CAPSTONE CANADIAN EQUITY INCOME STRATEGY

Q4 Commentary

CAPSTONE
ASSET MANAGEMENT™

AT A GLANCE

DECEMBER 31, 2022

- Dividend-paying Canadian equities mandate
- Emphasis on larger, industry-leading companies with sustainable free cash flow
- Active management approach driven by thorough fundamental research
- $1 MM AUM

MARKET & STRATEGY UPDATE

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

Throughout 2022, stock market volatility in Canada and elsewhere was more pronounced than normal. During the fourth quarter there were 23 days when the S&P/TSX Composite Total Return Index rose or fell by more than 1%, whereas this happened only four times during the entire year before COVID.

During the quarter, the Bank of Canada (BoC) raised its policy interest rate twice, starting at 3.25% and ending at 4.25%, while at the same time BoC projected a significant deceleration of economic growth in the years ahead. The higher interest rate environment combined with nervousness about what 2023 might bring caused investors to reassess stock valuations across a number of sectors. As a result, the dispersion of Canadian stock price returns in the quarter was exceptionally high – for instance, Bombardier and IAMGOLD more than doubled in price, whilst a number of stocks like Blackberry and Algonquin Power fell more than 30%.

We were able to navigate the choppy environment fairly well, with the strategy returning +6.0%. This was more than 3% better than the CCEIS benchmark, the S&P/TSX Composite Total Return Index, which returned +2.9%. To put this level of outperformance in context, it is important to reiterate that this strategy is designed to have a moderate amount of tracking error (~5%) relative to the Index. Our objective is to outperform the Index by 2% per year over longer periods of time. Therefore, this level of tracking error means that two years out of three, it is reasonable to expect our Index-relative performance to be 2% ± 5%, or somewhere between -3% and +7%. This also means that two quarters out of three, our outperformance can be expected to be between -2% and +3%. Considering this, our >3% outperformance in the strategy's first quarter can be characterized as a good outcome that we can expect will occur only once every couple of years or so.

Our best-performing investments included some of our smaller company holdings including Finning International, Stella-Jones and Exchange Income Corp., which returned 31%, 19% and 17%, respectively. These companies have been seeing strength in their respective businesses, and we continue to hold each of them, however, we have recently trimmed our exposure to all three. We also benefitted from one of our inaugural positions, Summit Industrial Income REIT, announcing in early November that it was being acquired for a +30% premium by a joint venture involving GIC, the Government of Singapore's sovereign wealth fund.

On the other hand, our performance was held back by some of our Energy and Utilities stocks including TC Energy (-6%), AltaGas (-10%) and Emera (-2%). With the prospect of slowing economic growth and the potential petering out of central bank interest rate increases both domestically and abroad, the relatively high and stable dividend yields of most Utilities stocks should attract some incremental investor capital. As a result, we continue to be meaningfully overweight in that sector.

At the end of the quarter, the expected annual dividend yield on the portfolio was approximately 4.4%, well over a percentage point greater than that of the Index. In other words, if stock prices don't move at all throughout 2023, this is the return that our CCEIS clients' accounts can expect to achieve. Having said that, we believe we have constructed a portfolio of undervalued equities that have the potential to appreciate even as the Canadian economy deals with recessionary forces. We continue to look for opportunities to reposition our portfolio into better risk/reward situations while always being mindful of our portfolio constraints.

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

Actual performance will be specific to each separately managed account due to variations in inception dates and security weights. CCEIS is a focused investment strategy. It is not intended to be a comprehensive wealth management approach and should form only part of a diverse portfolio. Each separately managed CCEIS account is governed by a discretionary Investment Management Agreement and customized Investment Policy Statement.

PERFORMANCE

Performance figures are from the CCEIS model account, which initially traded on October 6, 2022, and which is not subject to management fees.

	Capstone Canadian Equity Income Strategy	S&P/TSX Composite Total Return Index	S&P/TSX Composite Dividend Total Return Index
December 2022	-2.2%	-4.9%	-4.6%
Since Inception*	6.0%	2.9%	2.7%

**Trading commenced on October 6, 2022*