Quebec Emerging Managers Program*.

Despite present market uncertainties and volatile geopolitics, our investment strategies remain focused on navigating short-term volatility and positioning portfolios for strong long-term risk-adjusted returns. As always, we wish to express our sincere thanks to our loyal clients for their trust in us.

On behalf of the entire team including Lorie, Kate, Elisa, Helen, Olivier and Matthew, we wish you our warmest wishes for a healthy, happy, and peaceful 2024.

Stephen Takacsy	**Tony Boeckh**
President & CEO	Chairman

CANADIAN EQUITY

For the 4th quarter of 2023, the **LAM Canadian Equity Fund** produced a gross return of **+8.2%** versus +8.1% for the TSX Composite Total Return including dividends. While we slightly outperformed the TSX, the source of our return was very different from that of the TSX which was driven by the Technology and Financial sectors up +24% and +12.7% respectively. In fact, Shopify alone contributed +1.3% of the TSX return. Our main contributors were **Neighbourly Pharmacies** which announced a privatization, **Quarterhill**, **Jamieson Wellness**, **Pollard Banknote**, **Equitable Group**, and **Richelieu Hardware**. The privatization of Neighbourly by its controlling shareholder and Brookfield Asset Management shows once again that there is tremendous value in smaller cap equities. Detractors included **Velan** whose take-over by Flowserve was blocked by the government of France, and **Altus Group** which announced a slow down in sales and a large acquisition financed by debt.

For 2023, the **LAM Canadian Equity Fund** was up +**9.8%** versus +11.8% for the TSX Composite Total Return. Our underperformance was entirely due to not owning Shopify which added +2.5% to the TSX return. Our top contributors included strong returns from **Logistec** which announced it was being acquired, **Pollard Banknote**, and **Stella Jones**, as well as **ATS**, **Richelieu Hardware**, **Tecsys** and **Quarterhill**. Detractors included **Altus Group**, **Park Lawn**, **Pet Value** and **Northland Power**. We exited 3 stocks at a significant profit: **Brookfield Infrastructure** and **Kinaxis** which had reached our price targets, and **Canadian Tire** on concerns of a consumer slowdown. We used cash to increase our weighting in automation systems integrator **ATS**, supply chain solutions supplier **Tecsys**, funeral services provider **Park Lawn**, and accessibility equipment manufacturer **Savaria**.

So far in 2024, we are off to a strong start, up **+2.7%** versus +0.9% for the TSX at the time of this writing. The market seems to be turning the corner for small/mid cap stocks and for high dividend yielding defensive sectors such as Telecommunications and Utilities. We continue to take a conservative and disciplined approach including industry diversification to mitigate sector risk and minimizing exposure to commodity and resource-based companies to reduce cyclicality and volatility. Such principles have allowed us to outperform the TSX over the long-term with lower risk than the market. And more than ever, we continue to consider Environmental, Social and Governance (ESG) factors and environmental sustainability when making investment decisions.

U.S. EQUITY

During the 4th quarter, our U.S. Equity strategy was up +**10.2%** versus +11.7% for the S&P 500 Total Return. Global stock markets surged as investors suddenly anticipated interest rate cuts in 2024. Our return was driven by strong performances from regional bank **Fifth Third Bank**, medical research services provider **Charles Rivers Labs**, **Amazon**, and **Microsoft**. Detractors included **Arch Capital** as investors shifted from top-performing defensive stocks to more speculative ones, as well as **Cisco**, **Jacobs Solutions**, and **FedEx** reported slightly lower than expected results, causing short-term weakness.

During the quarter, we added **Clean Harbors**, a company renowned for its environmental services such as hazardous and non-hazardous waste disposal, emergency response, recycling, and site remediation. Given the growing global emphasis on environmental impacts, Clean Harbors is in a strong position, benefiting from rising demand and pricing power due to limited competition in its key service areas. We also increased our position in **Charles Rivers Labs** at an attractive price, which helped our performance in the quarter.

For 2023, our US strategy was up +**20.2%,** compared to +26.3% for the S&P 500 Total Return. The performance of the S&P 500 was mainly driven by "Magnificent Seven" (Amazon, Apple, Google, Meta, Microsoft, NVIDIA and Tesla) which represent about 27% of the entire market capitalization of the S&P500 and were up collectively 73%. Without them, the S&P 500 was only up around 6%, with most stocks down on the year until the end of October. Despite owning only 3 the "Magnificent Seven", we are very satisfied with our performance. We will thus participate in tech-driven rallies, but to a lesser extent, while suffering less volatility on the downside.

We continue to follow a diversified strategy and expect to expand it in 2024 as the market adjusts to the end of the rate hiking cycle and possible interest rate cuts. We are strategically deploying capital in select high-quality companies that we understand well, operate in growing sectors, exhibit sound fundamentals, have management teams with strong track records, and are reasonably valued relative to their growth profiles.

FIXED INCOME

The 4th quarter of 2023 was remarkable for most asset classes, particularly Fixed Income. In fact, the entire year's return for the overall bond market occurred in the last two months, with most bond indices being in negative territory as at the end of October (we remained in positive territory throughout the entire year).Trying to predict short-term movements in interest rates is next to impossible, and this is why in previous commentary we stated that Fixed Income was a highly attractive asset class, and that, despite the marked-to-market decline in bond prices, it was only a matter of time before bonds would rally strongly on lower inflation data. The **LAM Canadian Fixed Income Fund** posted a gross return of **+6.5%** for the quarter, versus a return of +8.3% for the FTSE Canada Universe Bond Index. For the full year, our Fund was up **+7.8%** versus +6.7% for the Index.

