2020 YEAR END LETTER

January 25, 2021

First and foremost, we hope that you and your loved ones are all healthy and able to cope with the challenges of this long and difficult global health crisis. On our end, 2020 was a year during which most of us have never worked harder. The LAM team remained safe and strong, alternating between working from home and the office as needed. Lorie, Patricia, Peggy, Celine, and Marc were able to provide seamless service to clients and keep operations running smoothly throughout the pandemic. Meanwhile our portfolio management team generated exceptionally strong returns well above the comparable equity indices despite market turmoil and economic uncertainty, again demonstrating the benefits of "active" portfolio management as opposed to "passive" index investing through ETFs.

2020 also saw us augment our investment expertise. Olivier Tardif-Loiselle joined our portfolio management team mid-year as Lead Manager Fixed Income, having worked for 7 years at Industrial Alliance, Canada's 4th largest life insurance company, as portfolio manager, senior bond trader and credit analyst. His addition greatly strengthens our ability to enhance returns in one of the most important asset classes for Canadian investors: Canadian Fixed Income, which is one of our core investment strategies. In an environment of persistently low interest rates, generating returns that are well ahead of inflation while preserving capital has never been more important. Consequently, and as previously announced, we recently launched the **LAM Canadian Fixed income Fund** which will provide better diversification for clients in addition to lower fees for many with balanced portfolios.

We are also pleased to report that we have continued to rise to the top of Canadian Equity managers according to **Global Manager Research,** a leading institutional database. Our annualized gross returns have consistently ranked in the 1st quartile out of 160 Canadian Equity managers for every period over the past 10 years. Specifically, we are ranked 3rd for our 10-year annualized return of 10.2%, 5th for our 5-year annualized return of 12%, and 6th for our 1-year return of 15.6%. Since inception on July 1, 2006 (14.5 years ago), we have generated a gross annualized return of 11% versus 5.9% for the TSX Composite Total Return. A $100,000 investment made then would be worth over $450,000 today.

Despite all the turmoil and uncertainty during 2020, we also finished the year with record assets under management. While we won some prestigious institutional mandates over the few past years, we really owe our success to our long-time loyal clients to whom we would like to express our sincere gratitude for allowing us to enjoy the work we do. There is never a dull moment in our business and our mission of trying to generate strong long term returns on the funds entrusted to us while taking on less risk than the overall market, makes our work most interesting and rewarding.

Best wishes for a healthy and happy 2021.

Stephen Takacsy	**Tony Boeckh**
President & CEO	Chairman

CANADIAN EQUITY

During the 4th quarter of 2020, the **LAM Canadian Equity Fund** rose **+14.9%** before fees versus +9% for the TSX Composite Total Return. After faltering in September and October, global equity markets marched higher on continued government stimulus and optimism that economies will normalize following the rollout of vaccinations, despite rising infections and renewed lockdowns. Small and mid-cap stocks were particularly strong during the period. Despite our low weightings in the beaten down Financial and Energy sectors which rose sharply, our outperformance was driven by strong returns from a diverse group of companies, many of which are thriving or unaffected by the lockdowns.

Our top contributors during the quarter once again included companies benefitting from the pandemic such as **MDF Commerce** which announced a significant contract with Aldi, one of the largest food retailers in the world, to implement a "click and collect" platform in the U.K., **Tecsys** which reported strong orders for its supply chain management software, and **Goodfood Market** which continues to see strong subscriber growth for its meal-kits. Independent power producers such as **Boralex** continued to perform well and are expected to benefit from additional investments in green energy following a democratic Biden victory. Other gainers included **Blackberry** which signed a partnership with Amazon to develop a data platform for the automotive industry, and **Pollard Banknote** whose iLottery and instant ticket business is booming.

For 2020, the **LAM Canadian Equity Fund** gained **+15.6%** before fees versus +5.6% for the TSX Composite Total Return, representing a significant outperformance of 10% for the year. Most notable is that we generated this return without owning Shopify or gold stocks which accounted for the entire TSX return. We achieved our strong performance through careful stock selection and risk management, and sound portfolio construction being largely comprised of businesses that are relatively immune to the ravages of the pandemic and still able to grow. In other words, it was done through "active" portfolio management as opposed to "passive" index investing through ETFs.

Our top contributors for the year, as in the 4th quarter, were not surprisingly companies whose growth has accelerated due to the pandemic, either from an increase in e-commerce like **Goodfood Market** (+287%) and **MDF Commerce** (+78%), or from higher demand for software services that enable digital transformation such as **Tecsys** (+133%) and **Kinaxis** (+80%). Our strong returns were also helped by renewable power producers **Boralex** (+93%) and **Innergex** (+62%), two long-time core holdings, which are enjoying the powerful trend of ESG investing in clean energy such as hydro, solar and wind. A timely purchase of **Brookfield Infrastructure** near the March lows, as well as **Pollard Banknote**, **Calian Group** and **Altus Group** also contributed meaningfully. Note that we ended the year with Technology as our highest sector weighting at just under our 20% limit, followed closely by Industrials and Utilities.

