THOUGHTS ON COMPOUNDING:
Positioning Over Predicting

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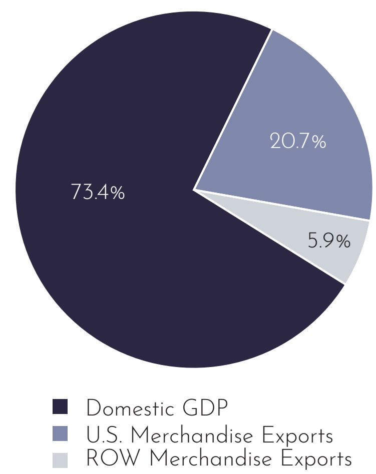
"The reports of my death are greatly exaggerated"

We believe that the current narrative suggesting that Canadian equities will perform poorly in 2025 due to proposed tariffs by President-elect Donald Trump is overly simplistic and ultimately misguided. Below, we outline why we believe Canadian equities, particularly those within the context of the Cidel Canadian Total Return Fund, remain an attractive investment opportunity despite geopolitical rhetoric.

Scope of Proposed Tariffs directly impacts ~21% of Canadian GDP

First, the proposed tariffs would only apply to goods manufactured or produced in Canada (or elsewhere) and exported to the United States. It is critical to emphasize that not all Canadian industries are heavily reliant on U.S. exports. Of Canada's C$2.89 trillion of GDP in 2023, only ~21% was merchandise exports to the U.S. The broader economy and equity performance are driven by sectors like financial services, industrials, and technology – areas that are less exposed to these specific trade frictions.

2023 CANADIAN GDP



*Source: Statistics Canada

Canadian Equity Market Structure is Different than Canadian GDP

Secondly, contrary to common assumptions, the composition of the Canadian equity market does not accurately reflect the structure of the country's GDP sources. While manufacturing contributes meaningfully to Canada's GDP, its representation in the equity market is limited. The S&P/TSX Composite Index, for example, is dominated by sectors such as financials, energy, and materials. Energy products like oil and natural gas, are in theory, directly exposed to potential tariffs. However, it is important to note that U.S. consumers are very sensitive to the price of gasoline which will make passing on the cost of the tariff directly to the consumer both economically difficult and politically unpalatable. While the direct impact of tariffs on Canadian financials would be minimal, there are potential follow-on effects to consider. Canadian banks, which are a significant component of the equity market, could experience indirect pressure due to broader economic disruptions and reduced cross-border trade. In any case, these factors are likely to introduce some volatility to these sectors.

Cidel Canadian Total Return's Positioning is Different than both Canadian GDP and Equity Index

It is important to note that the Cidel Canadian Total Return Fund has minimal exposure to these risks. The Fund has no direct exposure to the energy sector and maintains significantly lower exposure to Canadian banks compared to the broader index. This positioning minimizes potential fallout from tariffs or related economic headwinds.

[1] Mark Twain, as quoted in *The New York Journal*, June 2, 1897

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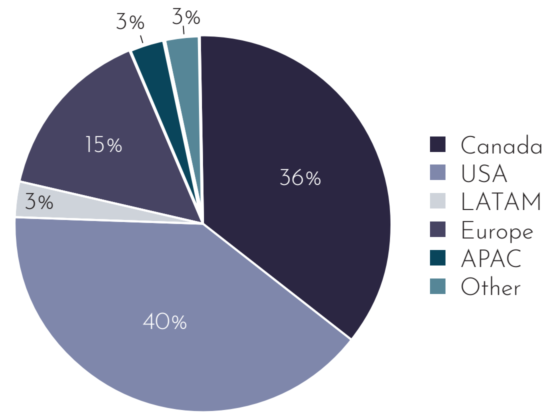
Sir John Templeton once said, "it is impossible to produce superior performance unless you do something different." We wholeheartedly agree. As such, Canadian Total Return is strategically differentiated from the broader Canadian equity market. Approximately 64% of the weighted average revenue of holdings in the portfolio is generated outside of Canada. This geographic diversification minimizes the adverse effects of proposed tariffs on Canadian exports to the U.S. In fact, other than being domiciled in Canada and listed on the Canadian stock exchanges, it would be difficult to distinguish these businesses from other global companies. Cidel's quality investment philosophy which emphasizes durable cash flow compounding businesses with strong global footprints should provide resiliency against any localized trade disruptions.

