LESTER ASSET MANAGEMENT

RESPONSIBLE GROWTH

2nd QUARTER 2026 LETTER

July 27, 2026

During the 2nd quarter of 2026, Donald Trump's relentless disruptive actions continued to cause much volatility in capital markets. His ill-conceived war on Iran, which caused the closure of the Strait of Hormuz and has emboldened the Iranian regime, caused stock markets to plunge by about 10% in March. This prompted Trump to reverse course and announce on-again off-again ceasefires leading to extreme volatility in energy markets with crude oil prices swinging from the low US$70s to over US$110. This in turn has created much uncertainty regarding future inflationary expectations, causing 10-year U.S. Treasury bond yields to skyrocket from around 4% to over 4.6% wreaking havoc in the bond market. Meanwhile, momentum investing resumed in earnest as the S&P500 rebounded by over 20% from the March lows, causing sector concentration to reach its highest level on record with technology representing nearly 40%, the top 10 companies nearly 41%, and AI related exposure topping 50%. This level of concentration represents a huge risk, as the main indices are increasingly vulnerable to growing doubts about future returns on the massive capital investments being made in AI, cybersecurity concerns, declining pricing from increased competition, decelerating growth and high valuations.

CANADIAN EQUITY

For the 2nd quarter of 2026, the **LAM Canadian Equity Fund** rose by **+9.9%** on a gross basis versus a rise of +7% for the TSX Composite Total Return. Our outperformance versus the TSX was most evident in June when we were up by **+4.2%** versus +0.5% for the TSX due to our low exposure to mining and energy stocks which sold off sharply. After more than 12 months of torrid gains, the Gold sector plunged nearly -16% during the quarter, while the Energy sector was down over -5% as oil prices declined quickly on increased supply through the Straight of Hormuz and demand destruction in China. Year-to-date, we are up **+6.7%** versus +11.2% for the TSX.

Top contributors during the quarter included **Bank of Montreal**, **Royal Bank**, and **EQB** (which completed its acquisition of PC Bank from Loblaw), as well as property & casualty insurance provider **Definity Financial**, space technology leader **MDA Space**, telecom services provider **Quebecor**, vitamin manufacturer **Jamieson Wellness** (which is exploring a sale of the company), and **Apotex**, a generic drug maker that we added having recently completed a successful initial public offering. Detractors included engineering firm **WSP Global**, IT consultants **CGI Group**, utility poles and rail ties manufacturer **Stella Jones**, and pet supply retail franchisor **Pet Valu**. We believe that the AI trade that has negatively affected other sectors such as software and professional services is starting to lose some steam, and that these "beaten-up" sectors are starting to rally back on continued strong earnings growth and historically low valuations. We therefore continue to avoid stocks where prices have been driven up to unsustainable levels by momentum investing strategies and remain focused on high quality, profitable, and sustainable growing businesses trading at attractive levels.

U.S. EQUITY

During the 2nd quarter, our U.S. Equity strategy returned **+9.9%** on a gross basis versus +15.2% for the S&P 500 Total Return Index, bringing year-to-date performance to **+6.1%** versus +10.2% for the benchmark. The AI trade gained further momentum as several hyper-scalers again raised their capital expenditure guidance. Market concentration is without precedent: the top ten names now make up over 40% of the S&P 500, well beyond the dot-com peak near 27%. Given our disciplined style, we participate in rallies, but to a lesser extent than the market. The portfolio's AI exposed stocks outperformed, led by **Cisco** and **Alphabet**, which saw strong bookings and new orders driven by hyper-scaler spending. **Eli Lilly** was rewarded for posting exceptionally strong results, with upbeat commentary due to continued GLP-1 demand and its FDA approval of the oral version, Foundayo.

Our main detractors included **T-Mobile**, which posted strong results that eased competition concerns but was pressured as fund flows rotated into other sectors. **Zoetis** declined on weaker results tied to fewer veterinary visits and softer demand for premium products. **Graco** was held back by a soft housing-related market, though backlog rose 13% from the end of 2025 on strong order flow for later this year. Given heightened and prolonged geopolitical risk, we believe our strategy remains well positioned through its diversified and defensive profile.

