QUARTERLY INVESTMENT REVIEW

Q2 and July 2023 Edition

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Summary

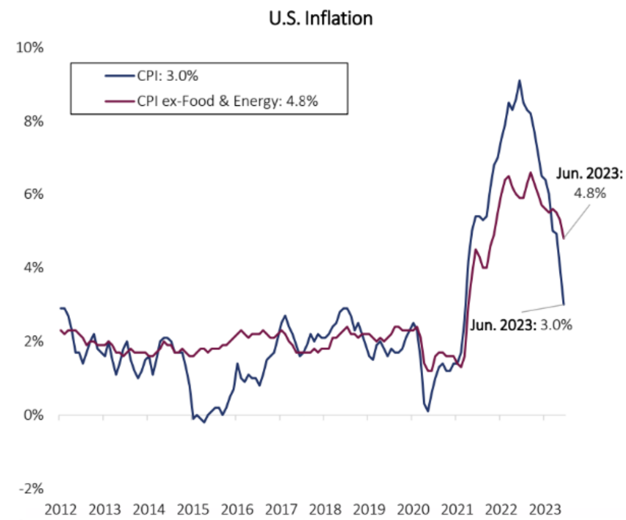
- Equity markets performed strongly in Q2, led by US large Cap (8.7%), which was driven by IT (excitement around AI), Communication Services and Consumer Discretionary
- Q2 performance was more broad-based, particularly near quarter-end with all equity markets, except for Canadian small cap in positive territory.
    - The debt ceiling was raised in the US in early June after an agreement was reached between the White House and Congress, which helped equity returns
- Bonds were down slightly (-0.7% in Canada and -0.8% in US) in the quarter as yields rose across the curve due to more hawkish tone from central banks. Canadian and US bonds were both still up approximately 2% YTD.
- Corporate bonds outperformed governments, as credit spreads tightened in investment grade and high yield corporate bonds, reflecting risk-on sentiment among investors.
- Sticky core inflation numbers, particularly in services, wages and shelter led the Bank of Canada (BOC) to resume its rate hike cycle, raising rates by 0.25% in each of June and July. In US, Federal Reserve raised rates in May to 5.0%-5.25% and then after pausing raised rates again in late July to 5.25%-5.50%.

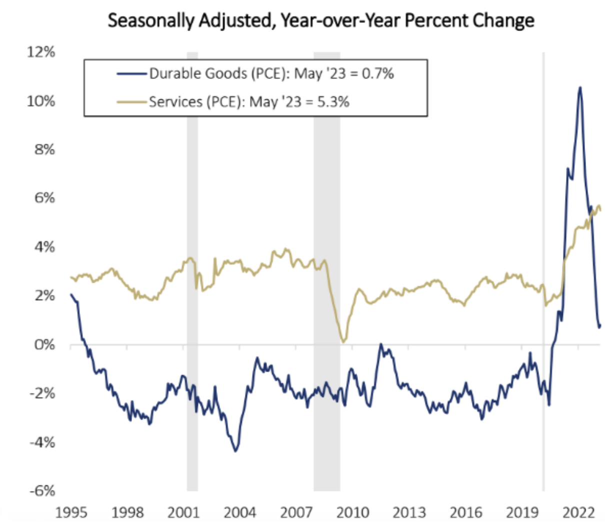
Inflation Update and Outlook

Inflation Trends:

Both headline and core inflation continued to decline in Q2. Central banks remain concerned though as:

- Cooling inflation rates had benefited from the base line affect (comparing cost for a basket of goods 12 months prior) as inflation had peaked in June 2022 (see chart below).
- Portion of the decrease was due Energy prices dropping by nearly 20% over that period but have recently started to rise.
- While goods inflation has stabilized at a low level, inflation in services (a much larger part of the economy) remains sticky with wages continuing to rise by over 4%; shelter and food costs continue to increase (2nd chart below).

