

IA Clarington Inhance Global Small Cap SRI Fund

Manager commentary – Q2 2024

Global small-cap equities, as measured by the MSCI World Small Cap Index (CAD), returned -1.7% in the quarter. Equity markets trended downwards in the first half of April on rising inflationary concerns in the U.S., before rebounding in the second half of the month. While markets were supported by a moderated inflationary environment, growth from artificial intelligence infrastructure build and a positive economic outlook, investors had been looking for some clarity on the timing and size of potential central bank interest rate reductions to push markets higher. This became clearer in June as rate cuts from central banks in Canada and Europe added weight to views of an “easing cycle” kicking off. While 2024 started with broad equity market strength, small caps lagged global large caps considerably in the second quarter and, overall, have had a very disappointing first half of 2024 relative to the performance of global large caps (particularly from mega-cap companies). Despite a favourable backdrop, small-cap performance was hindered by the narrow breadth of the equity rally, higher sensitivity to interest rates and macroeconomic sentiment, along with relatively weaker sale/earnings revisions.

IA Clarington Inhance Global Small Cap SRI Fund’s (the “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 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 basis points (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 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.

Over the quarter we initiated new positions in Topicus.com Inc. and AddTech AB. We exited our position in BlackLine Inc.

- Topicus (TOI) is a near replica of parent company Constellation Software Inc. (CSU), but at a smaller size and with a focus on European vertical market software (VMS) businesses (tailored software aimed to address the needs of any given business within a specific industry or market). The company acquires VMS businesses, invests organically to grow its cash flows, and then redeploys the internally generated cash in new VMS acquisitions. Similar to CSU, TOI’s businesses are often leaders in niche markets and provide mission-critical services to their customers across diverse end markets. Additionally, Europe is more fragmented than the North American market, which should allow TOI to find more opportunities at attractive deal terms. Topicus offers a unique opportunity to participate in a proven, high-growth business model with

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a much better risk/reward profile than what is on offer within most of the small-/mid-cap software universe.

- AddTech is a Swedish industrial serial acquirer composed of more than 150 subsidiaries that primarily serve the manufacturing and infrastructure sectors. The company buys high-quality, typically founder-run, small-sized industrial businesses with the intention of becoming a “forever home” (unlike private equity). AddTech has established a high-performance, decentralized operating environment (a decentralized operating environment is a system in which the control and decision-making authority is spread across multiple interconnected entities) where its subsidiaries are able to pursue profitable growth opportunities with the support of a large company. A commitment to a decentralized operating model, coupled with the prioritization of profitable and sustainable growth, has driven AddTech’s exceptional return profile to date (roughly 24% per annum since its listing in 2001). Going forward, we expect the company to keep doing what it has been doing for decades: stay decentralized, acquire great companies at attractive valuations, identify and excel in attractive niche markets with secular growth, and remain focused on improving profitability.
- BlackLine Inc. is a software company focused on accounting and finance departments of large and mid-size companies. While we continue to believe software providers are generally strong business models, value creation depends a lot on growth, an area where BlackLine is having challenges. While the company has a large potential total addressable market, there are questions on what penetration is achievable given that customer growth has slowed meaningfully and net retention has declined. Accounting software, while critical, has a limited scope within an enterprise, especially point solutions that BlackLine sells. In addition, small-mid cap software companies face a slower spending environment in general.

In terms of shareholder engagement in the second quarter:

- 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.
- A letter was sent to SiteOne Landscape Supply Inc. as a part of the Carbon Disclosure Project (CDP) non-disclosure campaign. The letter encouraged the company to disclose climate metrics in line with CDP.
- Vancity Investment Management Ltd (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.

Sentiment for small-cap stocks is low and has further deteriorated, widening the already-sizable relative valuation gap versus large caps. Small caps have historically outperformed large-cap peers following periods of relative underperformance, particularly when sentiment shifts to a broader “risk-on” appetite and after interest rates begin to decline. This remains a key question for investors. Although a monetary policy easing cycle has started in many regions, we expect markets will remain sensitive to shifts in the

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expected timing, frequency and size of future interest rate cuts (particularly from the U.S. Federal Reserve, which has delayed the start of its easing cycle further back than the market had expected at the beginning of 2024).

Overall, small caps continue to trade at attractive absolute and relative valuation levels, and this bodes well for a potential surge in relative performance of small caps versus large caps. However, this will depend a lot on broad investor positioning/fund flows, along with shifts in macroeconomic sentiment. As always, we don't pretend to be able to accurately predict when or if these inflections take place. We continue to focus on finding quality small caps with conservative balance sheets, pricing power, predictable revenue growth and durable competitive advantages, which give them the ability to weather any short-term economic uncertainties and compound investor capital at high rates of return over the longer term.

Fund and benchmark performance as at June 30, 2024	1 year	Since inception (Feb 2023)
IA Clarington Inhance Global Small Cap SRI Fund - Series A	1.4%	-2.1%
MSCI World Small Cap Index (CAD) ¹	13.4%	6.9%

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

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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 Fund's benchmark, The MSCI World Small Cap Index (CAD) captures small cap representation across 23 Developed Markets (DM) countries. With 4,139 constituents, the index covers approximately 14% of the free float-adjusted market capitalization in each country. The Fund holds 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 and sector 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

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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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