BARRANTAGH
Investment Management

BIM REVIEW

1Q24 | HURRY UP AND WAIT FOR THE FIRST RATE CUT

INVESTMENT ENVIRONMENT

- Upside surprises to growth and slower than expected progress on disinflation halved the expected pace of easing to take place in 2024.

EQUITY MARKETS

- Positive momentum and broader participation trends continued. A pickup in mergers and acquisitions activity implies improving corporate confidence.

FIXED INCOME MARKETS

- Acting too early could reignite inflation, and moving too late could lead to recession, so central bankers await clear signals to start cutting rates.

INVESTMENT ENVIRONMENT | CENTRAL BANKERS IN THE SPOTLIGHT

Embracing the momentum from a change in messaging from the U.S. Federal Reserve (The Fed) last fall, markets began the year factoring in approximately six rate cuts or 150 bps of easing for 2024. **Fast forward to the end of March, and upside surprises to growth data and slower than expected progress on disinflation pared back expectations to just under 3 cuts or 75 basis points (Figure 1).**

For some time The Fed has indicated that their actions will be data dependant and economic releases have yet to force their hand. Policymakers have termed the timing of an eventual first rate cut as significant and their preference for continued patience in containing inflation before taking such a step. A still healthy economy and labour markets also provide cover for cautious approach. Going forward, particular attention will be paid to the upcoming consumer price index (CPI) data for which there will be three releases prior to the June Fed update (which as of the end of March was the meeting at which the market expected the first rate cut).

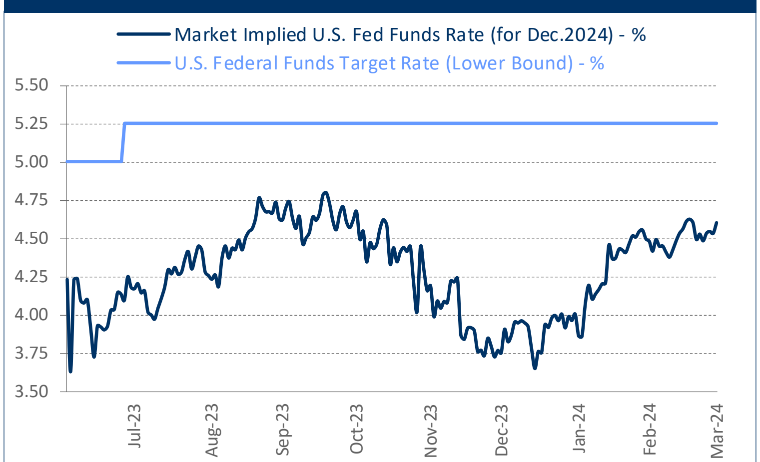
One potential development that would likely provoke a policy response would be an unexpected weakening in the labour market which to date remains resilient. While unemployment remains low at just under 4 percent, a revival of the prior linkage between it and U.S. job openings which broke down during the pandemic might signal some potential stress ahead and warrants monitoring (Figure 2). On a related note, companies with exposure to the low-end consumer have highlighted discretionary spending pressure, though behaviour of those in higher income brackets has been relatively unaffected to date outside of a few select subcategories. Headline consumer confidence surveys appear benign for the time being.

In contrast to the U.S., the Chinese economy has not been on sure footing of late enduring a difficult 2023 and start to this year. Yet recent data offered some signs of improvement with the manufacturing purchase managers index moving back into expansionary territory for the first time since last autumn. Measured stimulus alongside recovering exports and electronics demand has been encouraging though a lacklustre job market and still struggling property sector remain areas of concern. Actions including a cut to bank reserve requirement ratios seem to be having their intended effect as credit markets have become less restrictive. Some heavy lifting may still be required for China to hit the 5 percent growth target for 2024 though recent green shoots are certainly welcome events.

