INVESTMENT FUNDS

THEMATIC INNOVATION FUND

MONTHLY COMMENTARY

November 30, 2021

U.S. equity markets continued their strong performance in 2021, in a year when the valuation of the broad indices remained nearly flat while earnings growth materially surprised to the upside. With respect to the economy, fiscal policies remained supportive, enabling a surge in goods demand, creating supply chain bottlenecks and rising inflation while the great retirement in the labour market gave a hint of further decline of the equilibrium rate of interest. A few big themes dominated this year. First, the broadening impact of the digital revolution, as it transforms non-technological industries, was a big factor helping companies better execute in this environment. Second, the energy transition, and its long tail of CAPEX-heavy decarbonization opportunities, is becoming more and more of a reality and has also the potential to introduce significant volatilities in the commodity complex. We see opportunities spanning decades surrounding the technologies enabling the energy transition (see chart). Lastly, the emergence of Web 3.0 (e.g. digital assets) and the eventual next computing platform (e.g. metaverses) is still quite early but promises t change the status quo and unleash disruption along the way.

As we move into 2022, we also see opportunities revolving around the upcoming enterprise spending boom. We already have good visibility in a record level of CAPEX from the semiconductors industry, the public cloud build-out, and the telecom sector. We continue to favour cybersecurity as well, as the critical nature of digital infrastructure justifies massive investments on that front. Automation should also be favoured in this environment, either from a software perspective or from the need to modernize outdated equipment. As usual, we like to balance these opportunities with positions that have good potential as well but that also reduce the overall risk of the portfolio. Speaking of which, we like the traditionally defensive healthcare sector, which has underperformed significantly since mid-2020. We think an environment of declining fiscal and monetary supports, reduced political pressures and historical discount to the rest of the market bodes relatively well for the sector.

It appears that the pandemic is morphing into an endemic situation. How governments and companies deal with this in terms of its economic impact will remain a challenge going forward. The nature of the fiscal policies implemented in response to the pandemic was mostly considered an emergency, which means they should timeout and create a headwind to growth over the next two years. The same could be said about monetary policies, as central banks are trying to get out of quantitative easing and return to a path where they are able to raise rates. In that environment, and as long as supply chain bottlenecks get resolved gradually, we think that inflationary pressures should remain under control. Over the medium term, if inflation settles at a slightly higher level, it will mostly be positive for the equity market, as many companies would be able to operate with a higher pricing power level. There is a risk of an overshoot in the short term, especially if the winter is colder than usual and commodity prices rise further. Productivity could be accelerating as well as intellectual property product investments, patent applications and new business formations have all been accelerating since last year.

Market valuation is also elevated on a historical basis when looking at price-to-earnings ratios. That said, it's important to remember that the equity market valuation is inversely correlated to the interest rate level on a non-linear basis. That makes the multiple very sensitive to any significant moves in interest rates. So far, the great retirement in the labour force seems to be helping to reduce the equilibrium interest rate by offsetting reflationary pressures. In this environment, surprise positive earnings growth is a key driver of returns and we think that U.S. companies benefits greatly from the digital revolution, which results in a higher ability to convert earnings into free cash flow, which enables a higher level of capital returns and ability to invest for growth.

The Thematic Innovation Fund is a U.S. equity fund with a thematic investment style that invests in companies from all sectors benefitting from technological advances or prospering in a perpetually changing environment. This is a well-diversified strategy which makes it possible to have a strong focus on risk management while benefitting from a deep understanding of long-term innovation themes. We construct the portfolio using a barbell strategy. On one side, we like to have exposure to innovators and keep between 5% to 15% in small- to mid-capitalisation. Each position here needs to make sense from a risk-and-return point of view. We currently see overvaluation pockets in some themes, like electric vehicles and artificial intelligence hardware, for example, and think our active approach of avoiding theses deteriorating return propositions could result in alpha. On the other side, we go with dominant firms where we currently see more opportunities in some defensive sectors, like healthcare, and in companies that have historically showcased a higher level of pricing power.

Over the medium term, we are becoming more selective regarding our allocation in big technology companies. We think we are still early in the themes of the last decade: mobile internet, e-commerce, cloud computing and digital advertising, which means many years of strong earnings growth are still ahead. Having said this, a rising number of headwinds from regulation, fossilization, and technology (e.g. Web 3.0) are becoming a reality. As business models get proven and profitability levels are reached, we seek to gradually increase our allocation to what we consider the themes of the coming decades: energy transition, robotics, automation, AI-genomics fusion, next computing platform and Web 3.0. Doing this too soon would increase risks in a disproportionate way while alternatively investing in old economy business models facing disruption is also not an option. We have benefited strongly from the distribution of returns over the last decade and are laying the foundation for continuing to do so in the next one.

Our focus is on risk management and stock selection. Position sizing is very important for us and we apply strict guidelines to remain highly disciplined and not let emotions get in the way. In terms of selection, we think that investing is about the future and will continue work on our unique thematic style while incorporating our differentiated view of the future.

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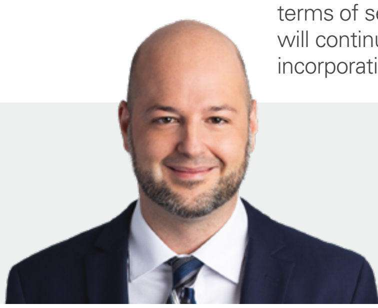

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— Senior Portfolio Manager, U.S. Equities
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Main funds managed by the team

✓	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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