LESTER ASSET MANAGEMENT

RESPONSIBLE GROWTH

3rd QUARTER LETTER 2024

October 17, 2024

The 3rd quarter of 2024 saw increased volatility in both equity and fixed income markets globally as economic and inflation data continued to send contradictory signals as to when and by how much central banks would start cutting interest rates. Heightened geopolitical tensions also added to the mix. Nevertheless, markets finished up sharply on subsiding inflation and a more aggressive initial rate cut by the Federal Reserve (Fed), with the Canadian stock market leading the pack. LAM generated strong returns in all of its asset classes, surpassing the TSX Composite in Canadian Equity and maintaining its significant outperformance in Canadian Fixed Income. Also, LAM's new **Lynx Global Biodiversity Fund**, launched in February and a first of its kind in Canada, continued its solid performance surging ahead of the MSCI World Total Return Index for both the 3-month and 6-month periods, despite not owning any of the MAG7 stocks and having a high cash weighting.

As we anticipated in our previous quarterly letters, inflation has subsided to within central bank targets amidst a soft landing. This finally triggered a first interest rate cut in the U.S. and further cuts in Canada, which sparked a powerfull rally in bonds. We had also expected market breadth to widen as equity valuations get buoyed by lower rates, which was the case in the 3rd quarter driving stock markets higher. Although we remain cautious on certain sectors and are cognisant of geopolitical risks, we remain bullish on both equity and fixed income markets, and in particular on our active investment strategies which have been generating strong returns.

CANADIAN EQUITY

For the 3rd quarter of 2024, the **LAM Canadian Equity Fund** generated a gross return of +**11.6%** versus +10.5% for the TSX Composite Total Return including dividends. Year-to-date, the Fund is up **+18.3%** on a gross basis, ahead of the +17.2% rise in the TSX despite having little exposure to the Energy and Materials sectors and having a low weighting in Financials, which have been the main drivers of the TSX return to date. Our outperformance during the quarter was due to strong returns by a diverse group of our small, mid and large cap holdings.

Contributors during the quarter included wireless antenna maker **Baylin Technologies**, space technology leader **MDA Space**, P&C insurance company **Definity Financial**, telecommunication services provider **Quebecor**, home accessibility equipment supplier **Savaria**, vitamin manufacturer **Jamieson Wellness**, engineering consultants **WSP Global**, fleet services manager **Element Fleet** and **RBC**. Detractors included automation solutions integrator **ATS**, seafood supplier **High Liner Foods**, and intelligent transportation systems provider **Quarterhill**.

As mentioned last quarter, we exited a few lower conviction positions and increased our weightings in **MDA Space**, **Element Fleet**, and **EQB**, all of which have been hitting historic highs. Also, our purchase of **Canadian Western Bank** on the announcement that it would be acquired by **National Bank**, has proven to be a good move rising 28% since we bought it. Besides trimming a few positions which had become too large, we exited **Flagship Communities REIT** and added to **Pollard Banknote** after it announced its first solo iLottery win in the U.S. and **Neo Materials** following its announced strategic review. Most companies in our portfolio continue to report good results and are trading at reasonable valuations, which should help produce steady returns going forward.

U.S. EQUITY

During the 3rd quarter, our U.S. strategy generated a gross return of **+7.1%** compared to +5.9% for the S&P 500 Total Return including dividends. Year-to-date, we are up **+18.4%** on a gross basis versus +22.1% for the index. Our outperformance during the quarter was driven by a broad group of companies reporting solid results. In fact, 17 different stocks in our portfolio rose over 10% during the quarter. Our top performers included **Allegion**, driven by good results from better pricing and improving volumes, leading the company to raise its guidance. **Lowe's** also performed well due to positive sentiment that lower interest rates should stimulate the housing market, and **T-Mobile** which continues to execute with better-than-expected customer wireless net additions. Our main detractors were **Alphabet** and **Microsoft**, which, despite reporting solid results, gave back some of their year-to-date gains along with many other technology stocks. Also, **FedEx** reported weaker than expected results, although their turnaround story remains a compelling case to continue owning the stock.

With the recent initial aggressive U.S. interest rate cut of 0.50%, we are confident that our portfolio will benefit from further cuts which should stimulate the economy. Looking ahead, we will continue to invest in companies that have clear short-term catalysts and predictable, visible earnings, trading at attractive prices, while managing risk by taking profits on those that trade at high valuations with limited potential for further upside.

GLOBAL EQUITY

In the 3rd quarter, the **Lynx Global Biodiversity Fund** generated a gross return of **+8.1%**, outperforming the MSCI World Index Total Return which rose by +5.1% including dividends in Canadian dollars. We are very happy with these results, as the Fund is now also ahead of MSCI World for the 6-month period, up **+10.6%** on a gross basis versus +9.3% for the index. Most of our companies reported strong earnings in July, with momentum continuing during the quarter. Since its inception in February, the Fund has generated a gross return of **+13.6%** compared to +15.6% for the MSCI World, which is a notably achievement considering the Fund does not own any of the MAG7 stocks, and while on average, the Fund was only around 67% invested during the period.

Our top contributors included **Eurofins Scientific** (laboratory testing) which is actively repurchasing its shares, **Brambles** (wood pallet recycling) which reached all-time highs after reporting strong free cash flow and a dividend increase, and **Tomra Systems** (reverse vending machines and recycling sorting equipment) due to better than anticipated earnings and an improved outlook. Our main detractor was **Montrose Environmental** (assessment and remediation) which became the subject of a short report. After a lengthy discussion with Montrose management, we remain confident that the allegations are unfounded. Also, **Bioceres Crop Solutions** (bio-based crop protection) and **Trex** (sustainable decking) declined due to weaker than expected results.