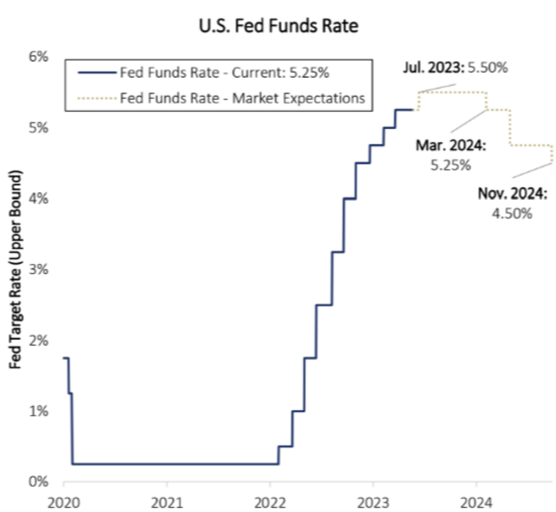


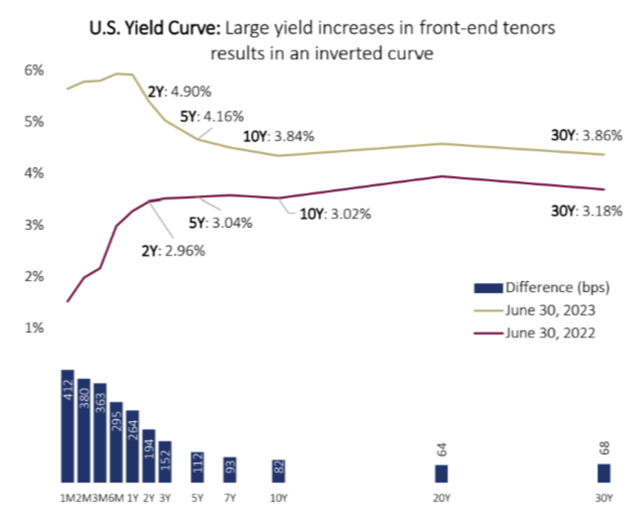


Source: Bloomberg Finance L.P., as of June 30, 2023.

Central bank policy and the yield curve's response

Yields on bonds rose during the quarter. In the U.S., the yields on 10-Year Government bonds increased from 3.5% to 3.8%. Similarly, in Canada, yields on 10-Year Government of Canada bonds rose from 2.9% to 3.3% over the period. These increases were largely due to rate increases by the Bank of Canada in June and July and expectations that the Federal Reserve would raise rates in July (which it did). CI GAM expects that rates likely have or are very near their peak. While central banks are now expected to keep rates 'higher for longer' to bring inflation back to their 2% target, markets still anticipate rate cuts in 2024, either due to recession or inflation being under control.

