IA Clarington Inhance Balanced SRI Portfolio

Manager commentary – Q2 2024

IA Clarington Inhance Balanced SRI Portfolio generated muted results over the second quarter as the underlying components saw a mix of positive and negative absolute returns. When compared to their respective benchmarks, both IA Clarington Inhance Bond SRI Fund and IA Clarington Inhance Monthly Income SRI Fund recorded an outperformance, while the remaining trailed their benchmarks. The funds' structural tilt towards the U.S. market within equities was beneficial to relative performance.

The Canadian fixed-income market produced positive returns over the period, driven by the Bank of Canada (BoC) lowering its policy rate for the first time in four years. Bond performance in other major markets were mixed as the European Central Bank and its counterparts in Switzerland and Sweden also cut rates, while the U.S. Federal Reserve and the Bank of England remained on hold.

On June 5, the BoC reduced its policy rate by 25 basis points (bps), from 5.00% to 4.75%. With tepid economic growth and domestic inflation narrowing within the BoC's target range of 1% to 3%, officials determined that monetary policy no longer needed to be as restrictive. Officials also suggested that it is reasonable to expect further policy easing if inflation continues to moderate.

The Canadian economy improved modestly during the quarter but remains operating below potential, especially in the context of strong population growth. Labour market data continues to show businesses are still hiring, although employment has been growing at a slower pace than the working-age population, which has led to a gradual rise in the unemployment rate.

Government of Canada bond yields were mixed on the yield curve, with declines observed in shorter-dated maturities and increases for longer-dated terms. The Canada 2-year yield led the way by declining 18 bps, while the 30-year yield saw an increase of 4 bps. The benchmark Canada 5-year yield started the quarter at 3.53% and traded to a high of 3.91% and a low of 3.28%, before closing the quarter nearly unchanged at 3.51%.

The FTSE Canada Universe Bond Index posted a positive return of 0.86% during the second quarter. All sectors within short- and mid-term maturities posted gains, while returns among longer-dated bonds were mixed, with both federal and high-quality corporate bonds posting negative returns. Overall, corporate bonds continued to outperform government bonds on a total-return basis, despite credit spreads moving marginally wider owing to a large amount of supply.

In the second quarter of 2024, preferred shares held in IA Clarington Inhance Bond SRI Fund (the "Bond Fund") were the largest contributor to relative outperformance against its benchmark, led by the Bond Fund's institutional holdings, which benefitted from renewed interest after several Canadian banks issued capital securities (corporate issues that offer investors a combination of the features of corporate bonds and preferred shares) in the U.S. market at much lower spreads, highlighting the attractiveness of similar existing securities in the domestic market. Positioning within short- and mid-term corporate bonds, as well as long-dated provincial bonds, also contributed positively to performance. The Bond Fund was quite active over the past three months, adding new issues from Glacier Trust and Videotron in the primary market, and strategically extending duration as yields moved higher. We also opportunistically rotated into a Province of Manitoba 2046 bond in a relative value trade versus Ontario. As well, we disposed of an existing First Nation Financing Authority bond holding amid ESG concerns regarding recently announced plans to finance a large fossil-fuel-based project.

The quarter ended with the Bond Fund maintaining its relative overweight position in mid-term bonds and a slight underweight position in both short- and longer-dated bonds. We continue to maintain a strategic position in preferred shares and an overweight position in shorter-dated corporate bonds (although this was reduced during the quarter with spreads narrowing), which still offer attractive yield relative to government bonds. The Bond Fund ended the period with a total positive impact bond weight of 24.8%.

After a strong first quarter, the equity markets trended downwards in the first half of April, before rebounding. Despite a shaky start, global equities, as measured by the MSCI World Index (CAD), ended the period with a return of 3.78%. Gains were fueled by optimism surrounding potential interest-rate cuts and excitement about artificial intelligence (AI). Seven of the 11 sectors were higher, with information technology and communication services continuing their impressive year-to-date performance as companies that are exposed to AI, such as NVIDIA Corp., Apple Inc., Microsoft Corp., Broadcom Inc. and Alphabet Inc., outperformed the broader market. The energy required for AI tasks is expected to increase substantially over the next several years, with one study stating that it is already accelerating at an annual growth rate of 26-36%, putting even more pressure on already-stressed electrical grids. This has led to increased investor interest in the utilities sector, which has outperformed the broader index over the past few months.

