INVESTMENT FUNDS

Thematic Innovation Fund

MONTHLY COMMENTARY

October 2023

Financial conditions under pressure

Cyclical slowdown fights secular tailwinds

October saw a massive increase in the U.S. 10-year Treasury yield, driving cyclical industries and long-duration assets lower. With rates hitting a decade high (again!) in October, and UAW strikes that kept gaining ground, the market has been skittish.

A government shutdown has been averted once, but the next deadline is November 17. Congress is trying to pass a funding bill to prevent a shutdown, and more news on that front is expected early in November. As for the UAW strikes, the parties came closer to an agreement at the end of the month, but questions remain as to the place these OEMs (Ford, GM, Stellantis) will have in the transition to EVs, because they seem to face a significant cost disadvantage in relation to new entrants, such as Tesla and foreign automakers.

Interest rates fight secular tailwinds

It was an especially tough month for companies connected to the energy transition. For example, NextEra Partners commented that it was getting more difficult to obtain funding because of high interest rates. With some companies delivering disappointing results on the back of inventory destocking, the whole sector was on sale. The key question remains: How will these new energy projects fare in a high-interest rate environment mixed with high inflation?

Many projects have cost overruns that have reduced their returns, and now high interest rates are putting a nail in the coffin for some of them. Even so, governments around the world are putting money to work to increase the share of renewable energy over the longer term. Are we seeing a short-term hiccup or a long-term issue?

Performance analysis

Selection was strong during the quarter and contributed most of our performance. We did especially well in consumer discretionary and information technology.

In consumer discretionary, staying away from Tesla was a strong contributor to performance during the month. The rise in interest rates put pressure on the entire EV complex, from materials producers to automakers. A reduction in demand for cars due to high interest rates, combined with the company’s high valuation, keeps us away from Tesla. We still believe in the electrification transition but we are playing this theme through other investment opportunities.

In information technology, our overweights in Microsoft and Palo Alto Networks were strong contributors. Cybersecurity remains a key concern for corporate decision makers and in our view will continue to support Palo Alto’s growth.

iA Financial Group

#1 In net sales of segregated funds in Canada since 2016

Maxime Houde, CFA

Associate Portfolio Manager, Thematic Investing

- Joined iA in 2015
- More than 10 years of investment experience
- Bachelor's degree in Finance, Université Laval

The shift toward a multipolar world is accelerating

As geopolitical tensions intensify with the tragic events in the Middle East and the Biden administration's further restrictions on chip exports to China, the financial landscape is rapidly shifting toward a multipolar world. This shift is expected to catalyze reshoring efforts and to increase investments in infrastructure. In line with these trends, we have continued to expand our exposure to innovative companies that drive such changes and stand to benefit from them.

> "In our view, the software industry should be strongly favoured by the rising automation needs, the transformative opportunity arising from AI and plateauing interest rates."

Accordingly, we want to invest in areas of the economy that will be among the most resilient in a potential downturn while leading the way out of it. To that end, we have started to take profits on AI hardware infrastructure winners and to reinvest the proceeds in the software layer that will benefit from rapid adoption of large language models.

In line with our barbell investment approach, we will continue to identify potential market leaders amongst innovative firms, while ensuring our capital is also allocated to dominant market players that stand to gain as innovation permeates the economy. This strategy offers the distinct advantage of mitigating risk as opposed to pure-play, innovative, high-octane approaches.

Key Takeaways

— The increase in interest rates is putting pressure on the market.

— The portfolio recorded a strong performance in October.

— We are slowly adding cyclicality to the portfolio.

About iAGAM

A magnet for top investment talent, iAGAM is one of Canada's largest asset managers, with over $100 billion under management across institutional and retail mandates. We help investors achieve their long-term wealth creation goals through innovative investment solutions designed for today's complex markets. We are building upon our historic success, supporting the growth of our core strengths and exploring innovative ways to meet investor needs. We are rooted in history and innovating for the future. Our experienced portfolio managers use a proprietary investment methodology, rooted in iAGAM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.