The on-going pandemic has created a stock-pickers market in which the divergence between winners and losers is large. This has created an opportunity for "active" portfolio managers like us to prove that their strategies can add value by outperforming the general indices. While 2021 is off to a strong start (up +5% as of the writing of this letter), we believe equity markets are well ahead of themselves in discounting an end to the pandemic and a return to normalcy. Many risks remain regarding the effectiveness of vaccination rollouts and new variants or strains. However, a flood of central bank liquidity and massive government stimulus are buoying-up financial assets, yet also fueling more speculative investments such as cryptocurrencies, overpriced IPOs, and SPACs ("blank-cheque" companies). Consequently, bubbles are forming (more on this later), and caution is warranted. As a result, we have raised our cash weighting to nearly 10% and continue to take a measured approach in selecting sound long term investments at attractive prices.

U.S. EQUITY

We also finished the year on a strong note with our U.S. portfolio rising **+15.8%** before fees in the 4th quarter, well above +12.2% for the S&P 500 Total Return. The rise in the U.S. benchmark index was also mainly driven by beaten down sectors such as Energy and Financials, whereas our outperformance was due to strong returns from a diverse group of individual stocks such as **MercadoLibre**, **Viacom**, **PG&E**, **Pinterest**, and **Activision Blizzard**, as well as being underweight the Technology sector which lagged the overall market during the last quarter of the year.

For 2020, our U.S. portfolio returned **+27.6%** before fees versus +18.4% for the S&P 500 Total Return. We are particularly happy with this performance considering we were significantly underweight the Technology sector which rose +42% on the year. Moreover, Apple, Microsoft and Amazon alone accounted for over half of the S&P 500 return. This indicates that the U.S. rally was not broad-based, evidently due to the massive divergence between companies that were positively or negatively affected by the pandemic, with certain technology stocks being among the biggest winners. Of the 3 stocks mentioned above, only **Microsoft** (+41%) was a core holding in our portfolio for the full year. Strong returns from **MercadoLibre** (+193%), **Pinterest** (+254%), **Purple** (+120%), **T-Mobile** (+72%) and **IAA** (+80%) also contributed to our performance, as did our timely profit-taking in August when we raised 20% in cash prior to U.S. markets correcting on fears of a second wave. We then redeployed this cash into high quality companies that had pulled-back to more reasonable levels such as **JPMorgan Chase**, **Eli Lilly**, video game developer **Activision Blizzard**, and renewable power producer **Nexterra**.

The 2021 forward Price/Earnings ratio of the S&P 500 is currently around 23x which is expensive on a historical basis, particularly given all the economic uncertainty. The last time the U.S. index reached such a rich valuation level was in the early 2000’s at the tail-end of the tech bubble. However, interest rates (10-year government bonds) were around 6% then versus 1% today, which could justify current valuations until interest rates begin to rise. Nevertheless, we are being cautious and holding around 10% in cash while we await better opportunities or clearer visibility on the end of the pandemic.

FIXED INCOME

During the 4th quarter, the second wave of the virus had the effect of slowing down the economic recovery, largely due to government-imposed lockdowns. Nevertheless, with the fiscal and monetary measures in place, the impact on financial markets and the economy was less than what was experienced in the spring of 2020. The U.S. election was another significant event during the quarter. Following Biden's victory, the interest rate curve steepened, with higher inflation and stronger growth expectations led by more aggressive spending and deficits under a Democratic presidency. The announcement of high efficacy vaccines also contributed to market positivism. This news pushed up the prices of riskier assets and, as a result, credit spreads on corporate bonds tightened further.

As mentioned in our last letter, preferred shares were attractively priced. In fact, preferred shares rose an astonishing +9% in the 4th quarter. As anticipated when we decided to increase our weightings to this asset class during the 3rd quarter, investors pounced on this rare pocket of value as high yields from quality issuers are scarce in this low interest rate environment. We loaded up on “rate reset” preferred shares with floors (which guarantee investors a minimum yield even when the dividend rate is reset while interest rates are low), which proved to be a winning strategy. Another reason that preferred shares have risen is that Canadian banks and energy companies have started redeeming some series of preferred shares, creating a scarcity value in this already small market.

As expected, our Fixed Income portfolio did very well in this environment, as we were positioned with short duration and overweight high yield corporate bonds and preferred shares. We returned **+3.0%** before fees during the 4th quarter versus +0.6% for the Canada Universe Bond Index and +2.5% for the Hybrid Bond Index. For the year, we finished with a respectable gross return of **+7.0%** versus +8.7% for the Canada Universe Bond Index and +9.0% for the Hybrid Bond Index, given that we take less duration risk than the former index and less credit risk than the latter index. As mentioned in our last quarterly commentary, the longer duration (i.e. longer bond maturities) of the two benchmark indices contributed to their strong performance as interest rates decreased considerably in 2020.

