

Q4 2022 Cidel Global Equity Strategy Commentary

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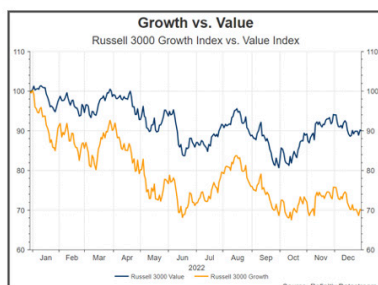
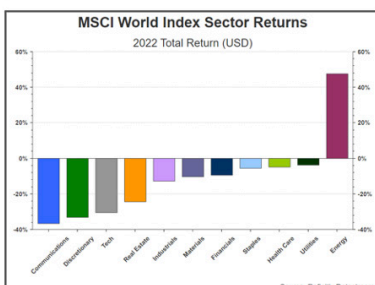
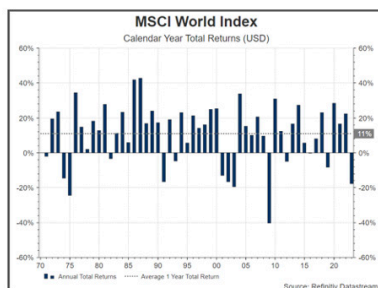
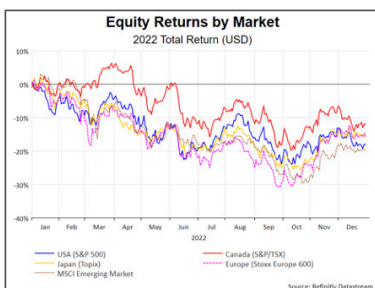
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After three years of abnormally strong returns, 2022 generated the worst stock market performance since the Global Financial Crisis of 2008. The MSCI World Index fell by 17.8% in U.S. dollars (or by 11.8% in Canadian dollar terms). Canada outperformed developed market peers, as that index disproportionately benefited from strong energy prices and a resilient gold price. For the first time in several years U.S. equities did not materially outperform Japanese and European stocks, owing in large measure to a long overdue correction in technology and other growth stocks, which can be found in greater abundance in the U.S.. Value stocks outperformed Growth stocks for the second year in a row. Amongst the MSCI World Index sectors only Energy was positive for year. Following Energy three of the most defensive – by which we mean profitability has less economic sensitivity – sectors were the best performing: Utilities, Consumer Staples and Health Care.

Financial Stocks (UOB and Chubb) and to a lesser degree from Health Care and Technology stocks (AstraZeneca and Analog Devices).

The Cidel Global Equity Strategy made five new investments during the quarter:

- We have started building a position in Hong Kong based pan-Asian insurer AIA Group Limited. Penetration of insurance savings and especially medical policies is low in Asia (more specifically Mainland China) compared to developed markets, and AIA is poised to benefit over the long term from this growth potential. Sales in the last couple of years have been negatively impacted by the pandemic lockdowns in Mainland China and Hong Kong, but as these economies re-open we expect AIA's sales to rebound. As a further result of the lock downs, the shares have traded down to sideways for the last few years and we believe they are now undervalued. The company manages its balance sheet conservatively and we expect earnings and dividends to grow significantly over the next decade.
- We have started building a position in American industrial gas firm Air Products and Chemicals Inc. The industrial gas business is attractive as though it is capital intensive, it is dominated by three large players (Linde and Air Liquide are the other key firms), and on-site customers typically sign 15 -20 year contracts. Air Products is one of a handful of global firms that are well positioned to benefit from the rising use of hydrogen as an energy source. The Biden administration's recent passage of the Inflation Protection Act provides multiyear regulatory clarity and incentives to support growing hydrogen infrastructure. We believe the market under-estimates Air Product's medium to long term earnings potential, and that the shares are correspondingly undervalued.



The relative outperformance of the Cidel Global Equity strategy in 2022 mostly derived from security selection, which is gratifying as stock picking is our core technique to generate superior returns. In particular our outperformance stemmed from stock picking in Consumer Discretionary stocks (principally Dollar General and Mahindra & Mahindra),

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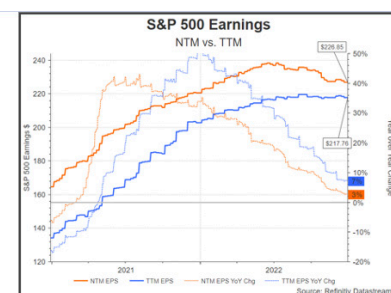
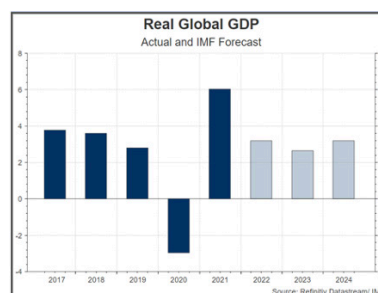
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- We have built a position in U.S. consumer goods company Church & Dwight Co Inc.. Church & Dwight's product categories include laundry detergent, cat litter, condoms, vitamins and water picks. Its best know brand in Arm & Hammer. Church & Dwight gets about 40% of its revenues from value priced products, an unusually large proportion for a branded consumer goods company. We believe this value-oriented mix is well positioned to gain share in the current climate of weak growth. Church and Dwight is a much more U.S. centric firm than many globally oriented peers, generating 80% of its revenues in its home market. The company has a good track record of growing cash flow, dividends and earnings per share.
- We have re-initiated a position in U.S. animal health care firm Zoetis Inc., a stock we have held in the past. Zoetis shares are emblematic of the many growth stocks that have been severely punished in 2022. As the company benefited from the boom in demand for household pets during the Covid 19 pandemic, its valuation went from an already lofty level of 35 times forward earnings to a peak of over 45 times forward earnings at the time of the U.S. market peak in December 2021. But after a share price correction of nearly 40% they are back to a more appropriate valuation of roughly 28x forward earnings (and thus at a roughly 20% discount to their pre-pandemic valuation).
- Finally we have started building a position in U.S. software firm Salesforce Inc. Salesforce is the third high revenue growth Tech stock we have picked up this year - the other two being PayPal Holdings Inc. and MercadoLibre Inc. - as Tech stocks have started to give back some of the excess gains they had acquired since the first quarter of 2020. Salesforce has been steadily gaining share from SAP and Oracle in its core sales and customer relationship management software offerings, and we believe these gains will continue. Historically the company's margins have been barely half that of large software peers. However we believe that management's recent strategic shift to start looking at costs seriously (hopefully including their frankly egregious stock option expense that can often

