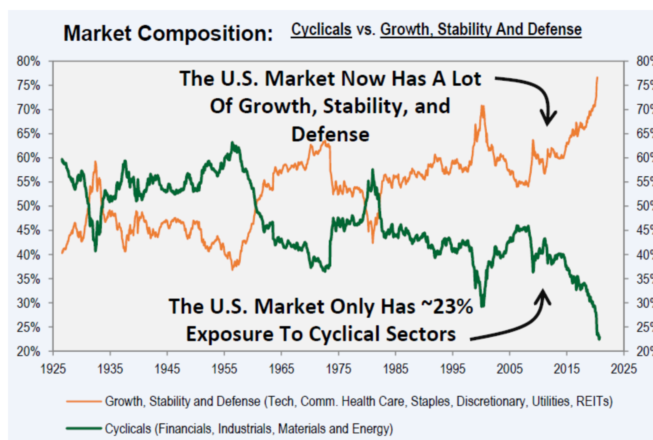
INVESTMENT FUNDS

THEMATIC INNOVATION FUND

MONTHLY COMMENTARY

May 31, 2021

The level of valuation of one country's stock market compared to another is mainly a function of its level of growth visibility and cyclicality of all the companies that make up the index. In essence, a lower cyclicality and a higher growth visibility will result in a higher market multiple. For example, if we take the cyclical exposure of the S&P 500 versus the S&P TSX in Canada and define cyclicals as the Financials, Industrials, Energy and Materials sectors, we notice a big difference between both, with approximately 26.5% of the S&P 500 being part of the cyclicals versus 69.0% for the S&P TSX. This fact explains most of the spread between the valuation of both markets, with the S&P 500 currently trading at around 21.20 times the profit valuation for the next 12 months earnings estimate while the S&P TSX is lower, at approximately 16.25 times. Simply put, investors don't want to pay a high price for a company that depends too much on the level of economic growth because at some point, the economic cycle will reverse and the company will see part of their profits melt away. The higher the importance of those companies within an index, the lower the multiple will be. It's called the composition effect. The flip side of this is a company with a relative stability in its level of sales and profit growth because of some defensive's attributes or a higher level of structural growth exposure. For example, Procter & Gamble and Adobe will always trade at a higher multiple than Chevron and JP Morgan.
The increasing spread between both markets within the last few years is also explained by the relative decreasing cyclicals exposure of the S&P 500 versus its Canadian counterpart. As you can see, the U.S. equity market got significantly less cyclical within the last few years.



SOURCE: CORNERSTONE MACRO

Thus, the argument of favouring one country over another should not be a function of the level of the price-to-earnings ratio between both. It should be a function of our cyclical outlook or how much we think things will continue to get better of the economic front.

After this summer, we think we will be at peak economic growth driven by peak fiscal and monetary policies, peak reopening, peak inflation in the U.S. and peak Chinese economic growth, all of which should favour outperformance of the U.S. equity markets because of its defensive and structural growth attributes, as markets stop to reward cyclical exposures, in the face of slowing improvements going forward. There is already a high level of visibility in all of those except maybe inflation, which could stay at a slightly higher level than expected in the short term, but the jury is still out. Don't get us wrong, we think monetary and fiscal policies will continue to support growth, but we don't think that it will get any better and, historically, that's never good for the average cyclical outperformance.

This is leading us back to many themes where we are starting to see a rising amounts of investment opportunities in the last few weeks. In my "Let's talk" presentation[1] back in March, I explained how we apply a technology lifecycle model, called the hype cycle, along with our traditional discounted cash flow valuation model, which led us to take lots of profits in some of last year's winners. Subsequently this framework did not disappoint, and we saw corrections in many themes that had seen their stock prices get too high, too fast. Fast forward to today, we are sharpening our pencils and coming back with new positions in themes that have been severely punished year-to-date.

The best expression of this is that we are coming back to our smart energy big theme with renewed exposures to renewables and energy storage. While stock prices corrected significantly there, the big picture improved with an increasing alignment of innovation, public and political support. Last year was a record year in terms of investment in the energy transition and this is just the start as, according to the International Renewable Energy Agency (IRENA), we will need to spend 2.5 times more per year on average until 2050 to get anywhere close to the long-term objectives from the 2016 Paris agreement. These targets could also be heightened with the big catalyst coming of the COP26 conference that will be held in Glasgow this fall, where we expect further commitments from governments around the world, so stay tune!
In conclusion, we will continue to work on our unique thematic style while incorporating our differentiated view of the markets.

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JEAN-PIERRE CHEVALIER, CFA

— Senior 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

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— 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

1 https://www.youtube.com/watch?v=HeJ284-FLfU

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