Q1 2023

TRADING ACTIVITY

BARRANTAGH INVESTMENT MANAGEMENT

Canadian Small Cap Equities

Amid much volatility, global equity markets delivered further gains during the first quarter. Sentiment shifted to risk-on to start the year, followed by risk-off in February, and finally large swings in March with investors gravitating to both defense (size, liquidity, stability) and growth (on views that interest rate hikes had peaked). Small caps lagged during the period outside of precious metals, where weaker USD, falling rate expectations, and flight to "safety" all aligned to lift gold prices. In this environment we lagged as our focus on quality small cap, cash flow compounding businesses at attractive valuations did not check the in favour "style" box for the quarter.

As we have noted in the past, we avoid the gold space, specifically in the small cap arena where the Canadian market is flooded with junior exploration companies with a history of sinking large swaths of investor capital into the ground at subpar long-term returns. Going back to 2009, (the history available for junior gold equities), the commodity has returned just under 7% annually, while the related equities delivered less than 4% annually. Not only do the gold equities trail the commodity, but by contrast, capital invested in our small cap strategy has appreciated by more than ~7x over that same period. During the short term, there are times it can be painful for a Canadian small cap manager to avoid golds; over market cycles we believe this discipline provides strong addition by subtraction.

Outside of materials, financials were the other main detractor from relative performance during the period where an overweight position and negative selection hurt. This was partially offset by relative strength in the more "defensive" sectors including real estate, consumer staples, utilities, and health care.

With market sentiment shifting strongly in one direction, some individual high-quality small caps have fallen out of favour, providing an opportunity to deploy capital at increasingly attractive valuations. One example is a long-term holding, Cargojet (CJT). This previous high-flyer (pun intended) has been trimmed over the years (most recently Feb/21 and Jun/20 at much higher prices) to manage position size given the accelerated pace at which CJT grew intrinsic value. Fast forward to today, the market has a myopic focus on the slowing freight environment, growing international competition, and deferral of the fleet expansion plans. We don't discount these challenges, but an overly short-term and pessimistic outlook loses sight of (1) the strength of the franchise (near-monopoly in overnight air-freight, long-term contracts, e-commerce tailwinds, etc.) and (2) the high likelihood that the current grey skies will pass. We added to our position in CJT during the quarter. We can't control when or how deep the pendulum will swing from euphoria to despair, but we can seek to take advantage of the opportunities when it does.

BUYS

No new buys were made this quarter.

Top-ups were made to the following names (funded with the proceeds from the SMU takeout): Brookfield Business, Cargojet, Dental Corp, Dye & Durham, Minto REIT, Neighbourly Pharmacy and Softchoice.

SELLS

Summit Industrial REIT (SMU) takeout by GIC/DIR-U completed on 2/28.

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