Environmental themed investing is in the early stages of multi-decade tailwinds driven by aggressive UN targets to halt and reverse biodiversity loss and restore degraded ecosystems, increased financial disclosure by corporations regarding nature-related impacts, dependencies, and risks, and heightened regulatory compliance regarding "greenwashing."

FIXED INCOME

It was a remarkable quarter for fixed income securities with bond yields falling for 3 months in a row, which caused bond prices to rise sharply. This trend was more pronounced in the short end of the yield curve where short-term rates had more room to come down versus long-term rates. Although there was mixed data during the quarter, there were enough signs of a slowing economy and subsiding inflation to reassure the Fed to initiate an aggressive 0.50% rate cut, while the Bank of Canada (BOC) cut rates three times by 0.25% each time. Once again, we are pleased with the performance of the **LAM Canadian Fixed Income Fund** which yielded a gross return of **+4.4%** during the quarter. This compared well to a +4.7% rise for the FTSE Canada Universe Bond Index, despite the much shorter duration of our Fund versus the index. Year-to-date, we continue to significantly outperform the market with a gross return of **+9.5%** versus +4.3% for the bond index.

Since the Canadian economy remains strong enough, credit spreads on corporate bonds tightened slightly, which was beneficial to our performance. However, the addition of longer-dated bonds in the Fund was the main driver of our performance. So, unsurprisingly, our main contributors were bonds such as **Government of Canada 3% 2034**, **Altagas 2.477% 2030** and **Telus 4.85% 2044**. Also, some of our preferred shares such as those issued by **Brookfield Office Properties** and **Brookfield Renewable**, continued to perform well due to the still attractively high yields of this asset class and redemptions at par by several other issuers. Finally, some of our high dividend yielding stocks and REITs, such as **Enbridge**, **Bank of Montreal** and **Choice Properties** also rose.

For the coming quarters, we remain very positive on the fixed income asset class. We still see value in preferred shares and corporate bonds, some of which still have high yields in the 6% to 8% range, well above the rate of inflation. Our Fund still offers a very attractive current yield of around 5.2% with a duration of 4.4 years. The cycle of interest rate cuts in Canada has likely just started, particularly if the economy continues to slow down and inflation drops below the BOC's target range. Lower rates will reduce financing costs such as corporate loans and mortgages boosting consumer confidence, which bodes well for the Canadian fixed-income market. Nevertheless, security selection remains an important aspect in the current environment, and we need to keep a close eye on economic data and geopolitical events that could create volatility.

MACROECONOMIC OUTLOOK

The underlying macro picture continues to be positive in the U.S. and is improving in Canada. The Canadian economy has been weaker than the U.S. but the odds of a pickup next year have strengthened for three main reasons. First, China's economic policy has shifted to a clear 'whatever it takes' stimulus to get the economy out of the doldrums. Its economy is almost as large as the U.S. and has a significant impact on global growth. Second, the U.S. economy, which had shown signs of a modest slowdown, appears to be strengthening again. Meanwhile, productivity is surging, the labour force is growing, unit labour costs are well contained, overall inflation (ex. housing costs) measures are already in the Fed target range, and expectations of future inflation give the Fed room to bring interest rates down further to sustain the easing cycle. The Bank of Canada, which had been the first major central bank to start easing, also has a lot of room to cut its policy rate as it is well above the rate of inflation, which itself has now fallen below 2%. Third, a change in Government in Canada seems high based on current polls, a recent by-election and general sentiment. Economic management of the country has been a failure on most counts. Real per capita income is at a 10-year low, and house affordability, despite a 20% fall in house prices, is still a severe problem draining consumer purchasing power. Data show that the average Canadian has to pay over half of their after-tax income on accommodations. A change in Government is likely to lead to a pro-growth policy, which would be good for the economy and stock prices.

While underlying prospects are for continued economic expansion in the U.S., economic recovery in Canada, and further declines in inflation and interest rates, there is heightened uncertainty and risk in the near term. The U.S. Presidential election in November appears to be a dead heat, and a Trump victory could well mean a return to his $17^{th}/18^{th}$ century mercantilist doctrine of trying to slash imports to create U.S. jobs. Canada, because of its very large trade surplus with the U.S., could be caught in the cross hairs. The Middle East wars are at risk of blowing out of control, particularly if the Persian Gulf is closed to oil shipments. This could spike oil prices in the short term which would trigger a rebound in inflation. How should investors react to these uncertainties? The world always faces potential risks resulting in increased volatility. The lessons from history are that invariably these risks blow over after a while and fundamentals prevail over the longer run. Should Trump get elected again, his previous protectionist policies did not amount to much more than a lot of threats as part of his transactional approach. Should war breakout between Iran and Israel and the Persian Gulf close, oil prices would spike but post-war history shows it would likely be short lived.

From a fundamental perspective, investors should expect a solid 2025 North American economy, improving corporate profits, falling inflation and lower interest rates, broadening out the bull market in both equities and fixed income securities. A global economic recovery driven by China would also strengthen commodity prices. Canada seems particularly well positioned for a strong recovery as there is more slack in Canada than in the U.S., inflation is lower, commodity prices would head higher, and the BOC has more room to cut interest rates. Coincidentally, the Canadian stock market has been outperforming the U.S. market recently and is setting new highs, and we expect it to recover more lost ground relative to the U.S. market in the year to come.

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