For 2021, we continue to be positive on the corporate bond and preferred share markets since governments and central banks should keep policy rates low. The Bank of Canada and the Federal Reserve have reiterated that short term rates should remain low for several years to support the economy post-pandemic. Also, vaccinations should allow for a more normal reopening of the economy in 2021, and we therefore believe that the yield curve could steepen (i.e. long-term rates will move higher while short term rates stay the same) as inflation expectations rise. We also believe that, like the Fed, the BOC could allow inflation to overshoot its 2% target before intervening. However, rising rates can cause the value of expensive assets to become more volatile, so we will remain vigilant.

This month we launched the **LAM Canadian Fixed Income Fund**. The objective of the Fund is to provide an attractive rate of return on fixed income securities while protecting capital. Our strategy is to maintain shorter duration than the indices (i.e. shorter maturities) in order to protect capital in a rising rate environment, while focusing on credit analysis to achieve higher yields on bonds and take advantage of undervalued securities such as preferred shares as previously explained.

MACROECONOMIC OUTLOOK: Beware the Bubbles

During 2020, the Bank of Canada, Federal Reserve and other major central banks flooded the world with liquidity while driving short-term interest rates to near zero and, in some places, below zero, to fight the economic and financial impact of the pandemic. Monetary policy also included quantitative easing, which is the purchasing of assets, usually government bonds, to provide liquidity to banks and lower long term rates, but also included corporate bonds (and even stocks in some countries!). This massive expansion in liquidity has reignited a bull market in equities, which is being further supported by expectations of rising profits when the pandemic ends. Fiscal policy has also been expansionary comprising massive stimulus packages to help offset the impact of government imposed restrictions aimed at fighting the spread of the virus. Vaccine rollouts will be uneven but, by summer's end, there should be a decisive shift in expectations as life returns to something like normal, with rising employment, spending, travel, and corporate profits. The biggest business losers from the pandemic should also get a big lift.

As we enter 2021, a major concern is the high level of speculation in certain investments and the inevitable correction that will occur. Examples are bitcoin, "concept" stocks (i.e. electric vehicles), and IPOs of companies that have no chance of justifying their egregious valuations or have no active business (SPACs or "blank-cheque" companies). Central banks have played a huge role in increasing investors' appetite for risk. This is great for financial assets such as stocks, bonds, and real estate but, unfortunately, flashes a big green light for speculators. The so-called "risk on" psychology has been growing since the market lows last March and has accelerated in the past few months. Almost every indicator is at an extreme level including margin debt, the ultimate sign that retail investors are piling in causing some valuations to go parabolic. Historically, such excesses lead to nasty corrections. Only the timing, magnitude, and spillover to less speculative parts of the market are uncertain.

A big contributor to overvaluation has been the exponential growth of “passive” money into ETFs and computer-driven “momentum” trading strategies. It is estimated that there is currently $11 trillion dollars in “passive” ETFs linked to the S&P 500 and $13.5 trillion in “momentum” strategies. This type of “hands free” investing is very seductive because it creates a self-feeding loop—the more money that flows into an index or “momentum” strategy, the higher the return, which then attracts more money into the index or strategy causing prices of the underlying securities to be bid-up to valuations that are not justified by fundamentals. Securities that are not included in a popular index can move in the opposite direction as they become increasingly neglected. However, these have a better chance of being undervalued (thus less risky and less volatile) and having more upside. These self-feeding loops inevitably reverse course as the “momentum” switches from overvalued to more reasonably valued securities. This anomaly creates great opportunities for “active” managers like us.

A shakeout in the more speculative areas of financial markets could cause some temporary collateral damage to other sectors. However, three things should be kept in mind: the degree of speculative excesses seem to be much less in Canada than in the U.S., valuation metrics are generally more attractive in Canada and, the underlying fundamentals of the market remain strong. Also, the recovery in the Canadian dollar versus the US dollar is likely to continue. Investors should remain focused on the long term historical trend of the market, which is up, and should view an eventual shakeout of speculative positions as healthy for the long run. Moreover, it would likely speed up the rotation into stocks that offer more compelling value as they benefit from a reversal of “passive” and “momentum” investing strategies.

Stephen Takacsy **Martin Gagné** **Olivier Tardif-Loiselle** **Tony Boeckh**

Lester Asset Management Inc. (“LAM”) publishes reports such as this one that may contain forward-looking statements. Statements concerning LAM, the LAM Canadian Equity Fund and the LAM Canadian Fixed Income Fund (the “Funds”) or any related objectives, goals, strategies, intentions, plans, beliefs, expectations, estimates, business, operations, financial performance and conditions are forward-looking statements. The words “believe”, “expect”, “anticipate”, “estimate”, “intend”, “aim”, “may”, “will”, “would”, “should”, “could” and similar expressions and the negative of such expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. These forward-looking statements are subject to important risks and uncertainties that could cause actual results to differ materially from current expectations. All data, facts and opinions presented in this document may change without notification. The information provided herein is for information purposes only, it is not intended to convey investment, legal, tax or individually tailored investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not consider any investor’s particular investment objectives, strategies, tax status or investment horizon. Past performance is no guarantee of future results. No use of the Lester Asset Management name or any information contained in this report may be copied or redistributed without prior written approval.