INVESTMENT FUNDS

Thematic Innovation (iA)

QUARTERLY COMMENTARY

September 2023

Higher for longer

Interest rates are running higher

The U.S. 10-year rate continues to make decade highs. Jerome Powell said at the Fed's September meeting that rates would remain higher for longer, and his statement was supported by unexpectedly strong economic data indicating a resilient consumer. Despite the stronger data, the market went into a tailspin at the end of the quarter on hawkish Fed comments and the ensuing move in rates. Market expectations for rate cuts have changed since the start of the year, with the idea of cuts being sidelined as rates are pushed higher. This context has been pressuring rate-sensitive sectors, such as utilities.

Resilient consumer but for how long?

Despite robust macroeconomic data, such as job openings, some early signs are pointing to a weakening consumer. Much of the rise in rates was recently absorbed by excess savings that were accumulated during the pandemic but are now depleted. Looking at consumer discretionary and transportation stocks, we see a blurry picture. Transportation companies are signalling a lack of seasonality in the second half of the year, although volumes usually pick up during the back-to-school season. As for consumer discretionary, traffic and average basket size are pointing lower, with consumers looking to trade down. Are we finally seeing the hiking cycle's effects on the consumer?

Performance analysis

The third quarter was marked by difficult stock selection. Despite strong selections in industrials and consumer staples, we were not able to make up for tougher picks in communication services, health care and consumer discretionary. As for outstanding picks, our positive view on the electrification of everything generated strong results with Eaton and nVent, which were top contributors during the quarter. In consumer staples, our overweight in Costco added value, as rising rates continued to push consumers to trade down or to hunt for deals, something that falls within Costco's wheelhouse.

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

Market outlook in turbulent times

AI technology advances, the rapid push for deglobalization and strong fiscal stimulus for the energy transition are accelerating the adoption of multiple innovation themes, such as big data lifecycle, cybersecurity, cloud supply chain, electrification, battery technology and renewables. We expect ongoing market fluctuations and plan to capitalize on such opportunities to enhance our fund’s risk-return profile.

“In the impending low-to-negative GDP growth climate, we think structural growth stocks will most likely be preferred.”

A useful guideline is that investments in structural growth and the innovation economy are best made after the low point of a cycle, when growth is scarce.

In our view, the software industry should be strongly favoured from this point by rising automation needs, transformative opportunities arising from AI and the prospect of 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 as we emerge from it.

We also see some opportunity emerging from a valuation standpoint on the renewables front after the rapid raise in interest rates.

Next-generation health care also continues to be an area of focus as the tailwinds, from demographic and technological standpoints, are strong and enduring. We are maintaining a significant allocation to health care large caps in the services and pharmaceuticals industries because, in the current environment, demand continues to be relatively strong and has historically been resilient to economic downturns.

Key Takeaways

— Interest rates continue to rise.

— The portfolio recorded a strong performance.

— We are positioned cautiously as we head toward the end of the year.

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.