INVESTMENT FUNDS

THEMATIC INNOVATION FUND

MONTHLY COMMENTARY

January 31, 2022

The setup for 2022 is one that is more likely to bring a higher level of volatility versus last year, which was quite below average from a historical standpoint. January showed that, with negative returns to start the year, with the S&P 500 returning -4.5% in Canadian dollars and -5.2% in U.S. dollars. The difference is explained by the Canadian dollar weakness, which tends to depreciate whenever the stock markets start to go down. It's the main reason why we don't hedge the portfolio for currency because it would negate this natural hedge.

This increased volatility is caused by many reasons, the main one being the Fed's hawkish pivot signalling the start of quantitative tightening this year. This move follows quite a swift change in tone from the Fed since Powell was renamed for another term late last year. This has caused market expectations for rate increases to move from basically none somewhere last summer to currently four or five during 2022. During this pivot, there has been real turbulence underneath the indexes. As of January 25, while the S&P 500, the Nasdaq composite and the Russell 2000 (small capitalization index) were down 11.0%, 17.3% and 20.0% respectively, the average stocks within those indexes were down 18.7%, 46.6% and 39.6%. From here, it's important to realize that, for a large part of the market, this has already been brutal.

Starting now, we think the risk is higher at the index level where many big stocks have simply refused to go down meaningfully. We don't have a crystal ball, but an analogy we would make is that in a war, the generals are usually the last to fall. Thus, we see better opportunities in stocks that have already gone down a lot and are opportunistically adding new positions in the portfolio. We approach the first half of 2022 as "hunting season" and have identified many opportunities for long-term alpha. This setup is very similar to the start of 2016 where many stocks were sold off quite heavily on a hawkish pivot from the Fed.

COVID is also seeing its impact on the market evolve as, early in the Pandemic, it was mostly seen as having a negative impact on demand, being deflationary and favouring stocks that are well positioned to benefit from behaviour changes of consumers and businesses. Since the Delta wave last year and following the many lockdowns and fiscal stimulus programs all around the world, COVID waves are now perceived as a source of inflation by adding to the current supply chain bottlenecks we see in many industries. How the world deals with this going forward will be very important and will continue to be a source of volatility. With Omicron, the situation in China is something we're monitoring very closely. They have been successful in limiting the impact on the supply chain so far in a very fluid environment.

We think that at some point the market will focus on the many derivative impacts from the labour and capacity shortages which are mostly pointing towards the need for increased investment in productivity-enhancing initiatives. We also think that in a world of higher wage growth, companies with a higher ratio of profits per employee are better positioned. That's what differentiates the U.S. market today, especially the technology sector, versus other higher inflation eras like the 70s. Coming back to productivity, we see three reasons that might be the source of sustainable upside on a broader level. First, momentum was accelerating at the end of last decade and we think it might come back after two years of pandemic. Second, we see recent evidence of technological acceleration with increased investments in intellectual property products (see Chart 1). Lastly, there has been increased economic dynamism with rising new business formations and U.S. patent applications. In short, we

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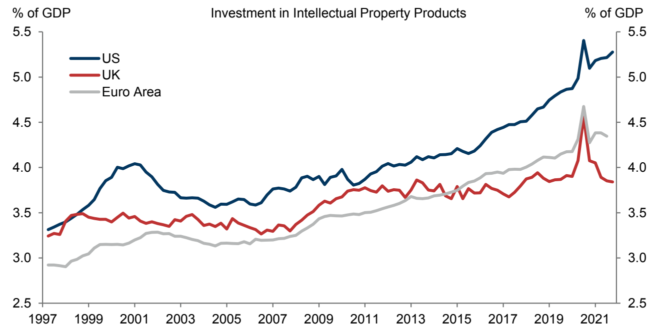
think that with supply chain problems gradually being resolved and demand moving away from goods to services (as we finally reopen economies), the debate might evolve from rising inflation and Fed hawkishness to one where we talk about declining inflation with rising productivity starting to help.

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 (i.e.: 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 next 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 benefitted strongly from the last decade's distribution of returns and are laying the blueprint to continue doing so in the next one.

Our focus is on risk management and stock selection. We refrain from selecting stocks based solely on their thematic exposure, it must make sense from a valuation standpoint. We use a discounted cash flow model to help our selection and we see many opportunities in secular growth stories with positive free cash flow yield that to us are currently dislocated following big selloffs. Position sizing is very important for us. We apply strict guidelines to keep a strong discipline and don't 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.



Source: Haver Analytics, Goldman Sachs Global Investment Research

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JEAN-PIERRE CHEVALIER, CFA

— Senior Portfolio Manager, U.S. Equities
— Joined iAIM in 2011
— 15 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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