

IA Clarington Canadian Small Cap Fund

Manager commentary – Q3 2024

The IA Clarington Canadian Small Cap Fund Series A returned 7.0% relative to 8.4% for the S&P/TSX SmallCap Index over the past quarter. On a one-year basis, the return was 23.5% for the Fund compared to 25.1% for the benchmark.

Despite the mid-summer volatility and concerns about weakening economic conditions, the market continued climbing during the last six-month period, supported by easing financial conditions.

The Bank of Canada (BoC) continued its trajectory of interest-rate easing with three quarter-point interest-rate cuts so far, and other central banks have since followed, including the U.S. Federal Reserve. With the BoC target rate still at 4.25%, there is ample monetary stimulus remaining to counteract weakening macroeconomic conditions, provided inflation remains in check.

Concerns about a weaker economy contributed to lower crude oil prices, but this has partly reversed with the escalating conflict in the Middle East.

The Fund's stock selection within the financials and consumer discretionary sectors contributed to performance in the six-month period, as did its underweight allocation to the energy sector. Individual contributors included Canadian Western Bank, which benefited from an acquisition offer by National Bank of Canada at a premium of 110% from pre-announcement levels. iA Financial Corp. Inc. benefited from higher equity markets, which supported its wealth management and insurance businesses, progress on cost-cutting efforts and strong balance sheet. E-L Financial Corp. Ltd. also benefited from higher equity markets that supported its corporate book of public investments, and the stock was inexpensive on a valuation basis.

The Fund's allocation to and stock selection within the materials and industrials sectors detracted from performance, as did stock selection within the health care sector. Individual detractors included Parkland Corp., which had an unplanned first-quarter shutdown of a refinery that led to a loss in the segment and lower guidance for 2024 expectations. Calian Group Ltd. faced challenges from cuts to the Canadian armed forces budget, which was expected to weigh on the company's organic growth over the next few quarters. TELUS International (CDA) Inc. faced some macroeconomic challenges from cost-cutting efforts by customers and uncertainty about the impact of artificial intelligence developments on its core digital customer service offering. It has also faced company-specific issues like aggressive capital allocation and delayed responses to competitive pressures, resulting in a change of senior management and a reset in expectations.

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New positions included TELUS International, as the franchise has improved over time by diversifying its customer mix and diversifying its service lines away from legacy call centre operations. While it has faced some challenges, it generates ample free cash flow, which should be directed to improving its balance sheet, and it appears well positioned to benefit from a turn in the economic cycle.

Increased positions included Sleep Country Canada Holdings Inc., which the Fund purchased in the first quarter before Fairfax Financial Holdings Ltd. announced its plan to acquire Sleep Country at a 28% premium to the pre-announcement price. Pet Valu Holdings Ltd. was increased as its risk/reward profile improved. The company is currently making supply-chain investments that should improve its distribution capabilities and competitive advantage.

Decreased positions included Canadian Western Bank. Its trading discount to implied acquisition price has continued to narrow as regulatory approval risk has repriced lower.

Near term, the U.S. elections loom, as does the spectre of increasing geopolitical tension. Economically, consumers and corporations may start to feel the benefits of lower interest rates and improved financial flexibility, although the possibility of rising oil prices may introduce pressure from a cost perspective.

The fund manager remains focused on diversity in the Fund's economic exposures and the capabilities of company management teams. Regardless of election outcomes and other unknowns, the fund manager anticipates continued recurring usage of basic essentials like insurance, food and beverages, internet and utility services, and the Fund holds positions in these industries. Additionally, the Fund has exposure to attractive secular growth businesses, such as those in e-commerce and healthcare. Importantly, the apparent lack of interest in smaller-cap stocks, evidenced by below-average valuations in the market segment, reflects both a heightened margin of safety from the unexpected and a favourable risk/reward ratio.

The Fund maintains exposure to resilient, growing and reasonably priced businesses. Additionally, about 85% of its holdings provide income through a 2.5% dividend yield, which is likely to demonstrate growth or be returned via share buybacks owing to the robust cash generation of many holdings.

Fund and benchmark performance as at September 30, 2024	1-year	3-year	5-year	10-year
IA Clarington Canadian Small Cap Fund - Series A	23.5%	8.5%	10.4%	6.0%
S&P/TSX SmallCap Index	25.1%	4.9%	10.1%	5.0%

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For definitions of technical terms in this piece, please visit iaclarington.com/glossary and speak with your investment advisor.

The performance data comparison presented is intended to illustrate the Fund's historical performance as compared with historical performance of widely quoted market indices. There are various important differences that may exist between the Fund and the stated indices that may affect the performance of each. The S&P/TSX SmallCap Index provides an investable index for the Canadian small cap market. It includes common stock and is calculated in real-time. To be eligible for inclusion in the index, the float-adjusted market capitalization and the total company market capitalization of a security must represent a minimum weight of 0.005% and maximum weight of 0.08% of the float and total market capitalization of the S&P/TSX Composite at the stock level on the reference date, based on the volume weighted average price (VWAP) of the security on the TSX over the last 10 trading days prior to the reference date. For the Fund's investment purposes, companies with a market capitalization of less than C\$ 3 billion are considered to be smaller capitalization companies. The Fund's sector and geographic exposure may differ from that of the benchmark. The Fund's currency risk exposure may be different than that of the benchmark. The Fund may hold cash while the benchmark does not. It is not possible to invest directly in market indices. The performance comparison is for illustrative purposes only and does not imply future performance.

Indicated mutual fund rates of return include changes in share or unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Returns are historical annual compounded total returns.

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