Q3 2023

TRADING ACTIVITY

BARRANTAGH INVESTMENT MANAGEMENT

Canadian Small Cap Equities

Canadian equity markets turned red during the third quarter, with negative momentum accelerating in September. Overall performance was buoyed by the energy sector (supported by rising oil prices), while under the surface pain was inflicted on areas with rate-sensitivity (defensives, utilities, real estate, etc.), as the "higher-for-longer" market narrative solidified.

Much has been written this year about the poor breadth this market "rally" has entailed. In the U.S. context, the bellwether cap-weighted S&P 500 is up ~13% year-to-date while the equal-weight equivalent is up just ~1%, as a small number of large-cap stocks have driven performance. This poor breadth has also been a factor for Canadian small caps. Excluding the top 10 stocks (~3% of the index), the aggregate return for the benchmark is -5% in 2023. Expanding this to the top 10% of stocks, the remaining 90% are -8% on the year, while excluding the top quartile shows -11% for the remaining three quarters of the index. If you have been under-indexed to pockets in energy, resources, and cyclicals, 2023 has been a challenging period.

As noted above, one area of the market showing strength is energy. Years of investor apathy and underinvestment, combined with the downside shock of the COVID pandemic has led to a much more disciplined supply dynamic in the sector. In our view this has lifted the floor higher on commodity prices, while at the same time companies have embraced shareholder-friendly capital return frameworks and lower balance sheet leverage. We added Logan Energy (LGN) during the period, see notes below.

It has been a challenging year so far for Canadian small cap investors with trading activity increasingly volatile on company updates. The market has taken a "shoot first, ask questions later" mentality on negative revisions (however short term they may be) or perceived macro headwinds. For example, for a representative basket of stocks in the portfolio that underperformed during the quarter, consensus earnings expectations actually increased ~1% over the three months. However, the negative moves in the stocks were driven by sentiment, with multiples compressing ~14% during the same period. Market emotion has swung much more towards the immediate-term environment versus the future earnings power of the business. For this same basket of stocks, the market currently ascribes trading multiples ~33% below their individual five-year averages. We acknowledge the higher rate environment today and the real impact on valuations, but also highlight the drastic undershoot that can occur on high quality names currently out of favour

– and the large latent valuation upside potential in the portfolio.

BUYS

Logan Energy (LGN)

Logan Energy a high-growth junior Montney producer lead by the highly regarded team behind previous Spartan entities. Their track record of growing production accretively, while managing the inherent risks in the sector, has resulted in a number of previous wins for shareholders. We like LGN's assets and the team behind it and think it will benefit meaningfully from the completion of the west coast LNG development over the coming years.

SELLS

None.

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