Global economies have faced significant challenges since 2020, including the recent spike in interest rates. However, despite these headwinds, most economies have demonstrated remarkable resilience. Looking ahead, we can expect a return of some positive tailwinds as interest rates start to moderate. This will provide some much-needed support to consumer spending and job growth, both crucial for economic expansion, particularly in-light of various political and economic uncertainties that remain. As such, it is important for businesses and portfolio managers to adopt a balanced approach to decision-making when faced with evolving market conditions.

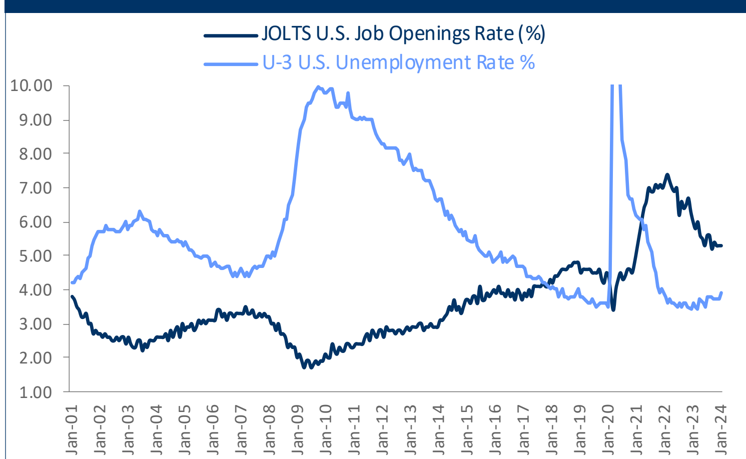
Equity markets extended their gains despite a repricing of Fed rate cut expectations in part due to better than expected growth data, while fixed income markets were more subdued. Financial markets will likely be quite responsive to economic data in the near-term which could introduce some volatility in the coming months.

FIGURE 1: EXPECTED PACE OF EASING HALVED SO FAR YTD



Source: Bloomberg

FIGURE 2: JOB OPENINGS AND UNEMPLOYMENT



Source: Bloomberg: Last Data Point = 5.3 (JOLTS), 3.9 (U.R.) at Feb-24

EQUITY MARKETS | POSITIVE MOMENTUM AND BROADER PARTICIPATION TRENDS CONTINUED

Equity Index Returns	1Q24 (CAD)	1Q24 (USD)	YTD24(CAD)	YTD24(USD)
Global (Net)	11.7%	8.9%	11.7%	8.9%
Canadian	6.6%		6.6%	
CDN Small Cap	7.9%		7.9%	

In the first quarter, the global index performance remains buoyed by the technology sector, driven by robust growth trends in artificial intelligence (AI) that have instilled significant confidence in investors. **While the rapid expansion of AI has exceeded expectations, there has been a recent diversification in equity returns towards undervalued and cyclical stocks.** This broadening can be attributed in part to global central banks' anticipation of inflation stabilizing within an acceptable range, thereby prompting a shift towards monetary policies featuring interest rate cuts in 2024. The resilient job market has effectively weathered peak inflation and interest rates extremely well thus far. Furthermore, with consumer and corporate demand expected to benefit from a lower interest rate environment, the employment situation should remain healthy. Canadian markets also benefited from the above mentioned broadening theme with positive impacts from many industries though none greater than the Energy sector which had the largest overall contribution.

BIM EQUITY FRAMEWORK

Mergers and acquisitions activity has shown considerable strength this quarter, signalling a willingness among corporations to take on risk and adopt a more proactive growth strategy (Figure 3). Additionally, IPO activity and debt issuance have demonstrated noteworthy strength this year, indicating a robust recovery from several quarters of subdued activity. While these indicators can be subject to volatility and reversals if economic conditions deteriorate, the current momentum highlights a positive trajectory following a period of relative stagnation. From an investment perspective, our Quality Value strategy prioritizes companies with disciplined capital allocation practices and a proven track record of successful acquisitions. Management teams with this expertise are well-positioned to capitalize on the current environment and drive shareholder value.

