INVESTMENT FUNDS

DIVIDEND GROWTH &
U.S. DIVIDEND GROWTH

MONTHLY COMMENTARY

July 31, 2021

July was another positive month for equities on both sides of the border, with both the S&P/TSX and S&P 500 hitting new all-time highs. We're in the later stages of the second quarter earnings season, and results have generally been good, with 86% of the S&P 500 and over 60% of the S&P/TSX beating estimates thus far. In addition, year-over-year earnings growth is strong in most areas of the market, as the second quarter of 2020 was the low point for earnings due to COVID-19. The year-over-year comparisons will undoubtedly get tougher as we move through the next few quarters; however, we continue to see a high share of companies boosting their guidance for the remainder of 2021.

One theme that had stood out to us after listening to dozens of earnings calls is the upward pressure on costs - specifically wages and labour availability, especially on the low end. Companies affected have had to boost wages to lure workers back, as government programs to protect income have been relatively generous and to date, have been slow to expire. We expect this situation to improve but it may be slowed by the recent spike in COVID-19 cases due to the Delta variant. In addition, inflation continues to run at higher-than-normal levels, led by rising energy prices, raw materials prices, housing prices, and even used car prices! Inflation now ranks as one of consumers' biggest concerns, and since overall wage growth is solidly negative when adjusted for inflation, we should expect upward pressure on wages as employees look for raises to offset the difference. As we assess the landscape after second-quarter reporting on this issue, our comment from last month still holds: there will be a premium on companies that are either unaffected by inflation or have the pricing power to efficiently pass the additional cost onto their customers. Some of the rare earnings misses we witnessed this quarter related to either supply bottlenecks related to COVID-19 or rapid inflation that will be slow or difficult for the company to pass on to customers.

Along with inflation, another potential risk to the equity market in 2021 is the emerging Delta variant of COVID-19. This variant is responsible for a substantial spike in cases in the U.K. and U.S., and while it has been less deadly to date, it will have negative impacts on mobility, supply chains, and a gradual return to normal, especially in countries with low vaccination rates and those which have been quick to lock down. While concerning overall, one small benefit of the Delta variant is that it seems to be responsible for causing an uptick in vaccination rates, as we are seeing that almost all serious cases are among the unvaccinated. To account for this emerging risk in our mandates, we have reduced our exposure to the energy sector, which has performed very well in the past year and would be pressured if the Delta variant continues to cause issues with an economic reopening.

Turning back to earnings, we were impressed with the latest quarterly results from Open Text, which has been a core holding in the fund for years. Earnings were ahead of estimates for the seventh consecutive quarter, but we were most impressed by their organic growth, which has moved several percentage points upward in the past year. The business is now at 80% recurring revenue, with almost 40% EBITDA margins. While the shares have done well, the company still trades at a much lower valuation than its peers. It also recently announced that it would be focusing 1/3 of its future cash flows to increase dividends and share buybacks, with 2/3 left for acquisitions and debt repayment. We believe the company is in a great position to continue its outperformance versus the S&P/TSX.

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DONNY MOSS, CFA

- Principal Portfolio Manager, North American Equities
- Joined iAIM in 2008
- More than 15 years of investment experience
- Bachelor's degree in commerce, Dalhousie University

Main funds managed by the team

✓	Dividend Growth
✓	U.S. Dividend Growth
✓	Dividend Growth Hybrid 75/25
✓	IA Clarington Canadian Dividend Fund
✓	IA Clarington Dividend Growth Class
✓	IA Clarington U.S. Dividend Growth Fund
✓	IA Clarington Canadian Conservative Equity 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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