GUARDIAN CAPITAL

GUARDIAN CANADIAN SECTOR CONTROLLED EQUITY FUND Q3 2024 MANAGER COMMENTARY

Market Review

The S&P/TSX Composite Index returned 10.5% in the third quarter of 2024, buoyed by strong performance in the Real Estate (+23.0%), Financials (+17.0%), and Utilities (+16.6%) sectors. The Energy (+1.9%), Industrials (+2.7%), Consumer Staples (+6.0%), and Consumer Discretionary (+7.8%) sectors all lagged the broader market.

Market sentiment was positive over the quarter, fueled by cooling inflation and stable economic growth in Canada, which boosted investor confidence. Canadian banks showed resilience with steady earnings and maintained strong capital positions. Steady demand was seen in commodities in part due to ongoing global geopolitical factors and infrastructure investments. The Bank of Canada (BoC) announced its third rate cut of the year on September 4, 2024, bringing the overnight lending rate down to 4.25% from the previous rate of 4.5%.

Below the border, the US Federal Reserve (Fed) cut its federal funds target range by 50 basis points from 5.25%-5.5% to 4.75%-5%, which helped fuel gains across the board. Notably, the yield curve de-inverted during the quarter, a milestone that can sometimes signal future economic softness. Better-than-expected GDP growth helped boost market confidence, easing fears of a potential economic slowdown.

Oil prices endured volatility, attributable to a combination of geopolitical tensions, supply concerns and global demand. Ongoing conflicts such as the Russia-Ukraine war continued to create uncertainty in the global oil supply chain. Global demand for oil fell to below pre-pandemic levels while supply remained strong, particularly from Canada, Brazil, and the U.S. The combination of strong supply and lower demand created an imbalance, pushing oil prices downward. The WTI settled at US$68.17, down from US$81 per barrel in June.

Performance Attribution

The Fund’s portfolio underperformed its benchmark, the S&P/TSX Composite Index, during the quarter. The underperformance was due to both negative sector allocation and stock selection.

Positives

- Contributions to performance from sector allocation were driven by being underweight Energy (+1.9%) and overweight Information Technology (+14.1%) sectors.

- Stock selection contributing to performance was driven by portfolio holdings within Utilities (Capital Power and Brookfield Infrastructure), Industrials (MDA Space, Element Fleet Management and Finning International) and Materials (Agnico Eagle Mines) sectors.
- Top stock contributors to performance during the quarter:

  - Brookfield Corp: Was a beneficiary of falling interest rates. Brookfield produced positive earnings and a positive outlook on their Investor Day.
  - Royal Bank of Canada: RBC delivered a strong earnings beat, surpassing market expectations with robust financial results.
  - Canadian Imperial Bank of Commerce: CIBC's earnings beat was one of the top in the Financial sector, relative to its peers.

Negatives

- Overweight allocations to Industrials (+2.7%), underweight Financials (+17.0%), and overweight Consumer Staples (+6.0%) sectors detracted from performance during the quarter.
- Underperformance from stock selection was primarily due to portfolio holdings within the Energy (Canadian Natural Resources and Suncor Energy), Consumer Discretionary (Restaurant Brands), and Information Technology (Open Text) sectors.
- Stocks that detracted from performance during the quarter:

  - Boyd Group Services: Boyd has suffered from consumer headwinds and challenging market conditions that has led to a lower frequency of auto repairs. The company is still an industry leader and enjoys a growing market share position.
  - AtkinsRealis Group: Having delivered an extended string of stellar results, Q3 earnings were in-line with expectations, prompting a softened share price reaction. Shares have since rebounded in anticipation of continued strong growth.
  - Canadian Natural Resources: CNQ sold off in Q3 in-line with the decline in oil prices.

Portfolio Transactions

There were no transactions in the portfolio during the quarter.

Portfolio Outlook & Positioning

Although inflation has clearly peaked in Canada and the US, it remains unclear when long-term inflation expectations will settle into the target range therefore dictating central bank policy. The Canadian dollar strengthen during the quarter with the Bank of Canada announcing its third rate of the year, with expectation of two more rate cuts to end 2024. Across the border, the US dollar weakened and bond yields fell as strong economic data, and the US Federal Reserve's rate cut in September 2024, signaled a shift towards a more accommodative monetary policy. Despite the onset of central banks easing globally, it is not clear whether the US and Canadian economies will fall into recession. Caution is warranted, however, as rates are still at elevated levels versus a few years ago, and companies and consumers still need to refinance existing debt on an ongoing basis.

At the company level, falling inflation and slowing growth could introduce revenue headwinds. 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. Over time, we expect higher-quality companies to overcome these headwinds, providing attractive opportunities, but investors need to be increasingly selective.

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.

Values are reported in CAD, unless stated otherwise.

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