GLOBAL MARKETS

The global freight industry is in a period of transition. The initial post-pandemic surge in goods demand has faded, with volumes declining as consumer spending shifted towards services and companies reduced excess inventory. However, this trend is expected to reverse in 2024. A strong labor market should lead to renewed demand for consumer goods, while companies are simultaneously nearing the completion of their destocking cycles.

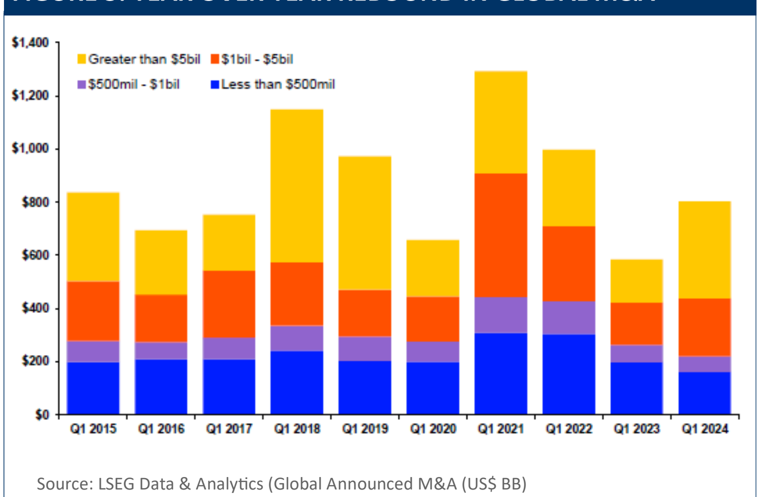
Such developments create a favorable environment for freight demand, particularly benefiting railroads. Not only are railroads a cost-effective and eco-friendly means of transportation, but they also stand to gain from the trend towards local and friend-shoring within North America. Notably, our investments in Union Pacific and CPKC railroads boast networks that reach into Mexico, which positions them to capitalize on the recent surge in exports to the US from that country.

CANADIAN ALL-CAP MARKET

In the 3Q23 edition of the BIM Review, we noted the potential benefits for the Canadian oilpatch as the Trans Mountain Expansion project (TMX) neared completion. Line-fill activities are now taking place ahead of an expected 2Q24 in service date with utilization to ramp-up in the coming years alongside narrowing price discounts for Canadian heavy oil. Improved relative pricing for Canadian natural gas may also be soon at hand with the completion of construction and commissioning activities for the TC Energy led Coastal Gaslink pipeline that will supply feed gas to the LNG Canada export terminal. Recent comments from an LNG Canada ownership consortium member implied that the maiden cargo of liquefied natural gas (LNG) that will finally connect Canada with global markets could ship by the end of this year with the run rate of ~ 2 bcf/d expected to be achieved by mid-2025.

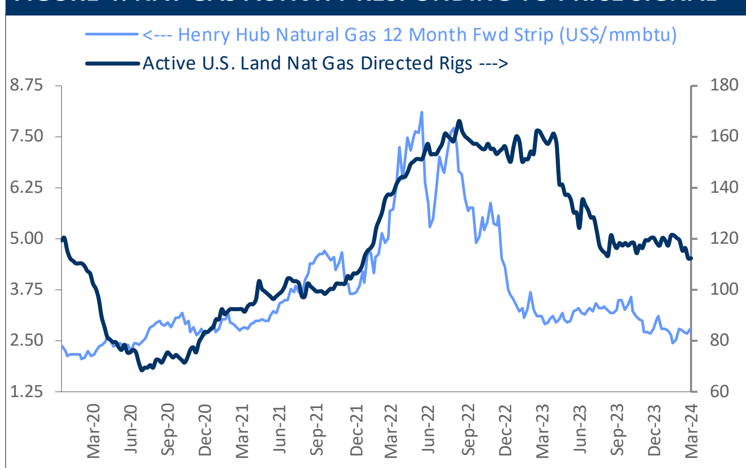
Natural gas demand growth is underpinned by the wave of oncoming North American LNG export projects and thermal power market share gains from coal. The fuel should also benefit from the ongoing build out of data centers which are largely powered by renewables, though also require baseload support due to the intermittent nature of wind and solar. Nonetheless, weather remains a wildcard for natural gas, and two consecutive warm winters hurt heating demand and storage inventories have inflated. The swoon in pricing has elicited a supply response with some U.S. players including Chesapeake Energy, and EQT Corporation either reducing capital spending plans or curtailing production. These actions are now showing up in the natural gas directed rig counts and spending discipline often contributes to improved fundamentals ahead (Figure 4).