Economic data and central bank rhetoric were the driving forces behind the strong year-end returns. November was marked by a pronounced slowdown in inflation and data indicating that consumers were more cautious and that the job market was weakening. This suggested that the cumulative rate hikes since 2022 were having the desired effect. Moreover, the Chair of the U.S. central bank suggested that the rate hiking cycle was potentially over. Markets were further boosted in December by more encouraging economic data and by the U.S. Federal Reserve (FED) forecasting 75 basis points in rate cuts in 2024, with the market expecting over 125 basis points in rate cuts. Consequently, bond yields fell considerably causing bond prices to jump.

During the quarter, our longer term corporate bonds such as **Brookfield Infrastructure 3.41% 2029**, **Telus 4.85% 2044** and **Altagas 2.477% 2030** contributed strongly to our return. We also had a meaningful contribution from **Altagas** preferred shares, as the company announced it would redeem its 5.393% series at par rather than reset the dividend rate higher (these shares were trading at a discount of over 20% to par value). This demonstrates that preferred shares are still priced at very attractive levels. Also, our **Videotron** bonds performed well given that the acquisition of Freedom Mobile by **Quebecor** was done on very favourable terms and that credit agencies are quietly anticipating an upgrade of the company's credit rating to "investment grade".

We remain very bullish on Fixed Income with inflation on the decline, and still see plenty of value in preferred shares and shorter term corporate bonds, particularly in high-yield and hybrid bonds where current yields to maturity are still in the 6% to 8% range. As always, we place great importance on credit risk and interest rate risk (duration) and continue to keep a close eye on economic data and geopolitics. Our **LAM Canadian Fixed Income Fund** continues to offer a very attractive average yield to maturity of **6.2%** with a term of 3.4 years.

MACROECONOMIC OUTLOOK

The Covid pandemic-related distortions to the North American economy and global financial system continue to unwind. These distortions were reflected primarily in massive fiscal stimulus that caused a huge increase in personal savings and expenditures, shortages in the supply of goods, disruptions to supply chains, shortages of workers, a sharp rise in house prices and overall inflation. This caused a roller coaster ride in bond and stock prices as inflation soared to levels not seen since the early 1970s. Equities took off on the initial surge in liquidity which was driven by both fiscal and monetary policy against a backdrop of extraordinarily low interest rates. The BOC and the Fed reacted too slowly, allowing inflation to take root and the economy to overheat. When they did react in March 2022**,** inflation had already surpassed 6%, and they had to aggressively raise interest rates and withdraw liquidity from the financial system. Monetary policy, being late to react, had to fight stimulus from massive fiscal deficits. As a result, interest rates had to rise higher and faster than otherwise would have been needed to cool the economy and tame inflation. As a result, bond and stock markets were volatile throughout most of 2023 with prices making lows in the latter part of October.

The turnaround in financial markets was triggered by a return of confidence that the distortions in the economy were finally dissipating. In particular, inflation and the expectation of future inflation moved lower throughout 2023, and by the 4th quarter had reached the BOC and Fed targets of 2%. Excessive savings and a tight labour market, which had supported high consumer spending, is normalizing. The labor market has begun to adjust positively as wage inflation, labour shortages and labour force growth is improving. Some sectors of the North American economy are slowing, however, the U.S. reported GDP growth of 3.3% annualized for the 4th quarter. Canada, on the other hand, has shown no growth for the past six months, in good part due to a weak housing sector and commodity prices. Canadian households are far more indebted than their U.S. counterparts and, with shorter maturity mortgages coming due, are more affected by high interest rates. The disappointing Chinese and European economies have also been a negative factor for Canada which is a more open economy than the U.S. Furthermore, Canadian fiscal policy turned more restrictive as 2023 progressed.

Looking ahead, 2024 will see a continued re-adjustment of the post-pandemic distortions, with inflation continuing to fall and the economy remaining soft due to the lagged effects of the prior restrictive monetary policy and removal of fiscal stimulus. While the overall growth rate in Canada could move slightly below zero for a quarter or two, a recession (as commonly thought of) is unlikely, for several reasons: Canada has a large influx of immigrants, the Canadian dollar is cheap, and the U.S. economy is doing well. Nevertheless, a slowing Canadian economy, weak inflation numbers and an improved fiscal situation will allow the BOC to take a more accommodative stance. The policy rate is likely to be cut significantly which will guide interest rates lower. This will allow mortgage rates to fall significantly, cushioning the blow to indebted Canadian households. Lower rates, combined with 2% core Personal Consumption Expenditures (PCE) inflation, suggest that a soft landing is very much in the cards.

The bottom line is that 2024 should see a softer economy but also increased confidence that inflationary expectations are well contained within the BOC's target range of 1% to 3%. Rate cuts and a further decline in yields across the maturity spectrum will produce higher bond prices. Stock markets will face crosscurrents, however falling interest rates are bullish for valuations as P/E multiples rise. Despite soft patches in certain sectors, falling interest rates should trump a temporary weakening in profits. The Canadian dollar is cheap, which translates into undervalued Canadian assets relative to the U.S. and the rest of the world markets.

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