INVESTMENT FUNDS

THEMATIC INNOVATION FUND

QUARTERLY COMMENTARY

March 31, 2021

The S&P 500 had a first-quarter return of 4.75% in Canadian dollars. During the first quarter of 2021, ten of the eleven sectors of the index posted positive returns, with Energy, Financials and Industrials being the best performers. Information technology, which represents almost a quarter of the index, was one of the worst performers with a flat return over the quarter. Consumer Staples, which are more defensive by nature, were the worst performers, driven by a rotation toward more cyclical names.

Over the first quarter, the fund slightly underperformed its index. Sector allocation was the main driver of underperformance, largely driven by being underweight in both top-performing sectors coupled with being overweight in Health Care, which underperformed the index due to its more defensive nature.

Stock picking was positive during the first quarter but not enough to outweigh the drag from allocation. Within Consumer Discretionary, an overweight position in Tapestry was a good contributor of performance driven by good second-quarter earnings that were published in February. In Information Technology, overweight positions in Micron, NXP Semiconductors and Concentrix were strong positives as they all returned double-digit returns.

As we're heading into the second quarter of 2021, consensus is expecting a fast reopening of the economy as, by the end of June, herd immunity could be reached in the United States following a very effective vaccination campaign. Equity markets are already pricing most of this as we note massive outperformance of cyclical industries since last summer. We think the slowing rate of improvement in economic data will dictate a much more balanced market leadership with strong earnings momentum into 2022.

On the political front, Biden's massive fiscal stimuli are partly offsetting potential increases in corporate taxation. It remains to be seen what will be in the final bill that should be passed by the end of this year but already we are hearing the need for significant concessions, like a 25% tax rate versus the 28% contemplated. We are not convinced by the negative consensus view on that front and remain neutral on the impact of this political agenda on the stock market return profile.

We think we are currently experiencing a temporary period of inflation driven by base effects, supply chain bottlenecks and fiscal policy response. These factors should continue to support gradual rising interest rates. By mid-2022 though, their temporary natures mean that the inflationary pulse should exhaust itself. The equity markets, which always look forward, should gradually start to price this in from the second half of this year, in our view. This also means that the profit surge of many cyclical industries will fade away at the same time. Whenever investors start to suspect that a situation will not be permanent, they usually react by cutting earnings multiple on the companies affected. Long story short, we think part of the cyclical leadership exhibited in the markets since last summer will gradually start to fade away with the accelerating pace of technological disruption and disintermediation continuing its marathon towards singularity.

In terms of positioning, we construct the portfolio with a barbell strategy. On one side, we like to have exposure to innovators and keep between 5% to 15% in small-mid capitalisations. On the other end, we invest in dominant firms which are currently slightly more exposed to the reopening of the economy. We intend to take profits in more cyclical positions in the next few months and reinvest in strong secular compounders that have lagged significantly in the last six months. We also think that the current recovery will be more targeted towards productivity than new capacity. To take advantage of this we are currently invested in themes like building efficiency, smart cities and industrial automation. We also think that the pandemic brought to attention the importance of investing in the future of healthcare. We think the confluence of connectivity and genomics is resulting in many opportunities from a stock selection point of view, especially now that many stocks of interest have corrected significantly in the last few months. We think a few themes went through a hype cycle recently and this has culminated, as always, in some turmoil and single name corrections.

As consensus gets away from those and stocks are left for dead, we think it's a fertile ground for the strategy. Let's not forget the big picture here. We think artificial intelligence, genomics, blockchain and smart energy technologies will be driving U.S. equity returns in the next decade, as digital advertising, smartphones, e-commerce and cloud computing did over the last decade. We live in a world of accelerating change from the adoption of exponential technologies, and COVID contributed to fast-forwarding all of this. Believe me, when bioinformatics collides with quantum computing, for example, sometime in the next decade, there won't be such thing as a growth versus value debate in the stock market. The impact is broad and across all sectors and industries. In our view, how companies are dealing with this is central in terms of stock selection from now on. In terms of selection, we think that investing is about the future and we will continue to work on our unique thematic style while incorporating our differentiated view of the future.

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JEAN-PIERRE CHEVALIER, CFA

- Portfolio Manager, U.S. Equities
- Joined iAIM in 2011
- 14 years of experience in the industry
- Bachelor's degree in Business Administration, Université Laval

Main funds managed by the team

✓	Thematic Innovation
✓	U.S. Equity
✓	Global Equity
✓	Global True Conviction
✓	Thematic Innovation Hybrid 75/25
✓	Global Equity Hybrid 75/25
✓	Global True Conviction Hybrid 75/25
✓	IA Clarington Thematic Innovation Class
✓	IA Clarington Global Value Fund

iAIM snapshot

- Principal asset manager for iA Financial Group
- Major player in the asset management industry
- Manages $97 billion in general portfolios and segregated and mutual funds
- A team of 184 people, including 108 investment professionals (including 44 CFA charterholders)
- Composed of experienced managers who emphasize fundamental analysis, identification of value and long-term investing

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