GUARDIAN CAPITAL

# GUARDIAN DIRECTED EQUITY PATH FUND QUARTERLY COMMENTARY

**JUNE 2023**

## Performance Attribution

The Guardian Directed Equity Path Portfolio (the "Fund") underperformed its benchmark[1] in Q2 2023. The stocks within the portfolio delivered a total return of 0.40%, underperforming the market given the narrow focus driving market returns during the second quarter. Option premiums earned from the covered calls were more than offset by the upside forfeited from the stock performance of various stocks, detracting approximately 0.88% and the put options decreased in value by 1.44%, from the reversal of the intrinsic value in the options. The Fund incurred operating expenses of 0.045. Global equities rallied during the quarter driven by moderating inflation, the AI theme, and prospects of an economic soft landing. The Fund primarily underperformed its benchmark due to stock selection. The combination of an underweight allocation and stock selection within the Information Technology sector as well as stock selection in the Consumer Discretionary had a negative impact on performance.

Option premiums have moderated with implied volatility falling to pre-Covid levels with more optimism on the horizon. We continue to cautiously balance the premium collected with selling further out of the money call options to protect against a sharp reversal to the upside while still collecting a moderate level of option premium. With the sharp rise of stocks benefiting from the AI theme during the quarter (MSFT, AAPL, GOOGL), some upside was forfeited in the portfolio. Time value decay, coupled with the strong increase in AI themed stocks resulted in the put options losing value, which detracted from the performance. We will continue to balance the trade-off between the premiums collected with the upside strike prices on the covered calls to provide a decent level of option premiums and upside participation.

Below is a summary of the key contributors to the stock performance within the Fund were:

**Microsoft (MSFT)** finished the period 15.74% higher. Quarterly results came in ahead of consensus with all key segments ahead of management guidance. The company is seen as one of the initial AI winners. It is building the next generation digital AI-based technology stack. By infusing AI into its platforms and software, Microsoft hopes to boost the uptake of its subscription services, such as Microsoft 365.

**Alphabet (GOOGL)**'s stocks ended 12.83% higher in 2Q. The stock gained as it became clear that its conversational AI chatbot, Bard, was capable of rivalling ChatGPT and other Generative AI solutions and, as a leader in the space, the company would benefit from the broader use of AI technology.

**Apple (AAPL)** shares outperformed in the second quarter (up 15.74%) as investors returned to the technology sector and the AI theme. Apple posted better-than-anticipated second-quarter earnings, boosting hopes of a tentative tech recovery and sending company shares up. The company reported revenue of $94.84bn in its second-quarter earnings, up from a predicted $92.96bn, and an all-time record in its services division.

[1] Benchmark : 40% FTSE Canada Universe Bond Index, 60% MSCI World Index (Net, C$)

**Mastercard (MA)** rose 5.98% in Q2. Mastercard exceeded investor expectations by reporting double-digit organic revenue growth, benefiting from resilient consumer spending and continued recovery in cross-border travel (now almost 50% above 2019 levels). Guidance for the year was slightly increased as well.

The largest negative contributors to returns over the quarter were:

**MarketAxess (MKTX)** shares fell -34.52% in the second quarter, declined after very strong performance at the beginning of the year. In the US high grade business, estimated market share declined and fee capture fell as trading was focused on lower duration bonds.

Shares of **Yum China (YUMC)** ended -10.9% lower in Q2. The stock was hit by China's slower-than-expected post-pandemic rebound. The company's Q1 results exhibited a strong rebound: same-store-sales growth was well ahead of consensus, and restaurant margins the highest since 2017.

**Illumina (ILMN)** fell -21.17% in Q2. Its quarterly results demonstrated good progress in transitioning clients to its new technology, NovaSeq X, but the resignation of its CEO, following a proxy battle and a refresh of the board, and uncertainty about the future of Grail as part of the group weighed on the stock.

**Nike (NKE)** finished the quarter -11.73% lower. Nike's share price was pressured due to concerns about the consumer backdrop. It recently announced its outlook for FY24, which disappointed the market. Commentary from key wholesale partner, Foot Locker, at its most recent results added to concerns about consumer pressure will demonstrate continued resilience in an uncertain economic environment.

## Portfolio Activity and Positioning

**YUM China (YUMC)** replaced **McDonald's Corp (MCD)** on relative valuation considerations and the expected growth strategy with new stores and loyalty program.

Consolidated the **Visa (V)** position into **Mastercard (MA)** to streamline the portfolio favoring Mastercard based on its stronger fundamentals and higher expected growth rates.

