GUARDIAN CAPITAL

GUARDIAN CANADIAN SECTOR CONTROLLED EQUTIY FUND Q4 2023 MANAGER COMMENTARY

Market Review

During Q4 2023, inflation continued to slow globally, due to higher interest rates and lower energy costs, and the S&P/TSX Composite Index increased (+11.7%). Interest-sensitive sectors including Information Technology, Financials, and Real Estate outperformed during the quarter. The Information Technology sector rose 22.9% as the central bank held interest rates steady and investors began to anticipate interest rate cuts in 2024. Underperforming sectors included Health Care, Energy, Materials, Consumer Staples, Communication Services, Consumer Discretionary, Industrials and Utilities.

Central banks globally held interest rates flat as inflation continued to slow, but remained stubbornly above their target due to ongoing consumer resilience. Central bank language has taken a dovish turn. The US Federal Reserve said during their December meeting that they expect to cut rates by 75bps in 2024 as economic growth has slowed. The Bank of Canada said during their December meeting that they are seeing growth moderations, but would like to see a drop-in core inflation and are prepared to raise rates further if necessary.

Oil prices declined during the quarter despite OPEC members having deepened their supply cuts due to concerns about global demand. As economic growth has slowed, investor hopes for a “soft landing” have slightly risen as central banks look to begin cutting interest rates in 2024.

Performance Attribution

The portfolio outperformed the S&P/TSX Composite Index during the quarter. The outperformance was due to positive sector allocation, and was partially offset by negative stock selection.

Positives

- Overweight Information Technology (+24.0%) and underweight Energy (-1.3%) contributed positively to sector allocation.
- Positive stock selection was driven by Consumer Discretionary (Gildan Activewear, Restaurant Brands), Financials (Brookfield Corp, TD Bank), and Materials (Agnico Eagle Mines, Wheaton Precious Metals).
- Top stock contributors during the quarter:

- Brookfield Corp.: The US Federal Reserve's dovish commentary drove a rapid fall in interest rates, a key sentiment driver for interest-sensitive companies like Brookfield. Meanwhile, the company continues to produce compelling and differentiated new business growth.
- Open Text: Open Text performed well following the company's announcement it would divest one of its newly acquired (non-core) divisions at an attractive price. This action accelerates growth and deleveraging, which should help OTEX's valuation to re-rate higher.
- Gildan Activewear: Gildan's strong outlook boosted the stock when the company reported quarterly results. The stock gave back some of the gains after the Board of Directors abruptly fired the CEO following disagreements about CEO succession.

Negatives

- Underweight Financials (+12.7%), were material headwinds in sector allocation during the quarter.
- Stock selection was negative primarily in Information Technology (CGI, Open Text, no exposure to Shopify) and Consumer Staples (Metro, Loblaw).
- Bottom stock detractors during the quarter:

  - SNC-Lavalin: Despite posting strong results, SNC shares paused this quarter after a very strong run earlier in the year.
  - Suncor Energy: Suncor shares fell in response to the drop in oil prices.
  - Finning International: Despite posting solid quarterly results, Finning shares pulled back during the quarter, in line with deteriorating commodity-related sentiment.

Fund Transactions

We outline position changes during the quarter below:

CIBC: We initiated a position in CIBC in early December due to favourable execution by the management team against a challenging backdrop. This purchase helped to narrow our underweight in the banks as valuations have compressed.

Gildan Activewear: Gildan's public clash between its former CEO and Board of Directors regarding CEO succession has revealed poor corporate governance practices. Given the Board's selection of a suboptimal candidate as the incoming CEO, and the potential for a proxy fight, we invoked our sell discipline until clarity emerges regarding the company's leadership and strategy going forward.

Fund Outlook & Positioning

Due to persistent economic momentum, the impact of central banks' aggressive tightening moves is being felt, but with a lag. While inflation has clearly peaked in Canada and the US, it is still unclear where the longer-term inflation expectations rate will settle. Bond yields and the US dollar backed off their highs during the quarter, as the US Federal Reserve indicated an easing bias looking into 2024. Still, it is not clear whether the US and Canadian economies will fall into recession in 2024. Caution is warranted as the policymakers' determination to bring down inflation could require intentionally guiding the economy into recession.

At the company level, falling inflation and slowing growth have introduced crosscurrents. Falling inflation is simultaneously a headwind for revenue growth and a welcome relief from escalating input costs. As such, companies are increasingly flagging slowing revenues, but resilient earnings are being supported by cost cuts. While we believe the companies held in the portfolio exhibit strong market positions and pricing power, the short-term impacts from the crosscurrents mentioned above are uncertain, which has led to valuation compression in many areas of the market. Over time, we expect higher-quality companies to overcome these headwinds, making current valuations attractive for long-term investors.

The portfolio maintains a strong quality bias and remains diversified across cyclical and defensive companies. Economic headwinds are expected to affect all portfolio holdings to various degrees; however, we believe that as labour markets and supply chains continue to normalize, multiple companies in the portfolio should benefit, irrespective of the economic outlook.

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