3rd QUARTER LETTER 2021

October 21, 2021

CANADIAN EQUITY

During the 3rd quarter of 2021, the **LAM Canadian Equity Fund** declined **-4.5%** before fees versus +0.2% for the TSX Composite Total Return. Year-to-date, the Fund is up **+6.5%** versus +17.5% for the TSX. While we got off to a strong start in the 1st quarter, we have since lagged the broader Canadian market as we remain underexposed to the "reflation trade", particularly in commodities. More specifically, we have no exposure to oil & gas exploration and production companies (in part due to ESG considerations), which were the main drivers of the TSX's positive performance. Rather, we prefer owning energy infrastructure companies, which are less volatile as they are less dependent on unpredictable commodity prices, and pay more stable dividends.

Our top contributors during the quarter included two technology companies that provide supply chain management software solutions, **TECSYS** and **Kinaxis**, as well as **CN Rail** which rebounded strongly after giving up its efforts to acquire Kansas City Southern. **Loblaw** and **Goodfood Market**, two consumer staples stocks also rose significantly during the quarter and were since sold. However, detractors more than offset gainers and included holdings in healthcare which was the worst performing sector of the TSX. Among these were **CareRx** (Canada's leading institutional pharmacy), **CloudMD** (a North American leader in digital health solutions), and **Sienna Senior Living** (owner operators of long term care facilities and retirement residences in Ontario and B.C.). Other detractors included **MDF Commerce**, which issued a large amount of equity to complete the transformational acquisition of Periscope to become the leading North American e-procurement platform for business to government commerce (B2G), **Brookfield Infrastructure** which was engaged in a takeover battle to acquire control of Inter Pipeline, and agricultural equipment maker **Ag Growth International** which is nevertheless enjoying a record year. All of the above detractors are well managed companies that continue to grow and are trading at very compelling valuations.

While we are disappointed with our performance over the past two quarters, we have been in a similar situation before and rebounded strongly. Many of our holdings are in sectors that are either temporarily out of favor such as renewable energy (ironically to the benefit of oil & gas producers) or healthcare, or are not subject to momentum investing by the herds. Nevertheless, we are confident that these will contribute meaningfully to our future returns. As stated in previous letters, we expect to lag the broader market during periods when the TSX's two most concentrated sectors, Financials and Energy, perform strongly, although such periods tend to be relatively short-lived as they are generally driven by large fund inflows from foreign investors and ETFs. Stock markets continue to be buoyed by low interest rates and easy money, however supply chain disruptions, supply-demand imbalances, labor shortages, changing consumer habits and continuing government restrictions to deal with the pandemic are creating near term challenges for many businesses. As a result, we continue to be selective and focused on long term opportunities with attractive valuation metrics.

U.S. EQUITY

During the 3rd quarter, our U.S. portfolios were down **-1.8%** versus a slight increase of +0.6% for the S&P 500. Year-to-date, we are up **+10.2%** versus +15.9% for the S&P500. From an industry perspective, our underperformance was due to our underweight positions in the Information Technology sector and to a lesser degree in Financials. We have also held a large cash balance throughout the year due to high valuations. On specific stocks, **Activision Blizzard** was our biggest laggard amid allegations of discrimination in the workplace which was promptly dealt with by the company. The stock is extremely cheap and has the best video gaming library in the business. **T-Mobile**, a long-time core holding of ours, was also a big detractor as the telecom sector was hit by increased competition in broadband. However, T-Mobile is mainly a wireless carrier not a wireline supplier of broadband, thus, we are confident its stock will rebound. Our biggest contributors were **Fifth Third**, a Midwest regional bank, and **Booking Holdings** which is benefitting from the eventual end of the pandemic travel ban.

We sold some high quality companies that reached our targets such as **O'Reilly Automotive** and **Union Pacific**, and have replaced them with **Ross Stores**, an off-price retailer in the U.S. and **Norfolk Southern**, a railroad which should benefit from a rebound once supply chain issues are resolved. We continue to hold an average cash balance of close to 6% and are ready to buy on any market-related pullbacks. In particular, we are looking to further increase the quality of the portfolio and add to our technology exposure on a sell-off.

FIXED INCOME

The 3rd quarter was relatively quiet in terms of interest rate volatility, except for the last week of September. For most maturities, interest rates rose rapidly by over 0.25% in the days leading up to the end of the quarter, pushing the quarterly performance of many bond indices into negative territory. Our short duration positioning and overweighting in preferred shares helped our performance. The **LAM Canadian Fixed Income Fund** ended the quarter with a gross return of **+1.0%** versus -0.5% for the Canada Universe Bond Index and +0.3% for the Hybrid Bond Index. Year-to-date, we are well ahead with a gross return of **+3.8%** versus -4.0% for the Canada Universe Bond Index and -0.3% for the Hybrid Bond Index.

Several notable events took place during the quarter, although some did not have much impact on the market such as central bank speeches and the Canadian elections. On the other hand, the end of the quarter was tainted by several significant events that pushed interest rates up and increased volatility in equity markets. Among them, China, which is facing a debt crisis that is shaking up the real estate sector, an electricity shortage that is shutting down factories, and the first slowdown in the country's manufacturing activity since the start of the pandemic. In the United States, the return of uncontrolled inflation fears, which could encourage the Federal Reserve to raise interest rates faster than anticipated and thus cause an economic slowdown, has also caused nervousness in capital markets.