GLOBAL EQUITY

The Lynx Global Biodiversity Fund returned **+3.3%** on a gross basis in the 2nd quarter versus +15.8% for the MSCI World Index Total Return (CAD$). Year-to-date, the Fund returned **+1.9%** versus +13.8% for the index. While we finished the quarter on strong footing by outperforming the index by over 4% in June, the quarter's shortfall reflects heavy sector concentration and momentum investing in AI-related stocks and banks, not broad-based fundamentals. We are underweight technology and financials, which together generated 73% of the quarter's return for the index. Additionally, the drawn-out war in Iran weighed on many portfolio holdings, despite most of our businesses posting record results.

Top contributors included **Schneider Electric**, helped by the AI-driven capex rally. **DSM-Firmenich** saw improved fundamentals, supported by the sale of its Animal Nutrition & Health business and an aggressive share buyback. **Trex** rose nearly 40% as new management and brand-awareness efforts, combined with an active share buyback, set a valuation floor for the stock going forward. Detractors were concentrated in software and engineering, two sectors that have unfairly been attacked by short sellers on the unsubstantiated threat of AI disruption. **Trimble** and **Bentley** posted strong financial results, but valuations were pressured as investors continued to rotate into hardware/AI-driven stocks. Several engineering firms saw the same phenomenon; while their underlying businesses continue to grow with record backlogs, valuations continue to compress. The Fund owns companies exposed to long-term structural drivers including growing demand for water and waste treatment, remediation, green infrastructure, responsible power generation, electrification, and energy transition, and nature-based solutions. The portfolio offers compelling upside potential, underpinned by attractive valuations and growing high margin businesses with strong future fundamentals.

FIXED INCOME

The 2nd quarter was positive for most asset classes, following a rather volatile start to the year with the outbreak of war in Iran. However, during the quarter, investors began to focus beyond the war and an eventual agreement, which of course has yet to be finalized. Capital markets were again driven by sectors related to AI, including massive debt issuance by technology-related companies. During the quarter, we witnessed a rare divergence between U.S. and Canadian bond yields. In the U.S., sustained economic growth, driven largely by massive investment in data center infrastructure and persistent inflation fears from higher oil prices, drove up yields across the curve, while in Canada bond yields declined amid an economic slowdown and stable inflation.

Our **LAM Canadian Fixed Income Fund** had a very strong quarter, with a gross return of **+2.3%** compared to +2% for the FTSE Canada Universe Bond Index. Year-to-date, we have generated a positive gross return of **+3.1%** compared to +2.2% for the bond index. Our main contributors included high-yield bonds, notably **GoEasy 6% 2030**, a Canadian lender specializing in consumer loans, whose bonds appreciated over 8% as the market was reassured by an access-to-financing plan unveiled by management, as anticipated in our Q1 letter. Also, **Laurentian Bank 7.403% 2081/2031** bonds, which were scheduled for early redemption in June 2026, were extended with a “reset” interest rate that is 2% higher than before, which caused a strong appreciation in the price of these bonds. The Fund continues to offer an attractive current yield of nearly 4.7%, well above inflation, with a duration of approximately 3.5 years, which is relatively short and designed to avoid any negative impact from inflationary surprises or rising bond yields.

MACROECONOMIC OUTLOOK

Despite all the noise, the overall macro environment remains relatively benign and supportive of financial markets. In the U.S., some economic slowdown is likely from the recent hot pace, reducing the risk of over heating and more rate hikes. “Pipeline inflation” from the Iran war-related rise in energy prices will abate when the war finally ends, although the timing in uncertain. General inflation will likely soften and Fed policy should shift to a more accommodative stance. Longer term, pre-COVID deflationary pressures will resume as unit labour cost increases are running close to zero, which will take headline inflation numbers down significantly.

The U.S. equity market has started going through a rotational correction, partially removing some of the extreme overvaluation in the hottest sectors. The powerful productivity enhancing impact of AI should continue to support strong profit growth and lower inflation. Canada will see a continued modest economic pick-up from the “near recession” of late 2025/early 2026. Inflation should ease as energy cost increases pass through the system. Housing prices in the most expensive areas around Toronto and Vancouver have weakened significantly and may spread to other areas. Therefore, general inflation should soften enough to allow the Bank of Canada (BoC) to shift towards an easier policy helping interest rates to remain stable or go down, barring a sustained spike in energy prices due to an extended closure of the Straight of Hormuz.