IA Clarington Inhance Global Equity SRI Class/Fund's (the "Global Equity Fund") lack of exposure to index heavyweight NVIDIA detracted from relative benchmark performance. Although NVIDIA is seeing unprecedented growth given its leadership in AI, we don't own the stock because the semiconductor industry is still considered as high risk owing to its cyclical nature and ties to the capital expenditure cycle and consumer spending. There are also other uncertainties, including the long-term demand for the company's processors and whether it could lap its elevated comps and sustain its triple-digit growth. At Vancity Investment Management Ltd (VCIM), our preference is to invest in businesses with a consistent track record of strong revenue and earnings growth, and stable balance sheets to weather downturns. Other laggards within the information technology sector included CDW Corp., which detracted alongside the information technology services subsector amid continued headwinds related to technology spending, and salesforce.com inc., which declined after releasing disappointing revenue and guidance. Elsewhere, LVMH Moet Hennessy Louis Vuitton SE. and CarMax Inc. within the consumer discretionary sector, as well as Adyen NV in the financials sector, also weighed on relative performance. Conversely, the impact of sector allocation was overall positive, driven by the Global Equity Fund's overweight allocation to the information technology sector and zero-weight in materials and energy stocks. Individually, Alphabet Inc., Costco Wholesale Corp., Novo Nordisk A/S., Waste Connections Inc. and Trane Technologies PLC were the top contributors.

IA Clarington Inhance Global Small Cap SRI Fund's (the "Small Cap Fund") performance over the quarter detracted relative to its benchmark, driven mainly by security selection, with sector allocation having a negligible impact in aggregate. Security selection was weakest in the health care, consumer discretionary and industrials sectors, particularly from holdings that had outsized reactions to earnings reports and/or guidance cuts. The sole bright spot was sector exposure to information technology, with the Small Cap Fund benefiting from an overweight allocation as well as solid security selection. On an individual basis, Five Below Inc., Stevanato Group SpA. and Carl Zeiss Meditec AG. were the largest detractors at approximately 100 bps each. All three names saw significant drawdowns in the quarter, particularly after guidance cuts that accompanied first-quarter results. There was a similar theme with Alfen NV, First Watch Restaurant Group Inc., SiteOne Landscape Supply Inc., Darling Ingredients Inc. and Lincoln Electric Holdings Inc. (each detracting 50 bps or more). The Small Cap Fund's largest positive contributors were from the information technology sector, with Nova Ltd and Guidewire Software Inc. contributing roughly 70 bps and 60 bps, respectively. Other larger positive contributors, at about 50 bps each, were Halma PLC., Softcat PLC., Globant SA and Diploma PLC.

In Canada, the S&P/TSX Composite Index declined -0.53% on a total-return basis in a quarter which saw the BoC reduce interest rates by 25 bps. Other than the materials (+7.4%), consumer staples (+4.1%), energy (+0.9%) and utilities (+0.2%) sectors, it was a challenging period for equities despite strong first-quarter earnings for many quality businesses.

IA Clarington Inhance Canadian Equity SRI Class (the "Canadian Equity Fund") was challenged during the quarter owing to the outperformance of commodities, energy, utilities and grocery stores. However, following the BoC's June rate hike decision, the Canadian Equity Fund delivered significant outperformance into quarter-end despite further energy sector gains. Individually, several high-conviction holdings delivered impressive results and no holdings experienced greater than 20% drawdowns. Cargojet Inc. gained +25% during the quarter after it signed a three-year agreement with a Chinese company to provide scheduled charter flights between Vancouver and China. Given there is minimal capital required to service this agreement, investors expect strong incremental free-cash-flow generation. Dollarama Inc. reported strong first-quarter earnings in June and continues to prove it can pass on inflation while growing its sales. The shares gained +21% during the quarter.

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IA Clarington Inhance Monthly Income SRI Fund's (the "Monthly Income Fund") overall allocation to fixed income (bonds and preferred shares) averaged 24.96% during the period, maintaining the strategic underweight relative to the benchmark. The underweight allocation to fixed income and overweight allocation to equities detracted from the Monthly Income Fund's overall performance, as equities lagged fixed income.

The equity component outperformed the S&P/TSX Composite Index as a result of the positive contribution from strong security selection more than offsetting negative contribution from weak sector allocation, aided by a positive effect from currency. Security selection was strongest in the health care and information technology sectors. In terms of individual holdings, owning Broadcom Inc., Element Fleet Management Corp., Canadian National Railway Co. and Texas Instruments Inc., as well as not owning Canadian Pacific Kansas City Ltd. and Shopify Inc., contributed the most to our relative outperformance during the quarter. Meanwhile, the Monthly Income Fund's fixed-income allocation remains tilted towards high-quality corporate bonds with terms of less than five years. As a result, the duration of the Monthly Income Fund's fixed-income allocation is significantly shorter than the FTSE Canada Universe Bond Index's duration, while yield curve exposure is all in the short end, which was positive for relative performance in the second quarter given the outperformance of shorter-maturity bonds on the curve. The Monthly Income Fund's preferred shares averaged a 5.6% weight over the quarter and outperformed bonds, which also contributed to performance. Ongoing redemptions in the rate-reset preferred share market continued to fuel expectations of further redemptions, putting a strong bid on existing issues.

