

1st QUARTER 2025 LETTER

April 24, 2025

The 1st quarter of 2025 saw unprecedented U.S. government domestic and international policy actions resulting in chaos and disbelief worldwide. As a result, global financial markets were highly volatile due to the geopolitical and macroeconomic uncertainty caused by Donald Trump and his administration. In particular, his harsh words against key allies and trading partners of the U.S. and his increasingly erratic behavior, further amplified post-quarter, is causing panic among investors. While European markets rallied from already low valuation levels on the news of massive German monetary stimulus, a sharp sell-off in U.S. equities hit technology stocks and the “MAG7” particularly hard. The S&P 500 and NASDAQ were down -4.3% and -10.3% respectively, dragging down most of the Canadian market as well, exacerbated by tariff and annexation threats.

As quickly as the Trump administration suddenly and unexpectedly turned hostile towards the rest of the world, international investor and consumer sentiment is quickly turning against the U.S. This is not only causing a massive sell-off in both U.S. equities and bonds which intensified in April, but is also leading to distrust in the U.S. government and ultimately a weakening of America’s leadership role and influence in global political, economic, and social affairs. While Donald Trump is out for the “Art of the Deal”, he is destroying an unquantifiable amount of U.S. goodwill among former allies while harming his own economy in the process. Meanwhile, we believe that Canada and its allies will come out much stronger in the end.

CANADIAN EQUITY

For the 1st quarter of 2025, the **LAM Canadian Equity Fund** declined by **-3.2%** on a gross basis versus a rise of +1.5% for the TSX Composite Total Return. Our underperformance versus the TSX was mainly due to our lack of exposure to the gold sector which was up over 34% and added +2.4% to the TSX return, and a few small/mid-cap stocks which declined more than the market. While down in the quarter, it should be noted that the Fund is having a strong positive month in April, significantly outperforming the TSX at the time of this writing.

Our top contributors included larger cap defensive names such as gas utility **Altagas**, telecom services provider **Quebecor**, P&C insurer **Definity Financial**, and discount retailer **Dollarama**. Our main detractors were mostly small/mid-cap companies with manufacturing facilities selling products into the U.S. such as agricultural equipment maker **Ag Growth**, home accessibility products supplier **Savaria**, vitamin maker **Jamieson Wellness**, and lottery ticket printer **Pollard Banknote**, despite the latter three reporting record results during the quarter. As stated on numerous occasions over the past few months, few companies in our portfolio are expected to be negatively impacted by U.S. tariffs or a consumer slowdown, and as mentioned above, the portfolio is holding up very well thus far in April. We have also been taking advantage of the market’s downside volatility to buy shares of quality businesses at cheaper valuations to generate attractive long-term returns.

U.S. EQUITY

During the 1st quarter 2025, our U.S. strategy declined **-0.6%** on a gross basis compared to a -4.3% return for the S&P 500 Total Return Index. Our relative outperformance was driven by several strong individual results during the quarter, and the portfolio’s diversified approach helped reduce the downside volatility. While the benchmark’s performance was heavily dragged down by the “MAG7” which collectively account for 32% of the index and declined on average nearly 16%, we benefited from lower exposure to this group with overweight positions in healthcare and financials, two of the quarter’s top-performing sectors.

Our top contributors included **CVS Health**, which benefited from favorable Medicare Advantage rate changes and renewed investor confidence in its turnaround plan. **Uber Technologies**, our newest position, delivered strong quarterly results, prompting us to increase our position after an initial negative price reaction. Shortly after adding to the position, a significant stake was disclosed by a large institutional investor, stressing Uber's "massive" discount. **T-Mobile** also continued to outperform, demonstrating its resilience as a defensive, cash-generating business. Our main detractors were unsurprisingly **Alphabet**, **Amazon**, and **Microsoft**. These declines were consistent with the broader selloff among large-cap technology-related stocks.

With ongoing uncertainty around U.S. trade policy and escalating tariffs, we believe our portfolio remains well-positioned given its diversification and defensive profile. Our largest exposures have limited sensitivity to cross-border trade, and in the event of an economic slowdown, our holdings should outperform due to their resilient business models. With approximately 5% in cash, we can take advantage of downdrafts to add sound, domestically focused businesses that are well insulated from tariff impacts and trade at attractive valuations.