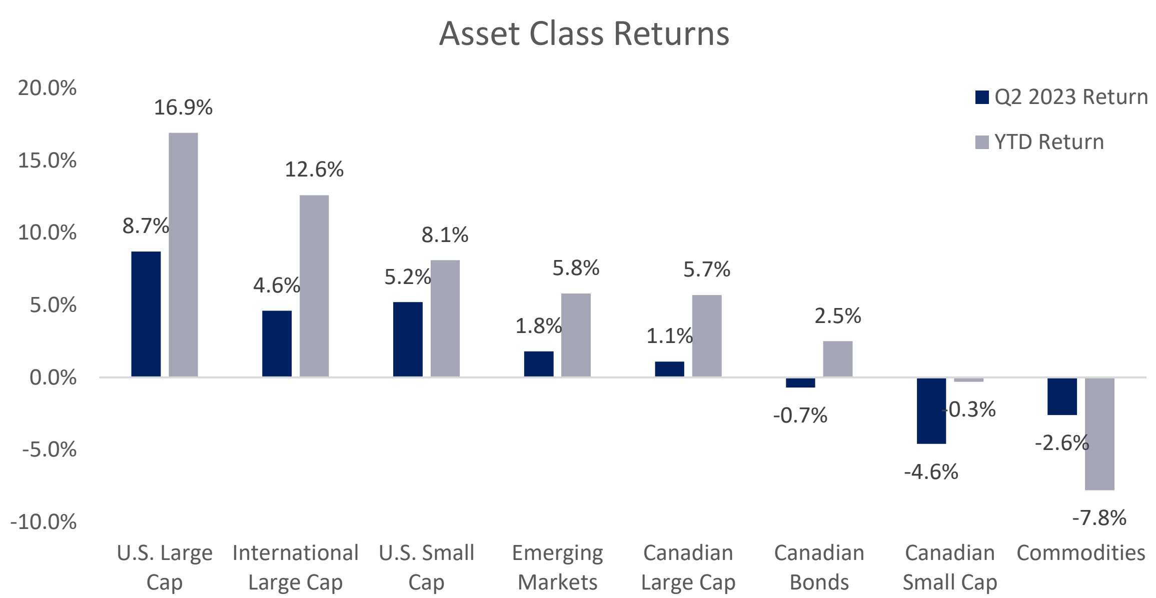




Source: Bloomberg Finance L.P., as of July 4, 2023.

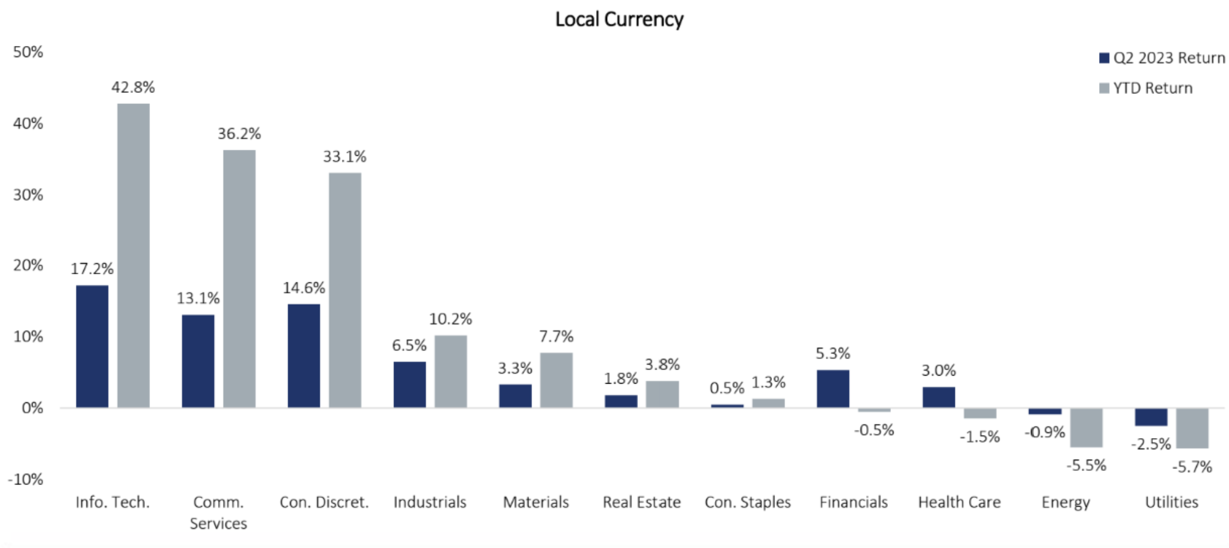
Asset Class Returns

- US Large-Cap stocks showcased robust performance, partly due to an agreement being reached on the Debt Ceiling, corporate earnings beating expectations and excitement around Artificial intelligence, particularly around NVDA's strong earnings and forecast.
- International equity markets all had positive performance in the quarter. Equity returns were more broad based than Q1 in the US, with US Small cap returning 5.2% in the quarter.
- Commodities continued to face challenges after strong performance in 2022 due substantial price declines in energy as well as industrial and precious metals due to the slower than expected economic recovery in China and fears of a global slowdown.
- Sectors underperforming in Q2 and YTD included financials, real estate, utilities and consumer staples. Higher borrowing costs impacted financials, real estate and utilities due to their higher debt loads. Consumer staples were impacted by slow growth and elevated costs due to inflation.