FIGURE 3: YEAR OVER YEAR REBOUND IN GLOBAL M&A



Source: LSEG Data & Analytics (Global Announced M&A (US$ BB)

FIGURE 4: NAT GAS ACTIVITY RESPONDING TO PRICE SIGNAL



Source: Bloomberg

CANADIAN SMALL-CAP MARKET

The positive momentum for equity markets continued into 2024, with risk appetite broadening from the narrower group of winners in the previous year. Supportive economic conditions and normalizing inflation has kept sentiment towards equities strong, though expectations for rate cuts have been meaningfully trimmed since the start of the year. Small caps performed well, aided by a strengthening commodity backdrop and a corresponding surge in resource names.

One area where we have observed a broadening of performance during the period was in the information technology sector. Our holdings, which we would describe as "value tech" (dividend payers trading at attractive valuations) were out of favour last year in a rising interest rate environment. Dye & Durham (DND) was impacted by a slow real estate market and higher borrowing costs, while Softchoice (SFTC) navigated a period of moderating I.T. spending from their customers, specifically around hardware sales. Today, some of these headwinds have shifted to tailwinds. DND has used more amenable credit markets to opportunistically refinance debt and is seeing pent-up demand building for housing transactions. SFTC grew through the market slowdown due to strength in their software/cloud solutions and signaled strong future free cash flow expectations to the market by issuing a sizable special dividend yielding 27%. Both stocks performed quite strongly during the first quarter.

BIM EQUITY THESIS SPOTLIGHT

RB Global is a leading provider of value-added auction services for commercial equipment and vehicles. Through its auction sites and digital platforms, the company serves customers in more than 170 countries. The company's extensive infrastructure and robust network of buyers and sellers provides a strong value proposition for its clients and underpins its competitive moat. The capital light nature of the consignment auction model produces strong returns on invested capital.

The company is best known for its Ritchie Bros. platform, which primarily focuses on commercial equipment. However, the early-2023 acquisition of IAA saw the company gain a leading position in vehicle auctions and nearly doubled the size of the company. We believe both verticals have tailwinds as improved construction equipment production should create asset turnover and moderating used car prices should incent insurers to write-off more vehicles for salvage. Additionally, we believe the company is in the early stages of extracting meaningful synergies from the combined businesses.

RB Global is trading at an attractive valuation as investors are not yet giving the company credit for the benefits of the IAA platform. However, improving service metrics in this business since the acquisition combined with CEO Jim Kessler's extensive experience interfacing with insurance clients underpins our belief that the company will reap the rewards of this acquisition.

FIXED INCOME MARKETS | BOND MARKETS TRYING TO KEEP A STEP AHEAD OF THE FED

Fixed Income Index Returns	1Q24	YTD24
Canadian	-1.2%	-1.2%

Economic data released in the first quarter of 2024 was encouraging. In Canada, GDP slowed throughout the quarter but remained positive, CPI stayed below 3%, and the unemployment rate was steady. In the U.S., GDP was fairly strong, the Federal Reserve's (The Fed) favoured measure for inflation remained below 3%, and unemployment held at around 3.9%. Both the Bank of Canada (BoC) and The Fed held two meetings during the quarter and each decided to keep the target overnight rate unchanged. The rationale for standing pat was a preference to have a greater level of confidence that inflation is moving sustainably towards 2% before making a move.

