Perspectives

with Vancity Investment Management Ltd.

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Equities

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- Equity markets have been bouncing back, and while we may not be out of the woods yet, it's clear we've seen a change in sentiment to begin 2023. There appear to be three drivers of market optimism:
  1. Inflation seems to be normalizing, although it's still at elevated levels and it'll be interesting to see the year-over-year numbers in the spring.
  2. As a result of inflation beginning to normalize, central banks are implying some level of rate stability over the near future. We don't know how long rates will be elevated or the extent of the rate cuts when it comes to that, but barring some unforeseen circumstance, it seems likely the worst of the rate hike cycle is behind us, based on what's being factored into recent market sentiment.
  3. Corporate earnings have been more resilient than some analysts expected. Quality companies with defensive competitive advantages and the ability to offset cost inflation have been able to extend their competitive advantages.
- Our reason for optimism lies in the third point – the resilience of quality companies and their ability to continue raising prices and maintain their margins without damaging their competitive advantages.
- It's important to understand that markets are anticipatory. We don't know when or if central banks will raise or lower interest rates, so we don't try to predict such decisions. Instead, we focus on investing in what we believe are the companies best able to withstand change under any economic regime.
- I'd like to highlight two names in the IA Clarington Inhance Canadian Equity SRI Class:

  ATS Corp.
  - Designs and assembles automation equipment for customers across a variety of regulated industries. For example, ATS designs the equipment that aids General Motors in assembling EV batteries.
  - Long runway to reinvest but also the ability to raise prices if needed.
  - Long-term thesis: the pressure wage inflation will put on the margins of ATS' customers will cause automation to continue to grow in importance.

  Jamieson Wellness Inc.
  - Household name and leading producer of vitamins in Canada.
  - There's an association between reputation, quality and trust in the products we consume and the relationship we have with brands. This is especially true of products like vitamins. For example, if you're giving vitamins to your children or elderly parents, you want to have a high level of trust that they're safe and regulated.

- Its brand strength creates a competitive advantage that enables Jamieson to price above the competition, as customers are willing to pay a premium for the safety of their loved ones.
- The company has a long runway to grow in underpenetrated markets and is able to maintain margins, especially in inflationary environments because it can price above its competitors.

- We don't know when the market will recognize the value of the companies we hold, but we believe that as long as we continue to invest in quality names, the market will take notice and value them appropriately.
- We are constantly reading annual reports and related material in search of attractive investment opportunities.
- Periods of heightened volatility are exciting for us because they present a greater opportunity to find quality companies at a discount to intrinsic value.

Fixed Income

Jeffrey Lew

- Inflation figures continue to look promising and it appears that they could get back on target sooner rather than later.
- In 2022, we saw very rapid rate hikes by the Bank of Canada (to over 400 basis points) and the Federal Reserve (to over 425 basis points). Both have signaled they're getting close to slowing down.
- Employment data has been very strong, which would signal that central banks could continue hiking; but at the same time, inflation data has been coming down, so there are signs that rate hikes have been working at least to some extent.
- Historically, it takes at least a year for a rate hike to have its full impact on the economy, so we could still see some pain ahead with the rate cycle only beginning last March.
- Markets are pricing in a peak for rates in mid-2023 in both Canada and the U.S., with cuts priced in for the latter part of the year.
    - But we're skeptical that we'll see those cuts. To see some loosening of monetary policy, we would have to see inflation come down significantly along with clear signs that the economy is slowing.
- Portfolio positioning:
    - Heading into this year, we were neutral duration and overweight credit; we also had about a 5% allocation to preferred shares.
    - We're starting to bring our duration down to slightly lower than the index level as more of a tactical shift.
    - As the yield curve is inverted, we're more heavily weighted towards the front end of the curve.

ESG

Morrigan Simpson-Marran

Shareholder engagement in 2022

- In November we filed shareholder engagements with four of the five major Canadian banks.
- We filed proposals with TD, RBC and CIBC to request disclosure of their CEO-to-median-pay ratio. The increasing pay divergence leads to employee discontent and higher turnover, which costs the banks millions. In all but one case this proposal went to a vote and we saw some great results.
- We co-filed a climate proposal requesting that Scotiabank prepare a report articulating 1) its expectations for the net-zero transition plans of high-greenhouse-gas-emitting clients, and 2) how the company assesses the sufficiency of those transition plans year over year in relation to the bank's 2030 emissions reduction and net-zero goals.

- We co-filed a climate proposal requesting that CIBC issue a report describing its expectations of credible transition plans for clients and sectors most exposed to climate-related risks. We're looking to ensure that CIBC reaches its 2030 interim targets to reduce financed emissions associated with its lending portfolio.
- In December, we co-filed a proposal requesting that JP Morgan Chase adopt a policy for the time-bound phase out of lending and underwriting of projects and companies engaging in new fossil fuel exploration and development.

Looking ahead

- Q4 saw the kickoff of our Climate Engagement Canada (CEC) engagements. CEC is a finance-led initiative that promotes dialogue between the financial community and corporate issuers, with the goal of facilitating a just transition to a net-zero economy.
- With the initiative and our co-signers, we met with Magna, Nutrien and Waste Connections Canada to discuss how critical it is to have a robust net-zero plan.
- This year, a significant portion of our engagements will focus on achieving our net-zero goal. This means, in part, that 1) 75% of financed emissions will be engaged by 2025 and 2) 90% of financed emissions in the materials sector should be considered net-zero aligned or aligning by 2030, or will have been subject to engagement.
- We are continuing our CEC dialogue and beginning engagements with CP Rail and West Fraser on these topics.
- On top of this, we are continuing to focus on biodiversity, environmental justice, human capital management, corporate culture and many other topics.

Visit iaclarington.com/SRI to learn more about Vancity Investment Management Ltd. and the IA Clarington Inhance SRI funds and portfolios.

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