Source: Morningstar Research Inc., as of June 30, 2023. Asset class returns are based on the following: U.S. Large Cap: S&P 500 TR USD, High Yield: ICE BofA U.S. High Yield TR USD, U.S. Small Cap: Russell 2000 TR USD, Canadian Bonds: FTSE Canada Universe Bond, U.S. Bonds: BBgBarc US Agg Bond TR USD, Intl Large Cap: MSCI EAFE GR LCL, Canadian Large Cap: S&P/TSX Composite TR, EM Equity: MSCI EM GR LCL, Canadian Small Cap: S&P/TSX Small Cap TR, Commodities: Bloomberg Commodity TR USD, Global Large Cap: MSCI World GR LCL, Real Estate: FTSE EPRA Nareit Developed TR USD

S&P 500 Sector Returns



Source: Morningstar Research Inc., as of June 30, 2023.

Equities and Fixed Income Overview

Canadian Equities: Canadian large-cap equities had positive returns in line with developed markets. Canadian small-cap equities had negative returns due to the large exposure in the asset class to resource sectors. Among TSX sectors, 7 out of 11 had positive performance, with Information Technology and Consumer Discretionary leading. Real Estate performed poorly.

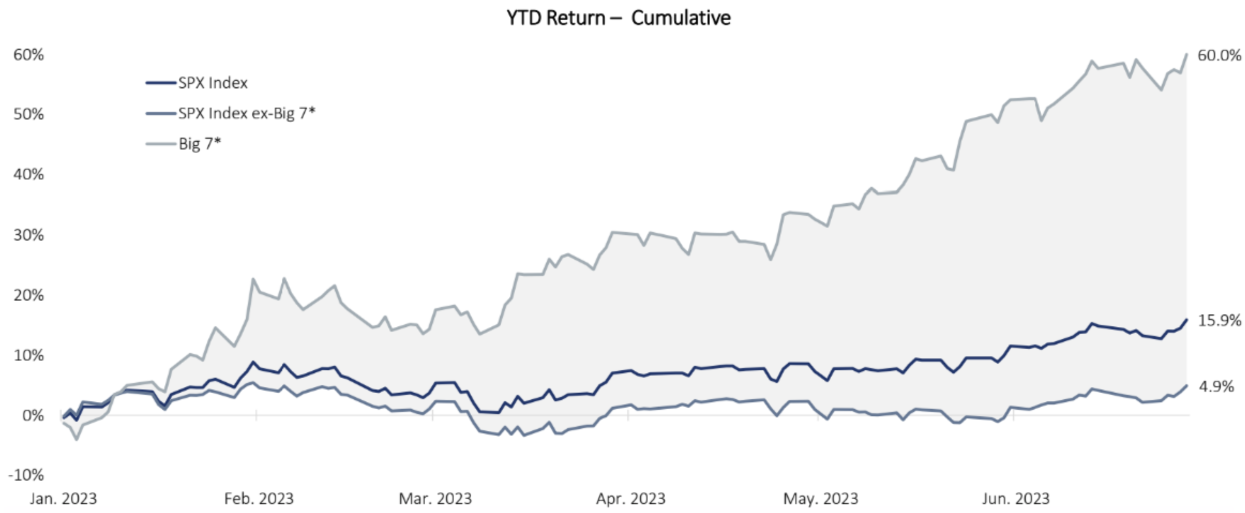
U.S. Equities: The S&P 500 rose 8.7% in Q2, extending Q1's positive trend. 9 of 11 sectors in the index had positive returns, led by Information Technology, Consumer Discretionary, and Communication Services. Energy and Utilities sectors saw negative returns.