GLOBAL EQUITY

During the 1st quarter, the **Lynx Global Biodiversity Fund** declined **-3.3%** on a gross basis compared to **-1.6%** for the MSCI World Index Total Return (in Cad\$). A mainly U.S. market selloff was driven by investor reaction to escalating U.S. tariff rhetoric and its potential economic implications, with smaller sized companies hit hardest. The Russell 2000 Total Return Index, a good proxy for small and mid-cap performance, declined **-9.4%** (in Cad\$). The Fund underperformed the larger cap MSCI index due to its roughly 30% exposure to smaller companies and it being underweight defensive sectors such as Consumer Staples and Utilities.

Our top contributors included water utility **Veolia** and waste management services provider **Republic Services**, two defensive holdings that we strategically increased at the end of 2024. Both have been executing well, demonstrating the durability of their businesses. **Corteva** also positively contributed supported by its diversified agricultural platform and defensive qualities tied to global food production. Our main detractors included **Tetra Tech**, as investors reacted negatively to its 10% revenue exposure to USAID contracts. We believe this reaction was overdone as these contracts represent low margin business and thus added to our position. Despite **Clean Harbors** performing well in its core environmental services segment, its shares sold off due to weaker results in its small more cyclical recycled oil business where aims to improve profitability. **Ceco Environmental** also detracted from our performance due to the broader risk-off sentiment towards small-cap companies. During the quarter, we added to several of our defensive holdings and exited our modest position in agricultural products supplier **FMC** following reduced visibility and concerns around its competitiveness and leverage. Overall, we expect the Fund's portfolio to exhibit resilience to any threat of tariffs or economic slowdown.

FIXED INCOME

The 1st quarter of 2025 was marked by extreme volatility across all asset classes, with the macroeconomic and geopolitical environment as the main causes. In particular, the announcement by the U.S. of major tariffs on all countries was the real trigger. This has focused investors' attention on the future global economic outlook and the risk premiums on various asset classes. As mentioned in our previous commentary, bond yields were particularly attractive, even considering that corporate credit spreads were tight, giving investors a refuge in the event of bad economic news, as was the case with the tariffs. We are pleased with the performance of the **LAM Canadian Fixed Income Fund**, which generated a positive gross return of **+2.1%**, while the FTSE Canada Universe Bond Index returned **+2.0%** and the Hybrid Canada Bond Index **+1.7%**. For the quarter, bond yields fell across virtually the entire maturity curve, while credit spreads widened. Our main contributors were, unsurprisingly, longer-maturity bonds such as **Government of Canada 2.75% 2033** and **Altagas 2.477% 2030**, whose prices appreciated. Some of our high dividend yielding holdings such as **Altagas** also rose, as did REITs like **Choice Properties** which continued to post solid financial results and demonstrate defensive qualities with a cheap valuation. Despite our strong performance year-to-date, the Fund still offers an attractive yield to maturity of around 5.3%, well above inflation and alternatives such as GICs, with a duration of only 4.3 years.

We remain positive on the fixed income market, given still elevated bond yields and recent widening of credit spreads. Also, the fact that Trump seems to soften his stance whenever U.S. treasury yields rise suggests that the downside is limited. This is because the cost of U.S. debt is a major expense in the U.S. budget. By the fall, we should see a clearer picture as mid-term elections take place in 2026. That said, markets will remain volatile, and security selection remains paramount, favoring companies that are immune to tariffs and a consumer slowdown, and have strong balance sheets. In Canada, the bond market generally follows the U.S., however any impact of tariffs on the Canadian economy will push the Bank of Canada to cut rates further to stimulate the economy, and the upcoming Canadian election results should reduce the level of uncertainty in Canada.

