CAPSTONE CANADIAN EQUITY INCOME STRATEGY

Q2 Commentary

JUNE 30, 2024

AT A GLANCE

- Dividend-paying Canadian equities mandate
- Emphasis on larger, industry-leading companies with sustainable free cash flow
- Active management approach driven by thorough fundamental research
- $18 MM AUM

MARKET & POOL UPDATE

Canada's economy was showing signs of strength at the beginning of the first quarter, as inflation cooled. In recent months, the news has not been as positive. Including preliminary numbers for the month of May, real GDP per capita has been negative three out of the last four months. At the same time, the Consumer Price Index rose 0.56% in May, much greater than the consensus expectation of a 0.3% gain. Other key data are suggestive of a weakening domestic economy. For instance, Canada's unemployment rate has climbed from 5.7% in January to 6.2% in May and is expected to continue to rise. Against this backdrop, it was unsurprising that returns were modest across the Canadian equity market this quarter.

Growth and value stocks both faced challenges over the past few months, as evidenced by the -1.7% total return for the Dow Jones Canada Select Growth Index and -1.1% total return for the Dow Jones Canada Select Value Index. Dividend stocks also struggled amid concerns over higher inflation potentially leading to elevated interest rates and bond yields—a typically adverse scenario for dividend-paying equities. Considering these headwinds, we are pleased to report that CCEIS continued to outperform the broad market indices, building on our strong performance from the first quarter.

Capstone's Canadian Equity Income Strategy (CCEIS) returned +0.4% during the second quarter, ahead of both the S&P/TSX Composite Total Return Index ("TSX Index"; -0.5%) and the S&P/TSX Composite High Dividend Total Return Index ("Dividend Index"; -1.5%). This quarter, we were able to add value across a number of sectors; however, the largest contributor to CCEIS' outperformance was our core position in Canadian Western Bank (CWB). On June 11, Quebec-focused National Bank of Canada (NBC) announced that it had entered into an agreement to acquire Alberta-based CWB. All CWB shareholders will receive 0.45 shares of NBC per share of CWB owned. CWB's stock price soared 68% the next day to $41.89 per share. Arguably, the stock price should have climbed more; however, the initial reaction of NBC shareholders was frustration that NBC appeared to be paying an excessively high price for CWB. As a result, NBC's stock price fell as much as 9% in the days following the announcement.

We believe that this transaction is an excellent strategic move for NBC, as it will allow the company to compete more effectively with Canada's Big Five banks over the long-term. Regulators recently approved RBC's acquisition of HSBC Canada, making it likely that the NBC acquisition of CWB will also be approved. As a result, we have decided to retain CWB in the portfolio for the time being. While we did reduce our position late in the quarter, we still hold CWB at a 6% weight within CCEIS accounts. As the anticipated completion of this transaction is not until some time next year, we will continue to monitor developments carefully at both CWB and NBC and adjust our position accordingly.

Year-to-date, CCEIS' +7.2% return is well ahead of both the TSX Index (+6.1%) and the Dividend Index (+2.8%). Inception-to-date, CCEIS' annualized return to the end of June is +14.7%, compared to the TSX Index (+12.1%) and the Dividend Index (+7.0%). Capstone's Investment Management Team continues to research and refine opportunities that match the Canadian equity mandate of the fund, while also meeting a rigorous, data-driven standard of due diligence.

If you would like to learn more about this fund, please reach out to your Portfolio Manager.

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