International Equities: International large-cap equities and Emerging Markets continued their positive momentum from Q1. Japan, France, and Germany had positive returns, particularly Japan with an 18.5% gain. The U.K. remained stable, while China had a negative return.

Fixed Income: Fixed income had a negative Q2. Canadian Fixed Income declined 0.7%, and U.S. Fixed Income lost 0.8% in local currency. Corporate bonds outperformed. High-yield gained 1.6% in Q2 and 5.4% YTD in local currency. Yields on 10-Year U.S. Government bonds and 10-Year Government of Canada bonds increased during the quarter.

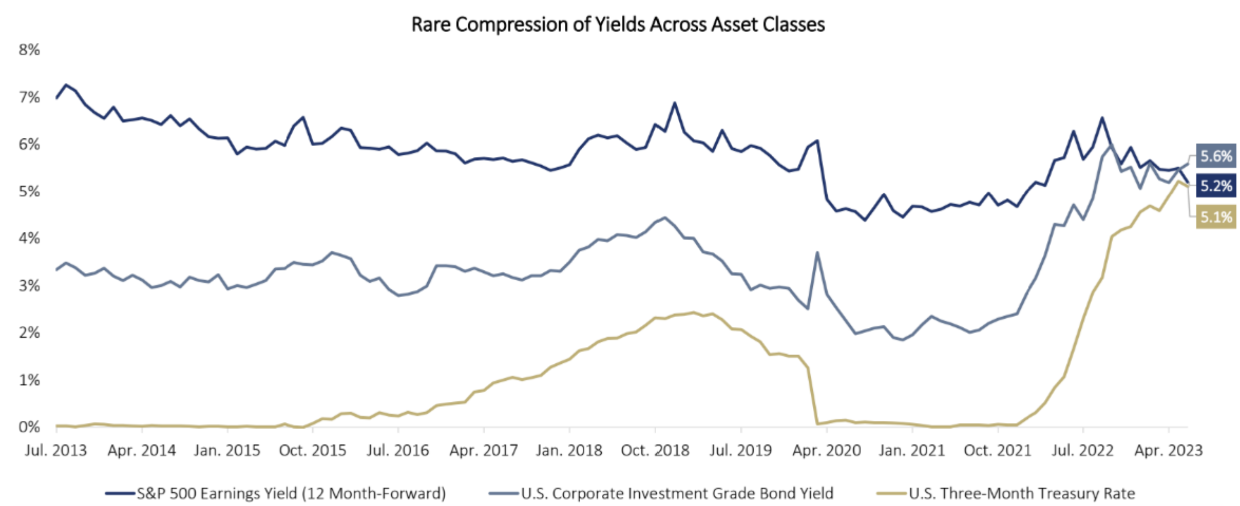
Markets are top heavy – S&P 500 performance dominated by tech mega-caps

- In Q2 2023, the S&P 500's performance was heavily skewed by the influence of the top 7 tech mega-cap companies, indicating a top-heavy market structure.
- Excluding these tech giants, the broader S&P 500's returns were up only 5%, emphasizing their outsized impact.



Source: Bloomberg Finance L.P., as of June 30, 2023. *Big 7 include: Apple, Microsoft, Amazon, Meta, Alphabet (Class A & C), Nvidia, and Tesla

Due to US equity outperformance and higher bond yields from interest rate increases, the equity risk premium has declined, making holding fixed income relatively more attractive with yields on US corporate bonds, 3-month treasuries and the S&P500 (earnings yield which is the inverse of the P/E ratio) all above 5%. Other global assets or investment vehicles are now offering competitive yields, steering towards a diversified global investment approach.



