TRIASIMA

Triasima Canadian Equity Fund

First quarter 2021 commentary

The economy

Cases of COVID-19 continue to fluctuate around the world, exacerbated by new variants. Vaccination efforts and various containment measures are ongoing. Meanwhile, economies are growing and, outside of the private services sector, have reached record levels of activity in Canada and elsewhere.

The services sector lags because it is people-intensive and requires person-to-person interactions. It is therefore relatively more impacted by the pandemic.

Just over a year ago, the pandemic shut down the world economy. It was followed by an unprecedented policy response, in the form of monetary and fiscal stimuli that kept economies and households afloat. This response is still ongoing while the uneven economic reopening carries on. For example, since the beginning of the pandemic, the Bank of Canada has been buying about one third of the Government of Canada bond issuances, and now owns 40% of them.

The recession was abrupt, and the rebound has been steep. ISM surveys continue delivering very high readings, such as 64.7 for March in the United States. The latest report reveals widespread struggles by manufacturing companies to meet demand due to pandemic disruptions, thus reducing the availability of parts and materials. This supply crunch is a worldwide phenomenon affecting everything from basic materials to semiconductors. This issue, combined with demand spurts in certain industries, is raising inflation expectations.

In Canada, consumers are flush with cash. The rise in real disposable income was measured at 9% for 2020, the highest since the sixties. This has supported consumption and will continue to do so while the economy emerges from the pandemic. COVID-19 vaccinations started slowly but have picked up pace, with 15% of the population having so far received at least one dose of a vaccine. This figure is 32% in the United States.

An issue that bears watching is the boiling Canadian housing industry. Sales have been above the very high level of 55,000 units per month for each of the last seven months, while housing inventory is at an all-time low of 1.8 months of sales. We would not be surprised to see, likely ill-advised, government action to cool this situation, rather than relying on a normal supply response.

Growing economies and higher inflation due to cyclical reasons have pushed up interest rates spectacularly in North America. For example, the 10-year Government of Canada bond yield more than doubled during the quarter, going from 0.71% to 1.58%.

The Canadian equity market

The S&P/TSX Composite Index advanced a strong 8.1% over the first quarter, spurred by the vaccines roll-out, but also by improving corporate earnings expectations.

From its month-end trough of March 2020, at the onset of the pandemic, the Index is up an amazing 44% over the past twelve months. This is the fastest rebound in history following a recession-induced bear market.

Inflation-sensitive sectors outperformed in the quarter, with Energy and Financials rising 20% and 14%, respectively. Strong oil prices helped the Energy sector while Financials benefited from a steeper yield curve and lower credit losses forecasts by banks.

Equity markets have experienced one of the strongest ever beta-factor rally since the Pfizer vaccine announcement in November 2020. Interest rates rose, and the value factor handily outperformed the growth and quality (stable earnings and high ROE) factors since.

Unrelated to the first quarter inflation theme was the 38% gain by the Health Care sector. Bausch Health, a large name within this sector, jumped 51% on strong guidance and results, while cannabis producers

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enjoyed a resurgence as cannabis use legalization is slowly gaining acceptance in the United States.

The out-of-favour defensive Consumer Staples sector lagged. So did the growth-oriented Information Technology sector, held back by the rise in interest rates. Worst off was the Materials sector, with a 7% pullback. It was driven down by the 14% gold producer subsector drop, a consequence of the rising rates and of higher costs. Within this sector, though, the base metals and lumber producers did well, operating in inflation-sensitive and cyclical industries.

The Fund

The Triasima Canadian Equity Fund had a 6.4% return in the first quarter of 2021, lagging the S&P/TSX Composite Index.

The Fund led the Index over the first two months of the year. However, the rotation away from the quality factor and towards the cyclical and value factors accelerated in March. This hurt relative performance since the Fund was not optimally positioned for this, being absent from the Health Care sector and overweight the Technology and Materials sectors. Performance attribution from the sector allocation was thus negative.

The attribution impact from security selection was mixed. Relative performance was helped by the underweight in the large gold producer subsector, and by strong advances in the stock prices of dry natural gas producer Tourmaline Oil and trucking company TFI International, both up 44%. TFI announced a large acquisition in the United States that was well received by the marketplace.

Several holdings experienced pullbacks in the 19% to 26% range, due to deteriorating outlooks or because their stocks were expensive and corrected in the face of rising interest rates. Cargojet and Ritchie Bros Auctioneers fit in the first category, while B2Gold, and renewable energy producers Boralex and Innergex Renewable Energy fall in the second category.

Turnover was elevated. A key objective was to continue rotating towards cyclical plays. New names or additions to existing holdings include Crescent Point Energy (light oil), Lundin Mining (base metals), BRP (recreational vehicles), and four of the six large Canadian banks. The Financial sector, especially, was steadily added to during the quarter.

Sales were mainly of defensive or expensive holdings. The first group includes gold producers and Consumer Staples names while the second group is made up of technology and green energy Utilities holdings.

The Fund has a fair presence in the cyclical and value factors as represented by a beta parameter significantly above one, valuation metrics in line with the Index and better earnings revisions.

Fund structure at the sector level is close to that of the benchmark, with no significant deviation.

Conclusion

The current monetary and fiscal policies and the vaccines rollout aggregate to a huge level of stimulus to the economy. The predictable path surely is GDP growth and profitability gains, alongside rising inflation and interest rates. As we will hopefully emerge out of the pandemic, economies will rejoin the late cycle stages where they stood in early 2020.

Expectations for equity returns are good. While the first twelve months of this bull market were spectacular, not surprising considering where we started from, we should anticipate further gains in 2021, with routine corrections. The only certainty about the stock market is that it will be volatile.

New growth and stimulus catalysts will be required to extend the cycle beyond 2021. Meanwhile, inflation is rising but it is for cyclical reasons. Longer term, we foresee inflation to remain muted due to unit labour costs being well contained.

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