Our exposure to preferred shares with "floors" or with high dividend "reset rates" contributed greatly to our performance. The increasing scarcity of this type of investment and the movement in interest rates have benefitted this asset class. The Canadian Preferred Share Index was up once again, rising +2.8% for the quarter. In fact, preferred shares have been one of the best asset classes year-to date, with a gross return of more than +20%. The other reason for our outperformance is our exposure to shorter duration high yield corporate bonds such as **Secure Energy 7.25%** and **Nuvista 7.875%,** and high dividend yielding equities in the energy sector such as **Enbridge** and **TC Energy**, which performed well due to a combination of strong earnings, higher commodity prices, and positive news.

For the coming quarters, volatility in bond markets will certainly be something to watch once again. We think that central banks announcing the end of quantitative easing (QE) may not be so negative for now. The market can adapt to the rhetoric, avoiding another "taper tantrum" as in 2013. The real risk lies in when short term interest rates finally begin to rise. This will have the effect of slowing down the economy which will make it more difficult and expensive for companies to finance themselves. It will also be important to see how central banks react to future economic data, specifically inflation. Moreover, it is hard to ignore the fact that the Consumer Price Index (CPI) is running at around 4% but that the Producer Price Index (PPI) is at around 6%. We would expect that many companies will want and need to pass on inflation to the consumer. On the positive side, the favorable commodity price environment remains beneficial to the Canadian economy.

MACROECONOMIC OUTLOOK

Media continues to be fixated on high reported "inflation" reflecting data published in the major indices and anecdotal evidence reported by companies and consumers. The current run up in prices, however, should be transitory. As we pointed out in our last quarterly letter, the sharp rise we have seen in many prices reflects the extraordinarily rapid global economic recovery following the outbreak of the pandemic which has caused temporary shortages and bottlenecks. In short, a supply shock. Prices not affected by the economic re-opening have remained subdued.

For most of the past two decades, the North American economy, as well as the EU, China, and Japan, have experienced powerful deflationary forces driven by chronic excess savings, technology, globalization, and low wages in less-developed countries. These factors will re-emerge as economic conditions normalize, as is already becoming evident. The rapid global economic rebound has already settled back markedly and will reduce demand while the supply shock is overcome by increased production. Growth in China has already slowed considerably, and 3rd quarter GDP growth in the U.S. is likely to be down versus past quarters, and probably revert to its long-term average of around 2%. Inflationary pressures typically lag economic growth by six months or more, so it seems reasonable to expect that bottlenecks and shortages will start to ease after year-end.

There are two concerns that have received a lot of attention from market observers. One stems from the sharp rise in house prices which may tend to push up rents, an important component of the CPI. The reality is that rents, and the overall cost of shelter (a much broader measure) in both the U.S. and Canada, have generally remained subdued as they did during previous bouts of rapid house price increases. The other concern is the big jump in fossil fuel prices – oil, natural gas and coal. This reflects the tremendous pressure in the fight against climate change by governments to phase out fossil fuel energy as fast as possible to protect the environment, as well as the trend towards ESG investing. This is a laudable objective that almost everyone would support. However, the resulting pressure does not reflect reality – the transition to a fossil-free world will take far longer than is widely assumed. Green energy production such as renewables have so far barely kept up with the growth in energy demand. Producers of fossil fuels have been forced to sharply curtail investment in new capacity because of the high cost of capital and the huge uncertainty over the terminal value of newly developed supply. The result is a massive disruption in global energy markets and sharp price increases in most parts of the world. When rising demand meets inelastic supply, prices always go up until demand gets choked off or more supply comes onstream. As they say: "The best cure for high oil prices are high oil prices", however, until supply and demand get back into balance, higher energy prices will persist.

These two concerns stemming from high house prices and energy shortfalls will continue to overhang financial markets in the short-term. The big risk is that central banks react to the transitory increase in the published inflation numbers and start to raise interest rates prematurely out of pressure to "do something". While it is one thing to ease off on quantitative easing (QE), it is another to raise interest rates. Ending QE just means ending asset purchases by the government and hence would have very little real impact on tightening credit conditions. Raising rates prematurely, on the other hand, would be a mistake on three counts: a) it is not necessary because in the long run, deflationary conditions will prevail; b) it will not ease supply shortages; c) highly leveraged borrowers would be hurt. Monetary tightening will not bring down prices without causing considerable pain, and in the longer run it would only increase shortages by reducing investment. Thus, central banks should remain accommodative.

When inflationary pressures do begin to ease, there still remains the risk of high volatility due to the resulting economic uncertainty and high valuations on financial assets. Since the Great Financial Crisis, there has been a powerful bull market which started in March 2009. Long bull markets generally lead to excessive optimism and valuations become stretched in many sectors, including today's much hyped speculative new asset classes like cryptocurrencies, non-fungible tokens, and SPACs. Such excesses end up being corrected. Until we actually start to see a fading of inflationary conditions, there remains a short-term risk of central bank policy errors and the bursting of speculative bubbles.

Longer term, the bull market should continue to be driven by the unprecedented surge in technology, low interest rates, high savings, and plentiful liquidity. Interest rates should remain low, with the 10-year Government bond yield remaining in the 1% to 2% range for some time. In addition, the Canadian market and the Canadian dollar continue to be relatively cheap against most other markets and buoyed by the commodity complex, and will, therefore, remain attractive for foreign investors.

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BUSINESS UPDATE

We are pleased to announce the promotion of Kate Passingham to the position of Associate Relationship Manager and Client Services. Kate joined us earlier this year as Assistant Portfolio Administrator having graduated from the John Molson School of Business at Concordia University and having worked for Maples Group, one of the world's largest fund administration and service providers. She will be replacing Patricia Purcell who is retiring after 41 years in the business. Pat has been a key member of our team and contributed significantly to our success over the past 15 years. We wish Pat all the best in her move to Nova Scotia and plan to continue working with her on a part-time basis.