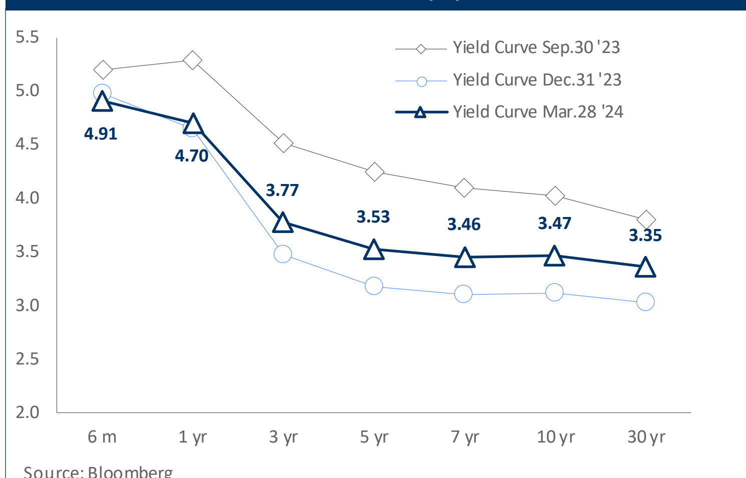
Expectations for rate cuts evolved as the quarter progressed. We started the year pricing in approximately 6 cuts in the U.S. and 5 in Canada for 2024 which reduced to about 3 cuts in both the U.S. and Canada by quarter end. **Commentary from Chair Powell and Governor Macklem acknowledged that monetary policy is tight, and that the timing of the first rate cut is important as acting too early could reignite inflation, and moving too late might lead to recession.** These outlooks underpin the data dependency of both central banks when setting monetary policy. We therefore expect volatility in the bond market to persist a little longer as market participants try to stay one step ahead of The Fed and BoC.

In the first quarter we saw peak to trough moves of 45 basis points in the long-end, and close to 60 basis points in the short-end of the curve. At quarter-end, Canadian Government bond yields closed wider to where they started with the greatest movement in the middle of the curve. 2-year yields moved by 28 basis points, the middle of the curve (5 and 10 year) by 35 basis points, and the long-end by 30 basis points as the higher-for-longer theme reasserted itself as the quarter came to a close (Figure 5).

BIM FIXED INCOME FRAMEWORK

Portfolios started the quarter positioned with a slight underweight in duration and an overweight in corporate bonds. By quarter-end, we had moved duration longer and reduced exposure to corporate bonds. Once we gain more conviction that rate cuts in Canada will be imminent, we will look to reduce our barbell approach (overweight in the short and long-end and underweight the middle of the curve) while also increasing our duration. Our overweight in corporate bonds has reduced somewhat and we remain biased towards shorter dated holdings, though any further moves would be dictated by incoming economic data and movement in spreads. At the current time, we have a bit of extra liquidity available to take advantage of any dislocations that might occur in the market.

FIGURE 5: CANADIAN YIELD CURVE (%)



Source: Bloomberg

BARRANTAGH
Investment Management

100 Yonge Street, Suite 1700
Toronto, Ontario M5C 2W1
(416) 868-6295
www.barrantagh.com

Barrantagh Investment Management Inc. provides disciplined portfolio management to institutional and individual investors. The firm is committed to a high level of client service provided directly by its experienced partners. We are dedicated to preserving our clients' capital while generating growth through consistent application of our quality value-based fundamental investment philosophy. We manage portfolios on a segregated basis to meet our clients' investment objectives. Because the firm is owned by our professional staff we maintain a completely independent and objective perspective.

For more information contact: Barrantagh Investment Management Inc. (416) 868-6295