CAPSTONE CANADIAN EQUITY INCOME STRATEGY

Q4 Commentary

DECEMBER 31, 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
- $28 MM AUM

MARKET & STRATEGY UPDATE

Capstone's Canadian Equity Income Strategy ("CCEIS") delivered a +2.3% return in Q4 2024, trailing the S&P/TSX Composite Total Return Index ("TSX Index") at +3.8% but outperforming the S&P/TSX Composite High Dividend Total Return Index ("TSX High Dividend Index") at +0.8%.

The quarter was marked by significant macroeconomic and geopolitical events. The Bank of Canada took the rare step of cutting its policy rate twice, lowering it by 50 basis points each time to 3.25%. This level of monetary easing has only occurred three times in recent decades: following the dot-com bubble and 9/11, during the 2008-09 global financial crisis, and in response to COVID-19. While some investors viewed the rate cuts as a bullish signal, others worried they reflected deeper economic challenges.

The 2024 U.S. election resulted in a Republican sweep, securing control of the White House, Senate, and House of Representatives. President-elect Donald Trump's pro-business platform, including promises of corporate tax cuts and deregulation, spurred optimism, with November marking the strongest month of the year for equities. However, markets were shaken on November 25 when Trump announced plans to impose a 25% tariff on all imports from Canada and Mexico. Given that over 75% of Canadian exports are U.S.-bound, such tariffs would have profound economic consequences. A survey by Canadian Manufacturers & Exporters revealed that nearly 90% of manufacturers would face significant operational challenges, prompting potential layoffs, investment cuts, and production shifts to the U.S. Despite this, the TSX Index hit a record high on December 6 before reversing sharply, making December the worst month for Canadian equities in over a year.

CCEIS underperformed the TSX Index primarily due to its underweight position in the surging Information Technology sector, where Shopify (+41%), Celestica (+92%), and Blackberry (+53%) drove exceptional gains. Conversely, our overweight allocation to the lagging Communication Services sector also detracted from performance.

Stock selection, however, added value overall. Our standout performer was CI Financial, which returned +69% following a takeover bid from Abu Dhabi-based Mubadala Capital. Acquired in April 2023 for just over $13 per share, CI was a textbook "deep value" play, trading at four times earnings. The market steadily recognized the benefits of CI's U.S.-focused acquisition strategy, driving its stock price higher. While we anticipated an eventual IPO for CI's U.S. business, Mubadala's $32 per share cash offer aligned closely with our fair value estimate, allowing us to exit the position in early 2025 and redeploy capital.

During the quarter, we also rebalanced our portfolio, replacing Manulife Financial with Power Corp. Manulife, initially purchased in 2022 at a significant valuation discount, delivered returns of approximately 45% in 2024 and over 100% since acquisition, achieving our target valuation. Power Corp. presents a compelling opportunity, trading at a 25% discount to its net asset value ("NAV"), with over 90% of NAV in publicly traded securities. The company's robust cash flows support a 5.2% dividend yield, which has grown at a 7% annual rate over the past decade. We expect another dividend increase of at least 5% this March, further underscoring Power's appeal.

For the full year, the CCEIS Model Account* returned +23.5%, outperforming both the TSX Index (+21.7%) and the TSX High Dividend Index (+15.7%).

**Actual performance is impacted by cash flows and allocation timing factors and will be individual to each separately managed CCEIS account*

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