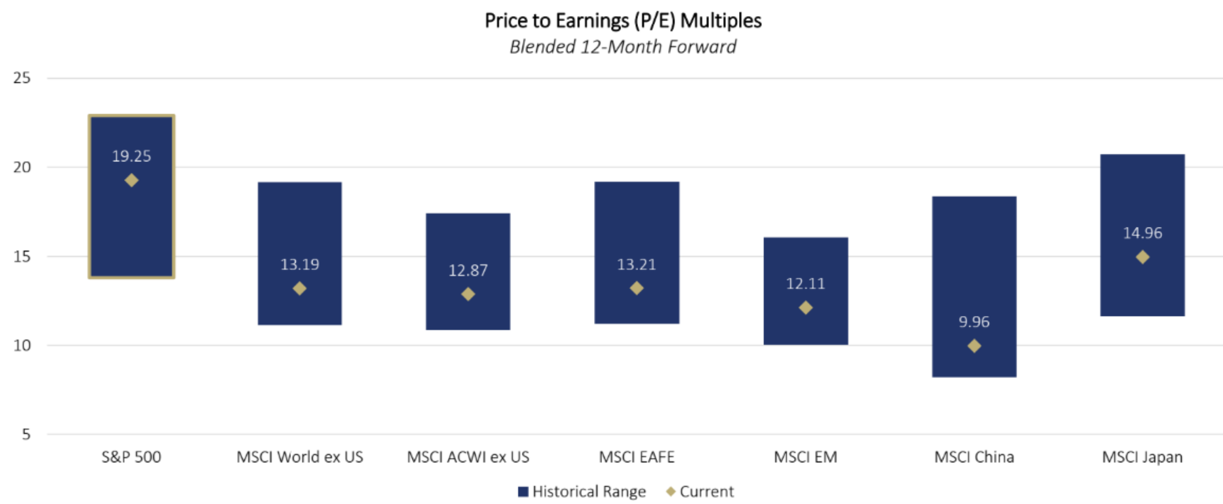
Source: Bloomberg Finance L.P., as of June 30, 2023.

<u>More attractive valuations exist outside of the U.S., notably Emerging Markets</u>

Other global assets or investment vehicles are now offering competitive yields, steering towards a diversified global investment approach.

- Emerging Markets (EM) are offering notably attractive valuations compared to other global indices at only 12.1 times forward earnings estimates.

- Other than the US, which is trading at an above average earnings multiple, largely due to the strength of the 'Magnificent Seven' and excitement related to AI, other markets offer more attractive valuations, highlight that compelling investment opportunities exist outside of the U.S.



Source: Bloomberg Finance L.P., as of June 30, 2023. Price to Earnings Ratios are Blended 12-Month Forward. Historical range is measured using weekly Price to Earnings ratios, from January 2020 – June 2023.

Tactical Research Recommendations

Macro (Lead: Alfred Lam)

Macro/Cross Asset	High conviction u/w	Low conviction u/w	Neutral	Low conviction o/w	High conviction o/w
Equity			✓		
Fixed Income		✓			
Alternatives			✓		
Cash				✓	

Equity (Lead: Stephen Lingard)

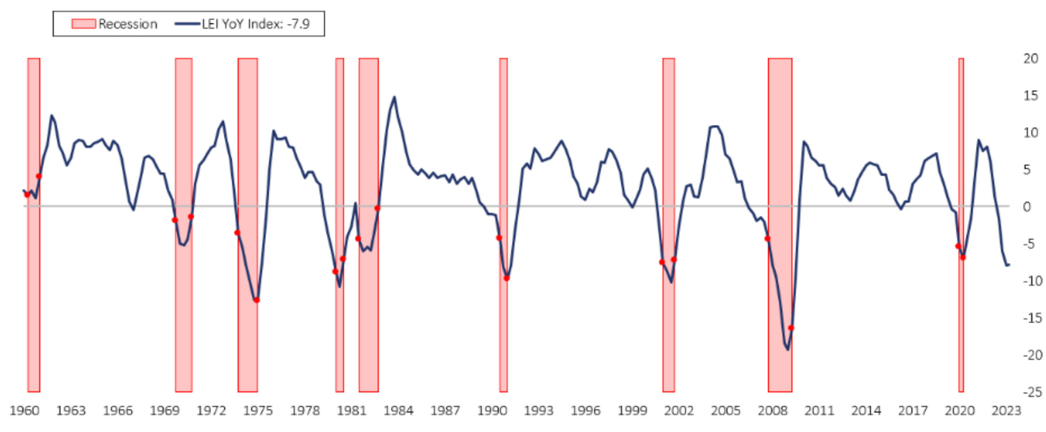
Equity	High convictio n u/w	Low convictio n u/w	Neutral	Low convictio n o/w	High convictio n o/w
Canada			✓		
United States		✓			
EAFE			✓		
Emerging Markets				✓	
Value <---> Growth		✓			
Small <---> Large			✓		
Cyclicals <---> Defensives			✓		

