NEI Long Short Equity Fund

Q3 2024 Commentary

NEI

Performance

Having been somewhat cautious at the onset of the period under review and with a U.S. Federal Reserve seemingly committed to sitting on the sidelines while a soft-landing narrative cemented in the minds of market participants, the subadvisor grew cautiously optimistic that deteriorating economic datapoints would at least level, if not turn positive at the margin during the period. The crux of the Fed position related to the inflation dynamic, where goods appeared to be in outright price deflation, yet core services inflation remained uncomfortably high, and firm in its footing. This "sticky situation" for the Fed, as they called it, almost *required* services inflation to roll over to offer the central bank a green light to cut rates. Yet, the longer the world's largest economy went without monetary easing, the greater the odds of recession.

Market sentiment did not seem quite as sensitive to this conundrum, it seemed, as their bias to be buyers on pullbacks offered only brief opportunities to do so in April and August, the latter being a more violent risk-off episode than the former, but neither being supremely compelling buying opportunities in retrospect. For much of the period in review, equity valuations remained high, positioning of market participants was stretched on the long side, and various signs of late-cycle speculation had returned to the market.

In accordance with National Instrument 81-102, the Fund's performance is not disclosed as the Fund has been a reporting issuer for less than a year.

Portfolio commentary

Positive sector contributors were stock selection in Energy and Consumer Staples. Being overweight in both Information Technology and Health Care also added to performance.

Two of the top single name contributors to the fund were Element Fleet Management Corporation and the Canadian Imperial Bank of Commerce:

- Element Fleet continues to execute, strong organic revenue growth this quarter alongside an increase in free cash flow
- CIBC had a strong quarter and continues to outperform given their positive operating leverage.

Negative sector contributors were stock selection in Information Technology and Financials. Being overweight Industrials and underweight Financials both detracted from performance.

Two of the bottom single name detractors for the fund were Brookfield Corporation and Bank of Nova Scotia:

- Brookfield Corporation – the fund holds an underweight position. Their share price grew due to rebounding because of lower interest rates as the company is quite levered.
- The Fund is also underweight Bank of Nova Scotia as the subadvisor has a preference for other banks.

During the period, they added to the Fund a new position in Bank of Montreal. They expect the bank's credit results in the United States to improve, and its valuation was lower than its peers.

A holding in Freehold Royalties Ltd. was eliminated from the Fund in favour of better opportunities within the oil and gas industry.

Outlook

Going into September, the U.S. Federal Reserve had to choose between stimulating a slowing US economy and remaining firm in its fight against potential inflationary forces lingering on the supply-side. The central bank chose the former and as of the time of writing, further rate cuts have been priced-in to interest rate markets, some of which could be larger or come sooner than earlier expected. The subadvisor believes the decision to cut rates this soon could stoke

inflation moving forward given the structural issues in housing and labour supply, as well as challenging supply-side dynamics in certain key commodities. This, in turn will have implications (i.e. shorter cycles, 60/40 underperformance and lower cash returns) which investors need to remain conscious of in relation to portfolio construction. To wit, these dynamics are a meaningful shift from the generally benign environment which allowed traditional balanced portfolio constructs to thrive for most investors' memories up to very recently.

On equity markets, as expected, the reaction to lower short-term interest rates was a burst of risk-on sentiment and as they are not as outright bearish relative to the last update (when economic indicators were deteriorating more broadly), they have taken the opportunity to increase cyclicality in equity portfolios at the margin. That said, they do remain cautious toward ebullient sentiment but believe the balance of probabilities remains constructive on a medium-term forward-looking view.

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