CAPSTONE CANADIAN EQUITY INCOME STRATEGY

Q1 Commentary

CAPSTONE
ASSET MANAGEMENT™

AT A GLANCE

MARCH 31, 2023

- Dividend-paying Canadian equities mandate
- Emphasis on larger, industry-leading companies with sustainable free cash flow
- Active management approach driven by thorough fundamental research
- $5 MM AUM

MARKET & STRATEGY UPDATE

Capstone began trading its first separately managed account (SMA portfolio) using the Capstone Canadian Equity Income Strategy (CCEIS) on October 6, 2022. Since then, we have applied this mandate to several additional accounts.

While measures of market volatility fell somewhat during the first quarter relative to last year, the last few months have seen some fairly dramatic swings in portions of the stock market. The drama experienced in the global banking sector during March was front and center in many investors' minds, as the sudden collapse of Silicon Valley Bank and Signature Bank (the second- and third-largest in U.S. history) along with the forced takeover by UBS of Credit Suisse, heretofore one of the stalwarts of the global financial system, caused some to worry that we may see a repeat of the Great Financial Crisis of 2008. Fortunately, calmer heads prevailed, and while certain bank investors experienced dramatic mark-to-market losses, the stock markets, as a whole, remained intact.

Arguably, the more significant factor that drove stock returns during the first quarter was the downshift by the U.S. Federal Reserve to 25 basis points (bp) interest rate hikes in both February and March, after over a half-dozen 50 and 75 bp hikes throughout most of 2022. (The Bank of Canada, taking it one step further, paused its overnight rate increases in March.) This change to the interest rate environment excited equity investors and ignited rallies in many stock markets around the world. For the first quarter as a whole, the Canadian stock market (as measured by the S&P/TSX Composite Total Return Index) returned 4.6%. Interestingly, investors reserved most of their enthusiasm for what hurt them in 2022 and rotated back into many of the growth stocks that suffered losses last year (e.g., the Dow Jones Canada Select Growth Index beat the Dow Jones Canada Select Value Index by almost 7%!). As a result, dividend-paying stocks - which have a high degree of overlap with value indexes - didn't get as much love, and the S&P/TSX Dividend Total Return Index finished the quarter up 3.5%.

Fortunately, Capstone performed well in the first quarter, returning 4.9%, approximately 30 basis points better than the composite index, and 140 basis points better than the dividend index. While CCEIS performance benefitted from a number of stocks across different sectors, our biggest positive performer was Open Text, which returned 30% in the quarter (31% including its dividend).

An enterprise software company, Open Text, saw its stock price fall 20% through the first eight months of 2022, as the general headwinds that tech stocks were facing at the time impacted just about every technology company's stock price, even companies like Open Text that were reasonably valued and that generated significant free cash flow. In August, Open Text announced its biggest acquisition to date - $6 billion for British SaaS company Micro Focus. Investors' initial response was brutal, sending the stock down another 14% the next day. We felt that the response was an overreaction, especially considering Open Text's long history of successfully integrating acquisitions, therefore we made Open Text a core holding in October. In February, Open Text announced surprisingly good quarterly results, and investors have been changing their opinion on Open Text and its ability to digest Micro Focus ever since. We continue to believe Open Text is attractively valued, can grow its earnings, and will increase its quarterly dividend (annualizing at a 2.5% rate currently) in the coming years. Having said that, we have taken the recent stock price surge as an opportunity to trim our position size and redeploy our clients' capital elsewhere.

Many of our holdings increased their quarterly dividends significantly. For example, BCE, Manulife and Stella Jones hiked their dividends by 5%, 11% and 15%, respectively. At the end of the quarter, the expected annual dividend yield on the portfolio was approximately 4.4%, the same as it was at the beginning of the year, despite the portfolio's appreciation. This 4.4% yield continues to be well over a percentage point greater than that of the broader market.

If you would like to find out more about this Strategy, please talk to your Portfolio Manager.

PERFORMANCE

Capstone's returns presented here are from the Capstone Canadian Equity Income Strategy's model account, which initially traded on October 6, 2022, and which is not subject to management fees. Performance varies among accounts due to variations in inception dates and security weights.

	Capstone Canadian Equity Income Strategy	S&P/TSX Composite Total Return Index	S&P/TSX Composite Dividend Total Return Index
Q1 2023	4.9%	4.6%	3.5%
Since Inception*	11.2%	7.6%	6.3%

**Trading commenced on October 6, 2022*