IA Clarington Canadian Small Cap Fund

Manager commentary – Q2 2024

Over the past quarter, IA Clarington Canadian Small Cap Fund Series A returned 1.4%, relative to 0.8% for the S&P/TSX SmallCap Index. On a one-year basis, the return was 12.8% for the Fund, compared to 14.4% for the benchmark.

The Canadian economy and consumers remain pressured, as observed by a continued uptick in the unemployment rate and indicators that financial strain for consumer credit card and auto loans now surpass pre-pandemic levels. This is balanced by inflation that remains below the high end of the 1-3% target range, and by some relief from a quarter-point interest-rate cut by the Bank of Canada in June. The Canadian small-cap benchmark had marginally positive returns over the quarter. Underlying participation was mixed across sectors, with energy and materials rallying higher alongside prices for natural gas, precious metals and base metals. Most other sectors failed to advance, with industrials, real estate and health care leading the declines. The Fund's more defensive positioning contributed to outperformance within the industrials and real estate sector.

The Fund's top-contributing investments in the quarter were Canadian Western Bank, Cargojet Inc. and Stella-Jones Inc. The largest detractors from performance were National Research Corp., Pet Valu Holdings Ltd., and Parkland Corp. Canadian Western Bank benefitted from an acquisition offer by National Bank of Canada at a premium of 110% from pre-announcement levels. The offer validates our investment thesis that the bank has been underearning relative to its potential and was significantly undervalued. The offer is subject to regulatory approval and is not expected to close until the end of 2025. In the meantime, we continue to hold the stock as there is a wide (but narrowing) spread between the current price and the stipulated acquisition price.

The Fund continued to build its position in Sleep Country Canada Holdings Inc. after introducing it last quarter. The company continues to adapt well in a tough macroeconomic environment where some consumers are deferring larger-ticket items like mattresses. Management has reacted to this by stepping up sales and marketing efforts aimed at taking market share within a weaker environment while preserving its gross margin profile. Longer term, Sleep Country is well positioned to extend its competitive advantage from the investments it continues to make, and should benefit from a rebound in consumer spending when it materializes.

We also added to our position in Definity Financial Corp., which has navigated a tough environment in the auto insurance cycle and an outlier year in catastrophe losses, while still maintaining roughly 9% operating return on equity for the year and an under-levered balance sheet relative to peers. Prospectively, we believe that risk-adjusted returns could be attractive as the auto insurance cycle turns, other parts of the business such as commercial insurance continue to experience strong share gains, and as capital is deployed towards accretive opportunities.

Year-to-date, the S&P 500 continues to be supported by strong momentum (roughly 30%) in seven stocks, while the remaining 493 companies have posted more normal returns closer to 4%. Prospectively, this may be encouraging if our thesis that future returns are best when capital is scarce (or when no one is looking) holds true over time. There may be fewer eyes on the small-cap market today, with higher interest rates and inflation-pressured consumers representing real challenges for some domestically oriented smaller-cap stocks. In addition, the higher cost of capital can weigh on smaller companies' cashflows and growth aspirations. However, these generalizations create ripe conditions for a reasonable opportunity set of select businesses within the small-cap space. We continue to allocate capital to sound opportunities with enduring franchises that are likely mispriced from a longer-term perspective.

Geopolitical concerns, inflation, elections and emerging markets are all uncontrollable external factors to stay abreast of, but focusing on controlling portfolio composition, asset quality and risk parameters may be more constructive. Year-to-date, the Fund has actively widened its foundational quality advantage (as measured by 4-year return on equity) and incrementally lowered valuation risk relative to the average Canadian small-cap company. Equally important, our Fund companies continue to thoughtfully deploy capital in a risk-managed fashion that makes sense irrespective of gyrations in market sentiment or how many interest-rate cuts occur over the balance of the year. Several of our top holdings have resourcefully diversified their businesses, augmented growth or opportunistically bought back their own stock. We expect to reap the benefits of these actions over the medium and long term.

Fund and benchmark performance as at June 30, 2024	1-year	3-year	5-year	10-year
IA Clarington Canadian Small Cap Fund - Series A	12.8%	6.6%	8.8%	5.1%
S&P/TSX SmallCap Index	14.4%	1.3%	8.1%	3.1%

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.

A mutual fund's "yield" refers to income generated by securities held in the fund's portfolio and does not represent the return of or level of income paid out by the fund.

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