

# THEMATIC INNOVATION FUND

## QUARTERLY COMMENTARY

December 31, 2021



U.S. equity markets continued their strong performance in 2021, in a year where the valuation of the broad indices remained nearly flat while earnings growth materially surprised to the upside. On the economic front, fiscal policies remained supportive, enabling a surge in goods demand, creating supply chains bottlenecks and rising inflation while the great retirement in the labour market gave hint of further decline of the equilibrium rate of interest. A few big themes were top of mind this year. First, the broadening impact of the digital revolution, as it transforms non-tech industries, was a big factor helping companies better execute in this environment. Second, the energy transition is becoming more and more a reality and has also the potential to introduce significant volatility in the commodity space. We see opportunities spanning decades around the technologies that enable the energy transition. Lastly, the emergence of Web 3.0 (e.g. digital assets) and the eventual next computing platform (e.g. metaverses) are still early but with promises of changing the status quo and unleashing disruption along the way.

It appears that the pandemic is morphing into an endemic situation. Emergency fiscal and monetary policies put in place to minimize the impact of the pandemic should subside and create a headwind to growth over the next two years. In that environment, and if supply chain bottlenecks get resolved gradually, we believe inflation pressures should remain under control. There is a risk of an overshoot in the near term, especially if the winter is colder than usual and commodity prices rises further. Nonetheless, we believe it will mostly be positive for the equity market, as many companies would be able to execute with a higher pricing power level.

Market valuation is elevated on a historical basis when looking at price-to-earnings ratios. Having said this, it's important to remember that 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 move in interest rates. Higher than anticipated earnings growth would therefore be a key driver of returns. We also believe U.S. companies benefit greatly from the digital revolution, which results in a greater 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 with a barbell strategy. On one side, we like to have exposure to innovators and keep between 5% and 15% in small- and mid-capitalization. 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 these 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.

The Law of Accelerating Returns says that the same exponential growth factors that made Moore's law possible, doubling of semiconductor capacity per square inch every 18 months, have extended themselves to all forms of technological progress. As an

investor, ignoring the indisputable parabolic curves emerging across industries and economies is not an option. Thus, the nature of the Fund's strategy is to add value by benefitting from an understanding of the pervasive impacts of disruptive technological innovations. The continuing evolution of the internet and the emergence of artificial intelligence, DNA sequencing, robotics and battery technology makes it a very interesting time in history comparable to the rise of the automobiles, electricity, and telephone technologies at the beginning of the 20th century.

As we move into 2022, we see opportunities regarding 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 also reduce the risk of the portfolio. Speaking of which, we like the traditionally defensive Health Care 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.



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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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- 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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