

2024 Portfolio Manager Outlook.



VCIM Pooled Funds

VCIM Short Duration Bond Fund

VCIM Bond Fund

VCIM Canadian Equity Fund

VCIM Income Fund

VCIM Global Equity Fund

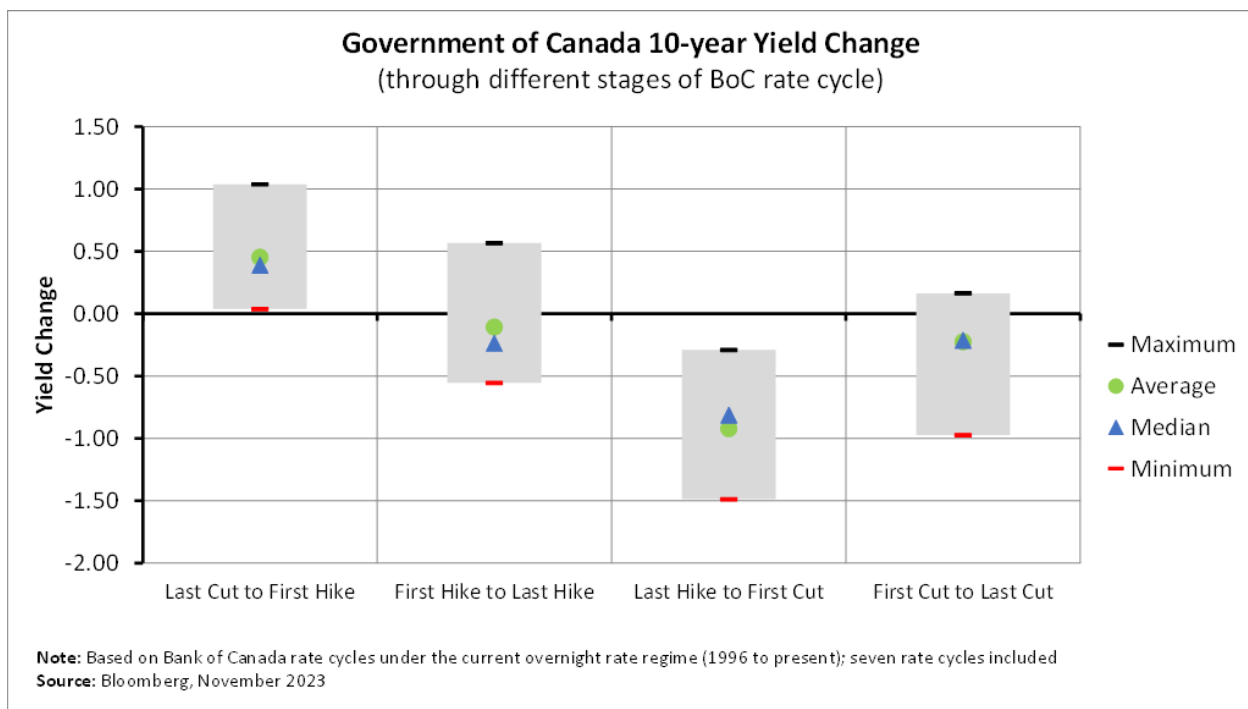
VCIM Global Small Cap Fund

Where are the opportunities?

Over the last year, equity markets have been reacting to several macro influences, including sticky inflation, rising rates and a potential game changing growth opportunity in artificial intelligence. The markets' reaction to these has created opportunities to enhance the future long-term return potential of investments by investing in quality growth companies that have come under pressure.

We currently see opportunities in health care and clean energy and believe global small cap companies provide a good hunting ground in the current environment as investors have focused almost exclusively on large cap, or even mega cap tech companies. We also see opportunities in companies that are focused on products and/or services which support the energy transition, including water management and energy efficiency. In addition, we expect to find more opportunities in companies involved in the circular economy as pressure grows to address waste generation and inflationary pressures drive consumers to seek bargains.

