

IA Clarington U.S. Equity Class

Manager commentary – Q3 2024

During the third quarter of 2024, IA Clarington U.S. Equity Class Series A returned 5.4% in Canadian dollars (CAD) versus 4.5% for the S&P 500 TR Index (CAD).

In the second quarter, benchmark returns were driven by a small number of mega-cap stocks that were related to artificial intelligence (AI) and had high price-to-earnings ratios in the narrowest market rally since 1974. Seven mega cap companies drove the entire return of the S&P 500 Index during the second quarter, while the remaining holdings cumulatively detracted 1%.

U.S. stocks rallied into the third quarter on continued hopes that U.S. Federal Reserve interest-rate cuts would engineer an economic “soft landing” following the S&P 500’s mid-summer decline. Meanwhile, 10-year U.S. government bond yields compressed in anticipation of multiple interest-rate cuts alongside falling inflation and weakening jobs data.

Market returns broadened in the third quarter as small-cap stocks, value stocks and sectors like utilities, industrials and financials led index performance.

The Fund’s stock selection in the industrials and financials sector contributed to performance over the six-month period. Individual contributors included 3M Co., as its second-quarter results led to a near-historical one-day positive re-rating in valuation. This was driven by impressive operating income and candid commentary from the recently appointed CEO highlighting the company’s priorities for improving growth prospects. Unilever PLC delivered strong earnings results, showing notable improvements in underlying sales growth and profitability. Lower commodity prices and carryover pricing supported significant operating margin growth. Oracle Corp.’s share price gains were driven by strong operating and financial results, as well as an improved growth outlook.

The Fund’s stock selection in the consumer staples, consumer discretionary and communication services sectors were the largest detractors from performance in the period. The Fund’s underweight allocation to the information technology sector also detracted. Individual detractors included PACCAR Financial Ltd. as management further lowered its outlook for Class 8 truck industry retail unit sales in Canada and the U.S., leading to share price weakness. Shares of The Walt Disney Company traded lower, primarily owing to a weaker near-term outlook within its key theme parks business, as consumer fatigue was expected to affect attendance over the next few quarters. Merck & Co. Inc. released second-quarter results that included weaker-than-expected Gardasil vaccine sales performance in China, leading to some negative reactions from investors.

IA Clarington U.S. Equity Class

New positions included Solventum Corp., as the company has exhibited stable profit margins and benefits from a strong competitive position in diverse, non-cyclical end markets, which has allowed it to generate consistent results over the last two decades.

Increased positions included Darden Restaurants Inc. Although the operating backdrop has remained difficult for the restaurant industry, the operator of Olive Garden and Longhorn Steakhouse continued posting relatively strong results with solid expense discipline in the face of a challenging same-store sales environment. The Fund's exposures to both Unilever and PepsiCo Inc. were increased on positive outlooks for underlying sales growth, driven by both volume and modest pricing gains.

Decreased positions included Bank of America Corp., JPMorgan Chase & Co. and Wells Fargo & Co., which were trimmed following strong gains over the past several quarters. Micron Technology Inc. was meaningfully reduced as AI-driven sentiment pushed valuations to cycle highs. Oracle was trimmed as its valuation reached new highs on an improved growth outlook. Lennox International Inc. and 3M were trimmed following strong share price gains.

The fund manager believes U.S. equities remain priced for a soft economic landing and a reacceleration of corporate profits despite signs of economic pressure. Against this backdrop, the best risk-adjusted opportunities for investors appear to be in high-quality businesses that demonstrate earnings stability and growth but trade at more reasonable valuations than market averages, as well as in businesses where low expectations embedded in current valuations could lead to attractive outcomes in an environment where expectations normalize.

The Fund continues to trade at a wide discount to the S&P 500, despite higher returns on invested capital, a superior balance sheet, a higher dividend yield and similar growth prospects over the coming year. The fund manager thinks this combination provides a meaningfully differentiated value proposition for clients to the broader stock market.

Fund and benchmark performance as at September 30, 2024	1-year	3-year	5-year	10-year
IA Clarington U.S. Equity Class - Series A	23.6%	14.0%	13.2%	8.4%
S&P 500 Index (CAD)	36.2%	14.3%	16.4%	15.5%

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

IA Clarington U.S. Equity Class

The performance data comparison presented is intended to illustrate the Fund's historical performance 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 500 Index (CAD) includes 500 leading companies in leading industries of the U.S. economy and is widely regarded as the best single gauge of the U.S. equity market. The Fund's market capitalization and sector exposure may differ from that of the benchmark. The Fund's currency risk exposure may differ from 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. Effective May 30 2019, the sub-advisor of the Fund was changed from Sarbit Advisory Services Inc. to QV Investors Inc., and the Fund's investment strategies changed.

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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