Added **Reckitt Benckiser Group Plc (RKT)** to increase Consumer Staples sector weighting. Reckitt is the world's leading consumer health and hygiene company. Trusted brands found in households in more than 190 countries. Trend towards better hygiene globally accelerated by Covid.

Added **Accenture Plc (ACN)** on strong fundamentals and future growth prospects. Accenture is a global professional services company that offers consulting, technology, and outsourcing services to clients across various industries. Accenture has exhibited strong quarterly revenue and earnings beat, a slew of strategic acquisitions, and a collaboration with Microsoft in co-developing AI-powered solutions.

Removed **Suncor Energy Inc (SU)**, **Duke Energy Corp (DUK)** – due to lower expected growth rates and to reduce the Energy and Utilities sector weightings.

Removed **Thermo Fisher Scientific Inc. (TMO)** to reduce the Health Care sector weighting in the portfolio related to weakening demand trends throughout the life sciences industry. Weaker industry trends saw many peers downgrade guidance for the year.

Cash used to reallocate to various stocks within the Financials and Consumer Staples sectors.

## Outlook

Guardian Directed Outcomes strategies offer investment choices designed to address different priorities of investor objectives for either growth with enhanced downside protection through Guardian Directed Equity Path, or for tax-efficient cash flow generation through Guardian Directed Premium Yield.

The guiding principles underlying the investment philosophy of both of the Guardian Directed Outcome strategies rests on the following key tenets:

1. Employing the security analysis and selection process of the high-conviction, concentrated equity portfolios within Guardian's UK, US and Canadian businesses
2. Identifying short- to intermediate-term catalyst and stock price behavior aligned with long-term quality growth intrinsic value estimates
3. Implementing varying option overlay strategies to tailor the return behaviour of the underlying positions to target the portfolio outcomes desired, as follows:

**Guardian Directed Outcomes strategies**
The premise of the Guardian approach to managing the Directed Outcomes strategies is to apply the bottom-up fundamental research from our concentrated equity teams in the United Kingdom, the United States and Canada. In effect, the Directed Outcomes portfolios will hold a concentrated portfolio of global high-quality growth securities (20 to 30 stocks) with a managed options overlay, taking into account intrinsic value estimates and catalysts derived from the research. This information will be complemented with a short- to intermediate-term technical and fundamental review to assess prevailing trend strength and stock price behavior to exploit shorter horizon trading opportunities.

**Guardian Directed Premium Yield Portfolio**
Risk Rating[2]: Medium

This Fund's portfolio is designed to deliver a high and consistent level of tax-efficient[3] cash flow – 6%[4],annually, distributed monthly – to investors, recognizing that securities within the portfolio may fluctuate according to prevailing market conditions.

Volatility levels have leveled out considerably with both implied and realized volatility normalizing. This strategy is expected to continue to collect attractive option premiums and participate in the upside in a more gradual manner.

**Guardian Directed Equity Path Portfolio**
Risk Rating[2]: Low to Medium

In the case of the anticipated Directed Equity Path outcome, the portfolio is engineered with the aim to manage volatility and provide downside protection, so that it is never exposed to the entire downside of

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2 As disclosed in the Fund's most recent prospectus and Fund Facts. The Risk Classification of a fund has been determined in accordance with a standardized risk classification methodology in National Instrument 81-102, that is based on the fund's historical volatility as measured by the 10-year standard deviation of the fund's returns. Where a fund has offered securities to the public for less than 10 years, the standardized methodology requires that the standard deviation of a reference mutual fund or index that reasonably approximates the fund's standard deviation be used to determine the fund's risk rating. Please note that historical performance may not be indicative of future returns and a fund's historical volatility may not be indicative of future volatility.
3 Distributions are expected to be primarily return of capital or capital gains generated from option premiums and securities transactions, which are taxed more favourably than income.
4 As disclosed in the Fund's prospectus, the Fund intends to make monthly distributions based on a targeted annualized monthly distribution of 6% of the NAV per Unit at the end of the prior year. Distributions may consist of net income, dividends, net realized capital gains, and may also include return of capital.

any position held. As a result, returns are expected to lag in a rising market environment (the sharper the rise, the larger the lag) and to help preserve capital in a declining market environment (the more severe the drawdown, the better the protection).

Volatility levels have leveled out considerably, with both implied and realized volatility normalizing. This Fund's portfolio continues to be positioned defensively with a high level of put option protection implying that the portfolio will be well insulated on the downside if market conditions deteriorate in the near-term. The strategy is expected to continue to collect attractive option premiums and participate in the upside in a more gradual manner.

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Date Published: July 19, 2023