MACROECONOMIC OUTLOOK

The U.S. economy, which Trump inherited at the beginning of 2025, was the envy of the world. The inflation and unemployment rates were low and stable, growth was good, U.S. stocks had outpaced virtually every other market in the world for years, business and consumer optimism in the future was high. In just three months, Trump's policies and abusive rhetoric have shattered this optimistic state. Confidence has plunged in the face of sharply increased risk, uncertainty and chaos. Washington insiders agree that it is impossible to decipher what policies will be proposed or rescinded on any given day, much less what will be the prevailing longer-term outcome of negotiations and the trade wars. Nobody knows if Trump's tariffs are an end in themselves or just a negotiating sledgehammer to get profitable deals for the U.S. Either way, it's a very risky strategy.

This environment naturally makes rational investing in the short term impossible because the Trump Administration is not rational and does not have any understanding of the destructive impact of tariffs. Because the situation is so fluid, it is essential, to try to look through the chaos and volatility and focus on well tested principles of investing. The first and most important is to focus on value and the longer-term. Strong and profitable companies with well protected business models which are not highly correlated with the economy will continue to do well. Second and very important, all governments have important constraints. Citizens and companies detest inflation and uncertainty. They stop spending and take their anger out in the polling booths on politicians whom they see as responsible for their worsening financial position.

Trump's tariff policies are a throwback to medieval mercantilism, an economic ideology which is based on how strong your exports are relative to imports. This ideology has been refuted by virtually every serious economist for over two hundred years. Tariffs raise price levels but only cause continuing inflation if the central bank creates persistent monetary expansion to counter the negative effects. Over time, tariffs reduce the efficiency of the economy and deflate wealth and incomes, making the population poorer. That is being increasingly understood and the reason why there is growing opposition to the Trump tariffs. Unfortunately, Trump is relying mainly on advisors that have no serious economic understanding and tell him what he wants to hear. Free trade, which allows for global specialization, increases national wealth, raises national incomes, and lowers prices. Steep tariffs in today's highly complex supply chain world will reduce incomes and raise price levels. The result would be stagflation. Stock and bond markets have naturally reacted negatively to Trump's tariffs because they are bad policy and risk starting a major global trade war. Rising bond yields in the U.S. treasury market in particular are starting to force him to blink as the cost of servicing U.S. government debt soars.

All governments face major constraints at some point. Republicans must be aware of the two previous periods of major tariff hikes by Republicans— the McKinley tariff of 1890 and the Smoot - Hawley tariff of 1930. Both led to a Republican slaughter in subsequent elections. The important point for investors is that the current chaos is very fluid. It is unlikely that Trump and the Republicans are that self-destructive. Either Trump will buckle under the rapidly growing fear of major wealth and income destruction from his policies or the Republicans will face massive potential losses in the 2026 mid-term elections. It would not take much of a shift in voting to flip both the Senate and House to democratic majorities and make Trump a lame duck president for his last two years. It should also be kept in mind that the real target of Trumps tariffs is China. This is quite popular in the U.S., even though potentially dangerous. Canada and Mexico are likely to come out of this, facing tariff that are far less damaging than most people fear but there will likely be many scary headlines before the smoke clears.

The North American economy has begun to soften, though at this point an outright recession seems unlikely. Inflation expectations have stabilized in both the U.S. and Canada and the easy gains of the past two years are over for now. If the Trump administration perseveres on steep tariffs, there will likely be a one-time rise in the price of many goods and services in the U.S. but not a sustained rise in inflation. This is not a comfortable environment for central banks. There is no policy to deal with a weakening economy and higher prices occurring at the same time. As a result, both the U.S. Federal Reserve and Bank of Canada are likely to stand pat until the macro environment becomes clearer.

The recent sell off in equities has created some excellent opportunities but the extreme volatility makes it difficult for investors to react quickly. The bond market has been equally volatile and can suffer from liquidity issues. On the political front in Canada a change for the better in economic policy is coming, regardless of which party forms the next government after the poor economic performance of the past 15 years. The focus will have to shift towards growth, efficiency, productivity, and increased investment. Over time this will make Canada an increasingly attractive place to invest, particularly as valuations are much better than in most other developed countries and the currency is cheap.

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Firm updates: Please note we have updated our relationship disclosure information (RDI) document; the most recent version may be consulted on our website at <https://lesterasset.com/>

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