Midway through 2026, Canada's economy is showing signs of improvement after a weaker-than-expected start to the year. On July 15, the BoC held its policy rate at 2.25% for a sixth consecutive decision, noting that growth resumed in the second quarter at an estimated 2.5% annualized pace and that the sources of expansion are broadening. Following the first quarter in which GDP was essentially flat versus a year earlier, the BoC’s new Monetary Policy Report projects modest growth of 0.7% for 2026, probably too pessimistic, Growth should accelerate to 1.8% in both 2027 and 2028. Business investment is picking up, boosted in the near term by the resource sector, particularly the oil and gas industry, while government spending on defense and infrastructure continues to support demand. Labour markets remain soft, with unemployment at 6.5%, and housing affordability and trade uncertainty remain the principal domestic constraints.

On trade, the July 1 CUSMA review deadline passed without an agreement to extend the pact. The agreement remains fully in force until 2036, and tariffs were unchanged until Trump threatened to increase them by 50%. CUSMA is now subject to annual reviews, institutionalizing the uncertainty that has weighed on trade-exposed investments. Roughly 90% of Canadian exports to the U.S. have remained duty-free under CUSMA, while non-compliant goods face a 10% tariff, and President Trump's musings that the U.S. would be "better off" without the agreement ensure that renegotiation risk remains a persistent overhang. Still, businesses are finding ways to navigate the uncertainty, and exporters continue to diversify to non-U.S. markets.

The war with Iran remains the dominant wildcard. A fragile ceasefire had allowed oil prices to return to pre-war levels by early July, but renewed U.S. strikes, Iranian attacks on shipping in the Strait of Hormuz and Houthi threats on Red Sea navigation then sent Brent back up to mid 1990s levels. This is still below this spring’s level and recent highs of over US$100, but recently oil has sold off yet again, a volatile reminder of how quickly things can change. The inflationary consequences are visible: Canadian headline CPI rose to 3.2% in May, the fastest pace since late 2023, driven by a 35% surge in gasoline prices. Encouragingly, inflation excluding gasoline was just 2.2% and the BoC's core measures held near 2%, indicating that the energy shock has not yet broadened into generalized inflation. In fact, inflation and inflation expectations remain well anchored and are likely to decline in the future under deflationary pressure stemming from productivity effects of the massive AI build out and downward pressure on wage rates.

The BoC has made clear it will look through the initial price shock but stands ready to act if inflation spreads beyond the gas pumps. A prolonged hold therefore remains the most likely path, with the next decision on September 2. The contrast with the U.S. is striking. Its economy is growing at about 2.5%, powered by strong consumption and booming AI investment, but inflation is running above 4%. Under new Chair Kevin Warsh, the Fed has held its funds rate at 3.5% to 3.75% while turning decidedly hawkish, raising its 2026 inflation forecast to 3.6% from 2.7%. Markets assign roughly one-in-four odds of a rate hike at the July 28-29 meeting, and futures point to policy rates approaching 4% by year-end, despite soft June payrolls of 57,000 jobs. Canadian policy rates thus sit well below U.S. rates. For the Canadian dollar, these crosscurrents largely offset. The Loonie touched a 15-month low of 1.425 per U.S. dollar in late June before rebounding to around 1.40, helped by strong domestic employment data and the BoC's steady hand. Oil strength provides some support, but U.S. rate differentials and bouts of risk aversion limit the upside. We expect the currency to remain range-bound between roughly 1.39 and 1.42 until there is greater clarity on trade and the war.

Fiscal policy remains a counterweight to private-sector caution. Ottawa's deficits have become large but Canada's debt-to-GDP ratio remains among the lowest in the western world, leaving room for continued robust spending on defense, infrastructure and tariff support. In the U.S., large deficits, inflation fears and uncertainty over Fed policy and de-dollarization pressures continue to keep long-term Treasury yields elevated. The Canadian financial system remains resilient, with OSFI maintaining its focus on real estate lending, non-bank financial institutions, private credit, and liquidity risk as geopolitical shocks persist. Canada's outlook remains one of slow growth with high variance, but momentum is finally turning. Energy volatility creates inflation noise and trade frictions restrain investment, yet the 2nd quarter rebound suggests the economy is working its way through this period of global upheaval. As oil prices normalize, disinflation should resume, allowing the BoC to eventually ease further, while healthy corporate profits continue to support a resilient economy and capital markets. The Canadian equity market has risen sharply, correcting some of the extreme undervaluation of past years. However, opportunities exist in the broader market and in overlooked sectors that remain undervalued.

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