In terms of shareholder engagement in the second quarter:

- The second quarter saw the continuation of VCIM's climate and governance engagements with the Canadian banks:

  - We attended the annual general meetings (AGM) of The Toronto-Dominion Bank (TD), Canadian Imperial Bank of Commerce (CIBC), Bank of Montreal (BMO) and Royal Bank of Canada (RBC) to present our shareholder proposals on disclosing CEO to median worker pay ratio. At TD, 12.6% voted in favour of our proposal, at RBC 11.41% of shares were cast in our favour, at CIBC we received 10.5% and at BMO that figure was 10.86%.

  - On climate, we reached withdrawal agreements with both The Bank of Nova Scotia and RBC. As such, we only presented a shareholder proposal at the TD AGM. We were pleased with the results as almost one-third (28.6%) of shares were cast in favour of this proposal.

- Additionally, VCIM presented shareholder proposals at the Canadian National Railway Co. (CN) and Canadian Pacific Kansas City Ltd. (CPKC) AGMs. The proposals respectively pushed for work with unions to negotiate paid sick leave policies. At CPKC we received 13.37% in favour, and 9.92% at CN. Both proposals passed the threshold to refile.

- An engagement with Nutrien Ltd., was initiated on biodiversity and nature as a part of the Nature Action 100 (NA100) campaign. We are working with multiple other investors to push the company to improve on biodiversity disclosure and practices.

- VCIM signed a statement on plastic pollution to demonstrate support from the financials sector for an ambitious international legally binding instrument to end plastic pollution and to set out what a robust agreement would include from the perspective of the financials sector.

- We continued our work on the Carbon Disclosure Project (CDP) non-disclosure campaign with letters to Savaria Corp., SiteOne Landscape Supply Inc. and Exchange Income Corp.

- Russel Metals Inc. reached out to VCIM to discuss their most recent say on pay vote and how to improve executive compensation practices.

- A letter was sent to Sleep Country Canada Holdings Inc. on human rights due diligence on its supply chains and how those can be maintained or improved.

- A call was held with Five Below Inc. to discuss the importance of living wages. The call was meant to ascertain the quality of their wage policy, if the policy is applicable to all employees, and if they have done cost-of-living analysis.

- As a part of Climate Action 100+ (CA100+) we continued our engagement with Trane Technologies PLC. The company continues to excel in climate work and prepping for the energy transition.

- A letter was sent to Amazon.com Inc. in support of the GMB Union in Coventry, UK.

- A meeting was held with Lululemon Athletica Inc. as a part of the Valuing Water Finance Initiative along with multiple other investors. The company took a keen interest in the work as it fits well with other environmental initiatives they have under taken.

- An inaugural Nature Action 100 meeting was held with Costco Wholesale Corp. The meeting was to introduce them to the initiative and familiarize them with the recently published benchmark.

We continue to remain aware of the ever-changing macroeconomic environment, as interest rates, inflation and other macro data points, such as housing sales and employment levels, remain in focus.

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We expect investors to stay focused on companies with business models that can withstand the fluid economic environment. Companies with high barriers to entry that provide mission-critical services and/or products should continue to be of interest to investors in a market where earnings growth is expected to remain muted and consumer spending starts to abate.

As always, we will remain true to our process of investing in ESG-focused companies with sustainable and growing competitive advantages. We are also turning over as many rocks as possible looking for new additions to our portfolios by focusing on industries that are being neglected by investors owing to short-term concerns or issues.

Fund and benchmark performance as at June 30, 2024	1 year	3 year	5 year	10 years
IA Clarington Inhance Balanced SRI Portfolio – Series A	7.1%	-0.5%	3.7%	3.9%
25% MSCI World Index (CAD)[1], 30% S&P/TSX Composite Index, 45% FTSE Canada Universe Bond Index	11.2%	3.6%	6.1%	6.0%

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

[1]Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI.

The Fund's strategy is to invest in other investment funds. 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 benchmark is a blend of 45% FTSE Canada Universe Bond Index, 30% S&P/TSX Composite Index and 25% MSCI World Index (CAD). The blended benchmark presented is intended to provide a more realistic representation of the general asset classes in which the Fund invests. The FTSE Canada Universe Bond Index is comprised of Canadian investment grade bonds and has significantly different portfolio duration characteristics. The FTSE Canada Universe Bond Index consists of a broadly diversified selection of investment-grade Government of Canada, provincial, corporate and municipal bonds issued domestically in Canada. The S&P/TSX Composite Index is the premier indicator of market activity for Canadian equity markets, with 95% coverage of Canadian-based, TSX-listed companies. The index includes common stock and income trust units and is designed to offer the representation of a broad benchmark index while maintaining the liquidity characteristics of narrower indices. The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index consists of 23 developed market country indices. The Fund has exposure to securities of companies which meet the fund manager's socially responsible investment principles, while the holdings in the benchmark may not align with these principles. The Fund’s market capitalization, geographic, sector exposure and credit quality 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. Overall, the Fund's bond and equity exposure can differ, because the Fund does not use a fixed ratio similar to the benchmark. 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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