

# Morningstar Strategic Canadian Equity Fund

## Fund Commentary

For the quarter ended June 2022, the S&P/TSX Composite lost 13.2% on a total return basis after a small gain registered in the first quarter. This represents the second worst quarterly return for the Canadian market over the last ten years, with the worst being the quarter ended March 2020 where the market lost close to 21% on a total return basis due to the global onset of COVID-19. The index has now lost 9.9% year-to-date.

All sectors lost ground in the second quarter. Energy, Utilities, and Consumers Staples had the strongest relative sector performances, losing 1.9%, 3.5% and 6.2% respectively on a total return basis. Good relative performance in the Energy sector was driven by Suncor Energy Inc., Cenovus Energy Inc. and Tourmaline Oil Corp., among others. The weaker performing sectors in the quarter were Health Care, Information Technology and Materials with total return performance of -49.6%, -30.7% and -23.6% respectively.

## Portfolio Performance

For the quarter, the Morningstar Strategic Canadian Equity Fund outperformed its benchmark, the S&P/TSX Composite Index.

Positive relative contributors to portfolio performance were the Toronto-Dominion Bank, Royal Bank of Canada, CCL Industries Inc. and Atco Ltd. Detractors from benchmark

relative performance among portfolio holdings were Dream Unlimited Corp., Torex Gold Resources Inc., CI Financial Corp. and Richelieu Hardware Ltd. Other contributors to relative portfolio out-performance were Shopify and Brookfield Asset Management, which are not held in the portfolio. At the sector level, Materials, Financials and Consumer Discretionary were positive relative contributors to performance while Real Estate, Energy and Communication Services were detractors relative to the benchmark in the quarter.

## Positioning and Outlook

Over the course of the second quarter, the Fund purchased one new position in Pine Cliff Energy Ltd. and sold none. As a result, at the end of the quarter, the Fund held 34 stocks.

Given the last few readings on inflation, the Bank of Canada (BoC) continues to readjust its policy rate to contain increasing prices. The Bank moved the target overnight rate from 50bps at the end of the first quarter to 150bps at the end of the second quarter and most recently, made a 100bps move to put the policy rate at 250bps. More increases are expected as the BoC intends to drive down demand to lower inflation. Unemployment rates remain extremely low relative to historic norms, with the latest release indicating a 4.9% rate. With the increases in rates, Morningstar expects to see a slowdown in economic activity. Adding to the difficulties that the BoC is dealing with is the supply chain variability

brought on by the virus as well as the ongoing war between Russia and Ukraine, two countries that are significant exporters of commodities. Risks are elevated given the economic and geopolitical environment.

The pace of growth that was expected just a few months ago is not likely to continue as central banks across the developed world begin to do what they can to contain inflation. The outlook for the Canadian economy and many developed economies has become more muted over the past months; housing prices have shot up and interest rates are rising, resulting in lower household disposable income. Relatively high consumer savings rates and low unemployment are currently positives for the Canadian economy. It is unclear how these adjustments will play out for consumer spending and what the related effect will be on public companies. For the most part, it appears that there has been a recovery from what has been the worst of the health concerns and lockdowns brought about by the COVID-19 virus.

The path that energy, and commodity prices more generally, will take has become more uncertain over the quarter as the war in Ukraine continues and as certain countries, most notably China, continue to have lockdowns. The path that interest rates take in the short to medium term and the related effect on global economies will also have the effect of slowing down demand for energy and other commodities. Countries dependent on Russian oil and gas continue to scramble for alternatives to keep their citizens and

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economies moving forward. To the extent that supply is curtailed, while at the same time demand likely recedes, there will continue to be volatility in pricing.

The Canadian economy remains strong but is likely in for some continued turbulence as we move through the summer months and into the fall. Morningstar's disciplined investment process helps to moderate potential behavioural driven decisions by remaining focused on companies with fundamentals that are more likely to endure. The companies that are held in the Fund have broad sector coverage and strong fundamentals that put them in good standing to weather the volatility that Morningstar expects to see over the next few quarters due to the several factors mentioned above.

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

<u>Sector</u>	<u>INDEX (%)</u>	<u>FUND (%)</u>
Energy	18.4%	10.0%
Materials	11.7%	11.8%
Industrials	12.0%	12.1%
Consumer Discretionary	3.3%	3.0%
Consumer Staples	4.1%	9.0%
Health Care	0.4%	0.0%
Financials	31.7%	27.0%
Information Technology	5.4%	9.0%

Communication Services	5.2%	9.0%
Utilities	5.2%	3.0%
Real Estate	2.6%	6.1%

Source: Morningstar CPMS

Quarter-end portfolio characteristics relative to the benchmark are provided in the table below:

<u>Weighted Factor</u>	<u>INDEX (%)</u>	<u>FUND (%)</u>
5 Year Average ROE	12.8%	16.3%
Last Reported Return on Equity	15.3%	20.0%
Price/Earnings (TTM)	13.7x	11.9x
Price Change (9 Month)	-6.1%	-7.0%
EPS Estimate Revision 3 Months	8.9%	3.7%
Quarterly Earnings Momentum	6.1%	2.3%
Reinvestment Rate (Earnings less dividends/book value)	9.6%	12.6%
Total Yield (expected yield + shareholder buyback yield)	0.6%	3.8%

Source: Morningstar CPMS

## About Morningstar Investment Management

The Morningstar Investment Management group, through 15 investment advisory subsidiaries, creates custom investment solutions that combine award-winning research and global resources with proprietary Morningstar data. With approximately US\$265 billion in Assets Under Management and Advisement worldwide as of March 31, 2022, the Morningstar Investment Management group provides comprehensive retirement, investment advisory and portfolio management services for financial institutions, plan sponsors and financial advisors around the world.

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## Quarterly Additions/Deletions

Additions	Deletions
Pine Cliff Energy Ltd.	

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