

# GUARDIAN i<sup>3</sup> GLOBAL QUALITY GROWTH FUND MANAGER COMMENTARY Q1 2024

## Market Review

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Global equity markets built on the gains of last year with a strong first quarter in 2024. As the late winter months unfolded, investors, who had been expecting aggressive rate cuts to start the year, had to face a reality check. In fact, the continued resiliency in the economic dataflow into the New Year - particularly firmer than anticipated readings on gauges of underlying inflationary pressures, and an indication that central banks may not be as proactive as hoped in moving toward a more “neutral” policy setting, had the market pricing in the first cut for late spring/early summer. With the exception of Japan and Switzerland, all the major central banks held their key rate steady throughout the quarter. A notable holdout to the global rally in equity markets was China, where the liquidity constraints and tepid housing demand continued to weigh on the economy, threatening its ongoing recovery.

Meanwhile, corporate earnings season kicked off on a strong note, as key indicators, like long-term sales growth and earnings growth forecasts, adjusted upward. As was the case last year, a cohort of large-cap growth stocks led the charge outpacing their small-cap counterparts. The market strength thus far, however, has been attributable to a relatively narrow set of names associated with artificial intelligence (AI) technology. NVIDIA, the large US semiconductor developer, more than tripled in 2023 and proceeded to rise a further 87% during the first quarter of 2024. Nevertheless, the dominance of these top performers saw a slight dilution, signaling a shift towards broader-based growth compared to the previous year, also reflected in the improvement in non-tech valuations.

Encouraging key macroeconomic signals further boosted global financial markets performance during the quarter. The US market outperformed relative to its global peers, driven by strong consumer spending and labour market strength, which helped keep recession at bay, with excess savings still in play. Furthermore, the ISM Manufacturing PMI in the US rebounded breaking even at 50.3, a level not seen since September 2022, indicating a positive outlook for economic expansion.

Even so, market volatility lingered during the quarter, with the CBOE Volatility Index (VIX) rising 10%. Contributing to this uncertainty was the sluggish activity in the housing market, and inflation concerns, which, although receding, still exceeded target levels. Investors remained cautious on the possibility of the underlying economic strength to impede anticipated rate cuts later this year.

Despite these headwinds, gains were broadly distributed across all 11 sectors, resulting in the MSCI World Index ending the quarter up 11.7%. Communication Services and Information Technology sectors emerged as top performers, while Real Estate and Utilities sectors lagged the broader market's performance. The Energy sector saw a significant recovery, with double-digit gains attributed to the rise in commodity prices.

## Performance Attribution

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The Guardian i<sup>3</sup> Global Quality Growth Fund (the “Fund”) outperformed its benchmark, the MSCI World Index.

The Fund outperformed in six of 11 GICS Sectors, with the two primary outperformers being Consumer Discretionary and Information Technology. While the Fund’s Manager sees growth moderating in the sector overall, we do see Amazon as the standout with sector-leading earnings growth. Amazon drove the Fund’s outperformance to this sector as the Fund is 4% overweight in Amazon, and it returned more than double the overall sector.

Semiconductors continued to outperform Software as a Services (SaaS) as the SAAS industry growth is more downstream given the current uptick in AI. US semiconductor developer, NVIDIA, again was at the forefront returning 87% during the quarter vs. the sector at 20%. Other large-cap semi-conductor companies such as Broadcom and ASML also outperformed the sector.

Negative performance from stock selection came from the Financials and Communication Services sectors. Banks (the Fund’s portfolio has no positions in Bank stocks) outperformed FinTech and Big Data (FactSet, Visa). In Communications Services, Google underperformed vs. Media companies (Meta, Disney, Netflix).

## Transactions

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Transactions in the Fund’s portfolio this quarter reflect the Manager’s further focus on forecasted secular earnings growth companies, while either taking profits in companies with lower growth that have stabilized their performance or exiting positions with deteriorating growth.

The Fund exited the Energy sector by selling EOG. Some Information Technology and Industrial stocks were sold on deteriorating forward-earnings: MicroChip Technology and Rockwell Automation. Nestle is in a downward trend in price and earnings so the position was exited as the Manager does not see further upside.

New stocks in Information Technology include Cadence Design Systems and Adobe. In Consumer Discretionary the Manager believes there are standout companies whose earnings are defying the overall moderation we see for the sector. New positions were taken in Booking Holdings and TJX. Also in keeping with the theme of growth coming from industrial automation and robotics in the Health Care space, a new position was entered into, Intuitive Surgical.

## Portfolio Outlook and Positioning

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The Manager's i<sup>3</sup> Investments™ team\* has a core belief that successful asset management is focused on three pillars of investment: Growth, Payout and Sustainability (or GPS) of earnings and cash flows. For outlook and positioning, the i<sup>3</sup> Investments™ team will address each of these core beliefs.