CIDEL CANADIAN TOTAL RETURN FUND
Weighted Average Revenue by Geography



Finally, there is a growing consensus among analysts and policymakers that the proposed tariffs are primarily a negotiating tactic aimed at achieving broader geopolitical objectives. In particular, the tariffs serve as leverage to encourage Canada and Mexico to engage more actively on border security and immigration reforms. Historical precedents, such as the renegotiation of NAFTA (now USMCA), demonstrate that initial aggressive trade positions often soften during negotiations, resulting in minimal long-term disruption to economic ties.

Additional Mitigating Factors

It is also important to note that there are several factors that could mitigate the impact of the potential tariffs:

1. <u>Favourable Currency Dynamics:</u> Potential currency fluctuations – such as a weaker Canadian dollar resulting from tariff concerns – could enhance the competitiveness of Canadian exporters in global markets, partially offsetting any adverse tariff impacts. A weaker Canadian dollar also improves the valuation of businesses that report in U.S. dollars, or that have material U.S. revenues. In fact, roughly 62% of the portfolio's weighted average revenue is in U.S. dollars.

2. <u>Potential for De-Escalation:</u> Political dynamics in the U.S. may lead to a softening stance on tariffs as economic realities set in. Opposition from key U.S. industries reliant on Canadian imports, such as automotive and agriculture, often leads to scaled-back or delayed tariff implementations.

3. <u>Increasing Economic Diversification in Canada:</u> Canada's growing emphasis on technology, renewable energy, and non-U.S. trade partnerships (e.g., Comprehensive and Progressive Agreement for Trans-Pacific Partnership, CPTPP) is reducing the economy's historical reliance on U.S. trade. For example, The Trans Mountain Expansion (TMX) pipeline aims to reduce reliance on the U.S. market by providing access to overseas (Asian) buyers. Similarly, the LNG Canada project is aimed at diversifying the demand for Canadian natural gas to Asian markets.

4. Structural Adjustments Would Limit Long-Term Underperformance: Even if tariffs were implemented, the immediate effects on companies would be limited, as businesses typically adjust supply chains over time. Canadian companies have shown the ability to pivot and adapt to evolving trade environments, reducing the risk of long-term underperformance.

Investment Philosophy: Compounding Resilient Businesses

In our Q2-23 Thoughts on Compounding, we explained (with the use of an illustrative parable) that our investment process focusses on identifying businesses with the resiliency to withstand and survive when the inevitable 'unknown unknowns' arrive. While the potential tariffs are largely known, the investment process remains unchanged – assemble portfolios to generate wealth over the long-term with businesses that we deem to be durable cash flow compounders. We recognize that the investment environment is complex and uncertain but seeking out the one 'truth' (as provided by Prognosticus) and investing with that 'certainty', can result in disastrous results (as witnessed by John and the other farmers). Rather we choose 'crops' by seeking companies with the following characteristics: attractive growth prospects based on sustainable competitive advantages with a high degree of predictability. These business models produce recurring cash flows and high returns on capital and, when combined with solid balance sheets, form the basis of eligibility for the portfolio. Attractive valuation is the final gate. The wider the margin of safety the better to handle the "unknown unknowns". And like Sophie's approach, the portfolio is a diversified collection of 'crops' designed to perform in all 'weather' conditions.

The alarmist view that Canadian equities will perform poorly due to proposed U.S. tariffs underestimates the resilience and structure of both the Canadian market and the Cidel Canadian Total Return Fund. With limited manufacturing exposure, substantial revenue generation from outside Canada, and a focus on high-quality, globally oriented companies, the Fund is well-positioned to navigate these challenges.

The Cidel Canadian Total Return Fund remains an attractive vehicle for capturing the growth potential of a select group of quality global businesses. As Mark Twain aptly noted, "the reports of my death are greatly exaggerated" — so too are the predictions of Canadian equity underperformance in 2025.