

# Morningstar Strategic Canadian Equity Fund

## Fund Commentary

The Canadian equity market posted a slightly negative third quarter, with the S&P/TSX Composite total return index losing 0.6%.

Sectors that performed well in Q3 were Health Care, Industrials and Real Estate, gaining 31.4%, 5.6% and 3.9% respectively on a total return basis. The strong return in the Health Care sector was primarily attributable to cannabis-producing companies such as Canopy Growth, Aphria Inc. and Aurora Cannabis Inc., all of which are highly volatile and bear significant risks. Some of the weaker performing sectors during the quarter were Materials, Consumer Discretionary and Energy, returning -12.9%, -8%, and -5.7% respectively.

Against this backdrop, the Morningstar Strategic Canadian Equity Fund underperformed its benchmark, the S&P/TSX Composite.

## Positive Contributors

Some of the stronger three-month contributors in the portfolio were Toromont Industries Ltd., Chorus Aviation Inc., Parkland Fuel Corp. and Canadian National Railway Co.

## Performance Detractors

Some of the portfolio detractors in the quarter were Dollarama Inc., West Fraser Timber Co. Ltd. and Norbord Inc.

Dollarama had a slight earnings miss and guided lower on sales for the remaining part of the year. The company has noted that it intends to temporarily minimize price increases to maintain its market share and value proposition. Fundamentals and guidance from the company point to a brief aberration.

The poor performance in lumber stocks was driven by rising interest rates both here in Canada and elsewhere, contributing to lower expected housing affordability. Morningstar Investment Management does, however, expect housing starts to continue to grow, more so in the U.S., but there may be some slight headwinds in the form of tight labour supply and related wage costs. Linamar Corp. and NFI Group Inc. have also shown some weakness over concerns caused by existing or expected tariffs applying to their raw material inputs and final products.

## Positioning and Outlook

Starting the quarter with 34 holdings in the portfolio, the Fund sold one position and bought three new positions, so at quarter-end the Fund holds 36 positions. The one position that the Fund sold was Northland Power Inc., which was due to a poor earnings surprise in its most recently reported quarter. The three companies that the Fund purchased were Parkland Fuel Corp. and TransCanada Corp. in the energy sector, and Nutrien Ltd. in the materials sector.

Looking at the latest quarter, the group of stocks in the Composite that tended to do well had less attractive fundamental characteristics in terms of risk, valuations and growth and would therefore not be stocks that would have been considered for inclusion within the portfolio. Morningstar Investment Management will continue to closely monitor company fundamentals and make alterations to the portfolio as the company fundamentals warrant.

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Weighted Factor	INDEX (%)	FUND (%)
Last Reported Return on Equity	13.8%	20.4%
5 Year Average ROE	13.4%	18.9%
Reinvestment Rate (Earnings less dividends/book value)	9.6%	15.1%
EPS Estimate Revisions 3 Months	1.3%	1.4%
Earnings Momentum	6.6%	7.0%
Total Yield (Expected yield + Shareholder buyback yield)	0.6%	1.1%
Price/Earnings	16.2x	12.3x
Price Change (9 Month)	-0.7%	-2.2%

Source: Morningstar CPMS

The outline for the United States-Mexico-Canada Agreement (USMCA) was agreed upon as the third quarter ended. The threat of tariffs on automobiles has been removed and a dispute resolution mechanism remains in place, which has in the past worked in Canada's favour as it relates to softwood lumber disputes. On the other hand, no adjustment was made to the current tariffs applied to steel and aluminum, so unless these tariffs are dropped, or a quota system is developed and agreed upon, we should expect to pay a bit more when we go to a neighbourhood car lot to buy a new car.

In the energy sector the struggle between supply and demand continues. New sanctions on Iran are expected to

become effective in November and energy prices have moved up in tandem. OPEC and its allies believe there will be adequate supply available to meet demand. Keep in mind that a variety of Canadian producers are still being affected by the same infrastructure issues that were present earlier in the year resulting in lower prices relative to their comparable U.S.-based competition. Demand will play a key role in the direction of prices, so Morningstar Investment Management will keep an eye on stock fundamentals and adjust the portfolio as warranted.

The Fund continues to target companies with the best combination of valuations, quality and risk for inclusion in the portfolio. There will be times when being in the market does not reward these types of companies, but over the longer term, Morningstar Investment Management feels owning stocks with strong fundamentals in terms of these factors will lead to outperformance, as per the stated objectives of the Fund.

As always, Morningstar Investment Management continues to apply the discipline of the investment strategy to the portfolio and its holdings.

Quarter-end sector weightings relative to the benchmark are provided in the table below:

Sector	INDEX (%)	FUND (%)
Energy	19.1%	5.7%
Materials	10.1%	13.4%
Industrials	10.6%	19.8%
Consumer Discretionary	5.3%	19.8%
Consumer Staples	3.4%	5.5%
Health Care	2.0%	0.0%
Financials	34.3%	24.9%
Information Technology	4.1%	5.5%
Telecommunication Services	4.4%	5.5%
Utilities	3.7%	0.0%
Real Estate	3.1%	0.0%

Source: Morningstar CPMS

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