**Growth** — We are seeing the current economy being in a relatively stronger growth and lower inflation environment, which has been favorable for large-cap and growth stocks. Overall measures of financial stress have declined, and credit spreads have been narrowing. We see this as a benefit for continued real capex growth which should support further earnings growth in stocks that provide thematic exposure to disruptive growth drivers. Cross-validating this with our AI Model\* forecasted earnings per share (EPS) growth predictions, we see growth moderating slightly in the Consumer Discretionary and Consumer Staples sectors in the US but still at a positive growth rate. In the Information Technology, Health Care, Industrials and Materials sectors, the predictions are pointing to a steady recovery in earnings. The outlook for the future year-over-year EPS growth is overall positive in double-digit numbers. These numbers are higher for the shorter term and moderating for the longer term. In Europe, the forecasts are lower than the model is predicting for the US, with a slightly positive overall earnings growth forecast. We are seeing more dispersion between the sectors in Europe. Health Care and Information Technology are seeing the most projected recovery for earnings.

We see the strongest revenue and cash flow growth from secular companies that are thematically driven, especially in the area of Information Technology, Industrial Automation and Pharmaceutical Technology. AI demand is certainly a tailwind, as well as continued chip re-shoring, and the implementation of AI into SaaS companies in multiple industries.

Notwithstanding the speculative nature of the Federal Reserve (Fed) interest rate cycles, the Fund is positioned for secular earnings and revenue growth versus timing the Fed's decision.

**Payout** — Global central banks are less hawkish, and while rate cuts in the US are expected in mid-2024, the European Central Bank remains united on later rate cuts. Only Switzerland has gotten ahead of its global peers with a 25bps cut in March. We see bond proxy segments including Utilities, and Communications Services companies stabilizing as rate risk continues to be priced in. As such, any further upside is unclear, and the portfolio does not hold any positions in this segment. Continued higher price appreciation potential comes from thematically driven "quality growth" companies in the Information Technology, Industrials and Health Care sectors as their earnings forecasts are showing a steady recovery.

In the prevailing market conditions, we believe that prioritizing profitability, stability, and safety is essential. Accordingly, we continue to focus on earnings and cash flow growth versus extraneous events.

**Sustainability (of earnings and cash flow)** — With the recent easing of financial decisions, volatility in the markets has remained stable, with the CBOE Volatility Index still trading around 13%. The systemic market up-trend as a reaction to the more dovish narrative is eclipsing any focus on continued need to manage inflation and recession risk. We believe that a focus on secular earnings duration within the growth asset class is still the primary means of realizing long-term earnings growth and price appreciation. We believe our AI-powered GPS offers a total return approach and the best of many worlds through owning companies that can continue to reward shareholders through growing earnings, revenue, and buybacks, combined with careful consideration of stock and sector allocations by actual portfolio managers.

While overall growth may be scarcer, we believe we can still capture leadership in “quality growth” stocks by focusing on companies that can innovate and launch new products, and that we believe have the ability to sustain and growth their revenue and earnings. We are consistently monitoring our exposures with respect to expected earnings growth and the probability of earnings disappointments, as well as avoiding companies with high variability of cash flow and revenue growth.

The Fund aims to invest in companies with quality earnings growth, rising cash flows and low cost of borrowing, which makes them less sensitive to interest rate moves. The Fund also holds secular growth stocks that provide thematic exposure to disruptive growth drivers and converging exponential technology offering long-term upside, meaning they should not be viewed through the short-term lens of market cycles. This includes leaders in innovation in Big Data and AI, Robots, Biotechnology, and Smart Cities. The Manager believes these forward-thinking companies that innovate and influence our lives daily in multiple areas are positioned to prove their resilience over multiple economic cycles.

On a sector level, the Fund remains overweight in Information Technology and Industrials. Information Technology and Industrials make up the bulk of the Fund’s quality growth and inflation protection positions. The Fund is underweight Financials (primarily banks) and has no holdings in Energy.

\* The i<sup>3</sup> Investments™ Team is a portfolio management team with Guardian Capital LP, that combines artificial intelligence and human intelligence to provide a modern approach to portfolio construction, incorporating the advantages of big data with the experience and perspective of our investment team. Investment strategies which rely on predictive artificial intelligence and quantitative models may perform differently than expected as a result of, among other things, the factors used in the models, the weight placed on each factor, changes from the factors’ historical trends and technical issues in the construction and implementation of the models. Please consider these and other factors carefully and not place undue reliance on modeled information. There is no guarantee that the use of the quantitative model will result in effective investment decisions, as the simulated results are subject to inherent limitations.

Returns are presented in CAD, unless otherwise stated.

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