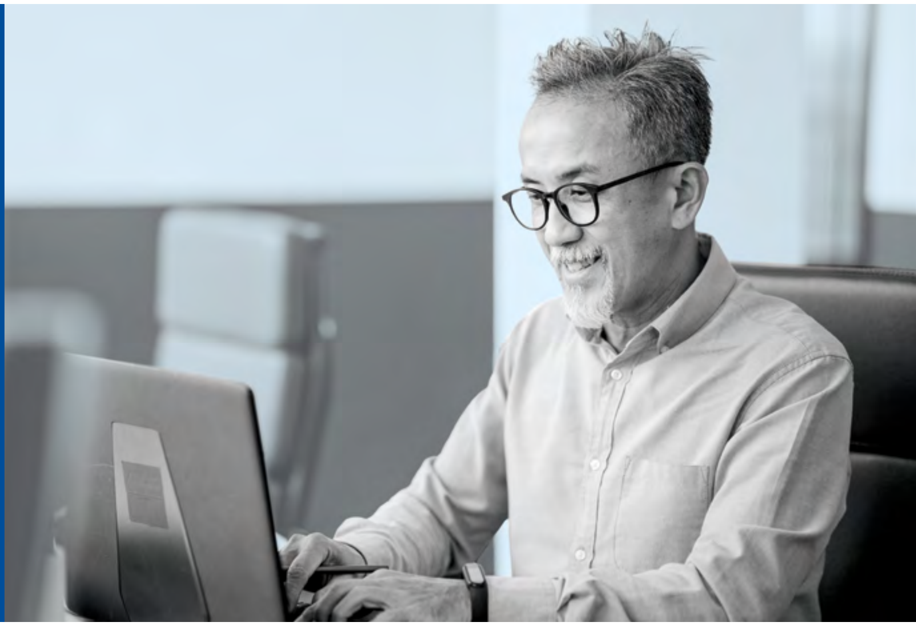
INVESTMENT FUNDS

North American Equity

QUARTERLY COMMENTARY

March 2023



The global economy has a rocky start to the year

Banks under scrutiny

The year got off to a good start on global markets, with investors expecting a pause in rate hikes by mid-year. Moreover, the consensus was that we would have a soft landing and that government stimulus, such as the Inflation Reduction Act and the Infrastructure Investment and Jobs Act in the United States, would be enough to support growth in the more cyclical parts of the economy, despite a macro slowdown.

In February, the CPI painted an inflation picture that was hotter than expected, causing rates to rise. Even so, the upward trajectory was short-lived, as March brought to light a new major risk factor: the regional banking system. The collapse of Silicon Valley Bank, a large regional financial institution, placed the entire banking system under scrutiny. This event affected not only the financial sector but also cyclicals, given that regional banks play a major role in the commercial and real estate lending markets. As a result, tighter lending restrictions took stocks in the industrials, basic metals and consumer sectors lower.

The return of tech mega caps

Even though many sectors and subsectors were adversely affected by the banking crisis, technology stocks, notably mega caps, staged a comeback. Rates started to fall materially after the SVB collapse, making long-duration assets more investable. Furthermore, the past 15 months have been difficult for large-cap technology stocks, some of which started to show very attractive valuations. Combined with their market-leading positions, these stocks became an investor haven during the banking turmoil.

Performance Analysis

Our sector allocation was a negative during the quarter, while our stock selection had a neutral impact on performance.

In terms of allocation, our underperformance was due to an underweight in the information technology sector. Lower rates combined with more reasonable valuations were enough to support a rally in technology.

As for stock selection, we generated value with our picks in industrials and health care. In industrials, the strongest performers were Bombardier, Hammond Power Solutions and Stantec. Bombardier continued its deleveraging with a robust backlog and strong execution. Hammond Power should benefit from the energy transition because dry-type transformers will be in great demand for EV infrastructure. Regarding Stantec, the company will benefit significantly from U.S government stimulus for infrastructure buildout. In health care, Exact Sciences and Natera were strong contributors. In the case of Exact Sciences, when competitor data disappointed, the market concluded that Exact Sciences was the front runner in cancer diagnostics. This strength was amplified by outstanding quarterly results. As for Natera, solid quarterly results and the announcement of expanded payor coverage for some of its products pushed the stock higher.

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Looking through the valley

The banking crisis caused a big shoe to drop, and its impact on the economy will continue to be felt in the coming months. Restricted lending in response to the crisis is perceived as the equivalent of a 50-basis-point rate hike by the Fed. The odds of a serious economic recession have increased materially. Although this is bad news for corporate earnings over the short term, the bright side is that it brings us closer to the end of this 15-month bear market.

> "We will start to add cyclical names in a gradual, disciplined manner, targeting stocks with steep valuation discounts and solid growth prospects."

In the United States, we expect to see continued volatility in the first half of the year and will take advantage of it to keep improving the fund's risk-return profile. We think the best approach is to use a barbell strategy, with emphasis on dominant firms that focus on free cash flow, while gradually increasing our allocation to what we consider the themes of the coming decades: the energy transition, robotics, automation and artificial intelligence.

We think large language models, such as ChatGPT, are this tech cycle's "iPhone moment" and will have major repercussions across the technology ecosystem and the economy as a whole. As the technology matures and use cases are developed, we aim to gain exposure to companies benefitting from mass adoption of such models, while avoiding those at risk of being left behind.

Key Takeaways

- The Fed changes its tone slightly.
- CPI prints show some positive signs.
- A bank crisis hits the United States and Europe.

About iAIM

A magnet for top investment talent, iAIM 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 iAIM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.

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