Despite a decent rally in bonds in late October, bond yields remain not far from their highest levels in more than 15 years, providing attractive income generation and perhaps more importantly, capital appreciation potential as central banks near the end of their rate hiking cycles. Historically the period between the last hike of the tightening cycle and the first cut sees lower bond yields across the curve and decently positive fixed income returns.



What are the challenges?

Wildly diverging opinions on the path of inflation and economic growth has created some uncertainty on whether central banks are done with their rate hiking cycles. Ongoing government budget deficits, de-globalization, and disruptions caused by the Russia-Ukraine and Israel-Hamas wars could reignite inflation pressures, forcing central banks to resume hikes or at least keep policy rates elevated for an extended period.

As more and more countries adopt human rights due diligence legislation – including Canada’s Bill S-21, which is expected to come into force on January 1, 2024 – many companies face heightened reputational and financial risks associated with supply chain management. Combined with commitments made at the last United Nations Biodiversity Conference (COP15), which include requirements for multinational corporations to monitor, assess and disclose risks and impacts on biodiversity, responsible supply chain management is going to be a key challenge this year.

Equity markets will continue to be reactive to data releases, central bank policy changes, and narratives from forecasters and policy setters, which provides challenges over the short-term but opportunities over the long-term as share prices diverge from company fundamentals. Through history markets have and are expected to remain volatile, making it easy to lose sight of the long-term growth opportunities equities provide. Over the years markets have contended with many shocks and periods of heightened volatility but through it all equities have continued to follow a long-term upward trend.

How are you positioning the funds?

Elevated interest rate volatility for a second consecutive year provided ample opportunities for active management in the fixed income space. Movement along the Government of Canada yield curve allowed for tactical changes to positioning, particularly during the first half of the year. With a large inversion persisting in the long-end of the Canada curve, the bond fund is positioned with an overweight to the mid-term sector and defensively with shorter-dated long bonds. Rate volatility also presented opportunities for the fund to strategically extend duration, notably in early October as yields probed their highest levels in more than fifteen years.

The bond fund remains overweight corporate bonds but continued to shift its corporate exposures to shorter duration versus the corporate index as risks to the Canadian economy appear to be mounting. The fund continues to maintain a small exposure to defensive preferred shares to further enhance the fund’s yield.

Late in the summer, we initiated a cross border relative value trade, selling an off-the-run longer-dated Government of Canada bond to buy a similar duration U.S. Treasury bond. The yield relationship of the two bonds was trading near historical spreads, providing significant additional yield carry and potential for capital appreciation if the relationship between the two bonds reverts to historical levels.

Within the equity portfolios, we have continued to take advantage of temporary selling pressure by increasing the weights of high conviction companies, such as Danaher and Elevance Health, two health care companies in the global equity fund. Both these companies hit multi-year low valuations earlier this year, but we expect to continue producing strong results in the years ahead. We have also been uncovering new high-quality companies that we believe are being mispriced by the market including a European consumer staples company that has been compounding its earnings at a double-digit growth rate that we expect will continue for the foreseeable future.

Why is this the right approach for 2024?

With the Canadian economy already showing signs of slowing and risks to the consumer growing as a significant number of low-rate mortgages are renewed at higher levels, the Bank of Canada is likely done with its hiking cycle, which should bode well for fixed income returns going forward. To perform in this environment, the bond fund is slightly long duration versus the index and defensively positioned credit wise in shorter high-quality issues.

While it is impossible to time the short-term shifts in equity markets as they react to various macro and investor influences it is possible to identify quality growth companies. We focus our efforts on the possible not the impossible, and our approach for the next year – as it is every year – is to search out investments with a focus on improving the return potential of our funds. We expect volatility to continue as markets try

to anticipate shifts in macro trends and sentiment and we will use any short-term market pressure to our advantage for the long-term.

Finally, our integrated ESG investment process helps position us to monitor and avoid risks associated with poor supply chain management practices and helps us identify unique opportunities to invest in underpriced companies that will benefit from the energy transition and the increased focus on circularity and reuse of resources.

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