run in excess of 10% of revenues) will usher in a new era of more disciplined financial management which should benefit long suffering shareholders.

We financed these purchases by selling our positions in Salmar ASA, Vina Concha y Toro , Taiwan Semiconductor Manufacturing Co Ltd, The Walt Disney Company and The Procter & Gamble Company.

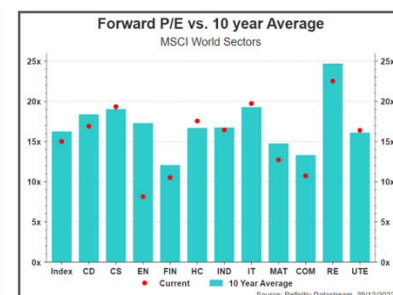
There is no great mystery as to why Equities performed poorly in 2022. The usual suspects - valuation, liquidity, growth - were responsible for 2022's weakness. We began 2022 with elevated valuations in the U.S. equities, and particularly in U.S. growth stocks. Elevated valuations are always vulnerable to higher interest rates, and as both long term and short term interest rates rose, equity valuations compressed. By summer the post-pandemic bounce in consumer spending started to wane, the slowdown in Europe brought about by the consequences of the Russian invasion of Ukraine, and the ongoing lockdown in China all conspired to sharply reduce GDP growth expectations. Lower economic growth means lower corporate earnings growth, and after peaking in early July forward earnings estimates for stocks started to roll over.



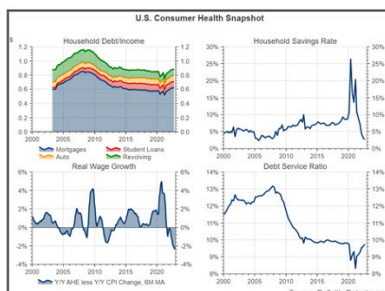
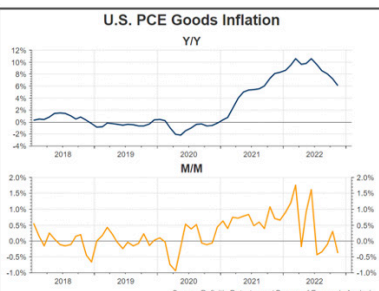
The outlook for Global Equities in 2023 will depend largely on the U.S. Federal Reserve, and more specifically how it interprets inflation data. Most inflation measures peaked on a month over month basis (which better captures the rate of change than the year over year basis) over the summer, and have actually pulled back significantly in the November and December data releases.

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U.S. Goods inflation has actually been negative month over month in four of the last five months, and we expect this to continue into 2022 due to elevated inventory levels across a host of product categories. However wage inflation has not yet fallen, and central bankers across much of the world will worry that high wages will re-enforce high inflation expectations. Further hikes in interest rates to slow the consumer demand, and thus labour demand, and in turn wage and inflation expectations is a likely outcome. In addition to slowing the economy through interest rate hikes, the Federal Reserve is also draining liquidity from the financial system by not rolling over its maturing bond portfolio; The San Francisco Fed published a paper in December suggesting that this “Quantitative Tightening” in effect equated to a further 2% of interest rate increases. The impact of tighter liquidity has already been seen in U.S. Consumer spending, which has decelerated rapidly throughout the course of 2022.



While the business cycle has its inevitable ebbs and flows, our philosophy remains unchanged: We seek to maximize our odds of making money for clients by investing globally in cash generative, highly profitable businesses with strong balance sheets. The strategy to execute the philosophy – stock picking as opposed to making big, concentrated bets on short term macroeconomic swings – is also unchanged. We thank you for your ongoing business, interest and support. Best wishes for 2023!



As we enter 2023 there are no shortage of warning signs (not the least of which is the steeply inverted yield curve), yet the valuation excess that was in the market a year ago has been removed, and the ever present, existential threat to stocks and other risk assets -ie central bank tightening – has largely played out and is increasingly in the rear view mirror. While further market weakness in 2023 wouldn't be a huge surprise, because the valuation backdrop has normalized, and because we are no longer in the first inning of central bank tightening, we believe the medium term outlook (three years plus) looks reasonably constructive.

*Cidel is an operating name of Cidel Asset Management Inc.

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