- The tactical research team has made some minor changes to their allocations. Equity has moved from slightly underweight to neutral. Fixed income has moved to a slight underweight as the capital gains expectations on bonds is likely delayed due interest rates staying higher for longer. Cash has also moved down a bit but remains overweight given high current yields.
- Equity allocation remains similar to last quarter with EM overweight, Canada and EAFE at neutral and US at underweight. Stylistically the only change is to underweight value vs. growth, while Small to Large Cap and Cyclical to Defensive remain neutral.

Potential Market and Economic Disconnect

Equity markets positive albeit moderating rally in Q2 was indicative of the continued bullish sentiment that began in late 2022. Resilient corporate earnings and low unemployment have been supportive of the market rally, however, there are also signs that central banker's rapid rate increases are having an impact on economic conditions. Several key economic measures, such as the ISM survey, Leading Economic indicators and an inverted yield curve point to a slowing and perhaps recessionary environment ahead.

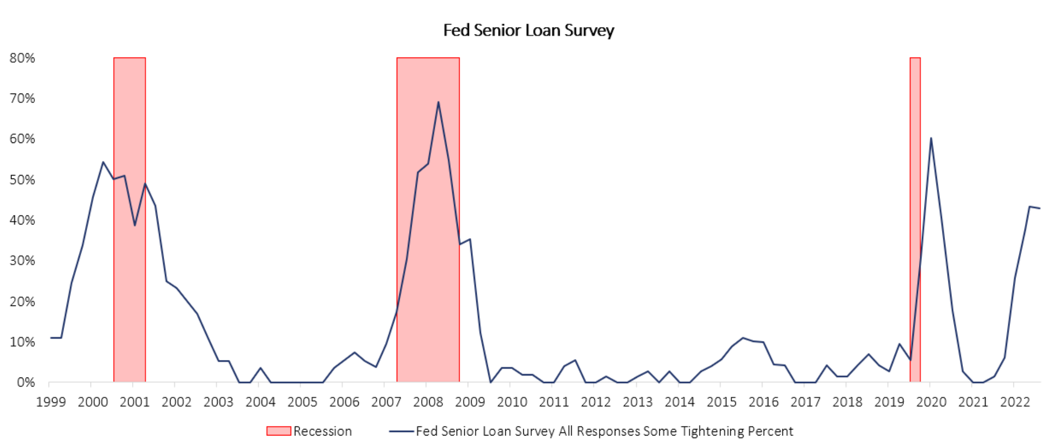
U.S. leading indicators negative YoY



Bloomberg Finance L.P., NBER, as of July 4, 2023. "LEI YoY Index" represents the Conference Board US Leading Index (Ten Economic Indicators YoY).

As higher interest rates aimed at stemming inflation slow economic growth, institutional lenders have become more cautious. Not only is the cost to service debt much higher now, but the chart below shows that lending institutions are also tightening their credit standards to levels similar to previous recessionary periods.

Tighter Lending Standards in the U.S.



Source: Bloomberg Finance L.P., as of June 30, 2023.

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