CUMBERLAND

Private Wealth

June 30, 2023

Second Quarter Review

NORTH AMERICAN EQUITY STRATEGY

So "What's Going On" according to Ed Yardeni June 2nd, 2023.

> *"The US government won't default on its debts. There are plenty of jobs. Unit-labor-cost inflation is moderating. The banking crisis is abating. The recession is still a no-show. Earnings were better than expected during Q1 and are probably bottoming during the current quarter (Q2). The FOMC likely will pause (they did) its rate hiking for at least one meeting. AI will boost productivity if it doesn't kill us. Summer is coming. No wonder the S&P 500 sailed to a new 2023 high yesterday."*

This quote was music to our ears even if it was not from Marvin Gaye. It is in line with our current thinking at Cumberland and pretty much summed up what happened in the second quarter. In fact, the S&P500 officially entered a new bull market on June 8th, up more than 20% from its 52-week low of 3577.03 on October 12th, 2022.

Let's start with a review of the performance of the markets in the second quarter and then drill down on a few of these points raised above. During the second quarter, the S&P500 total return was +8.7% in US dollars. Adjusting for currency, the S&P500 returned +6.4% in Canadian dollars, since the Canadian dollar appreciated about +1.5 cents, closing the quarter at US$0.7552. The TSX total return was +1.1% in the second quarter. While technology stocks continued to dominate the performance of the S&P500, we did see considerable widening in the breadth of performance late in the quarter as the market began to price in the possibility of an economic soft-landing (no recession). Meanwhile, in Canada, energy and materials held back the performance of the resource-heavy TSX.

As was generally expected, the Federal Open Market Committee (FOMC) of the Federal Reserve (Fed) voted not to raise the Federal Funds Rate at its June 14th meeting. At Fed Chair Powell's press conference, he stressed the need for more time to assess the impact of "long and variable lags" of the Fed's massive tightening cycle that began in March 2022. Perhaps more interesting was the Fed's June release of its Summary of Economics Projections (SEP) shown in **Exhibit 1**. For 2023, the Fed raised its economic forecast for real GDP growth to 1.0% from 0.4%, reduced their target unemployment rate to 4.1% from 4.5% and lowered their PCE inflation forecast from 3.3% to 3.2%. Individually, these numbers might be considered rounding errors but collectively, we don't think so as the moves all suggest an improving economic picture and arguably lend more support to the soft-landing versus recession camp. Also supporting the soft-landing camp were the strong non-inflationary payrolls data for May (released June 2nd) as 388,000 new jobs were created versus consensus of 188,000, while the unemployment rate rose from 3.4% to 3.7% as more people were looking for work.

The one negative in the June SEP was that the Fed raised their forecast for interest rates this year from 5.1% to 5.6% or two more 25 basis point hikes. This likely reflects the Fed's concern about stickier core PCE inflation also shown in the Fed's SEP, although May's report (released June 30th) directionally showed an improvement. So, the question we are asking ourselves is whether two more rate hikes is enough to undermine the soft-landing scenario that the market seems to be acclimating towards or whether they will hike only if the economy can support it and will be truly data dependent as the Fed stated, "*Holding the target range steady at this meeting allows the Committee to assess additional information and its implications for monetary policy*". Currently, the market is pricing in only one more hike as shown in **Exhibit 2** and then rates falling considerably in 2024. There will not be a lot of economic data out between now and the next Fed meeting on July 26th, so right now it's a bit of a coin flip whether we see another rate hike at this next meeting or not.

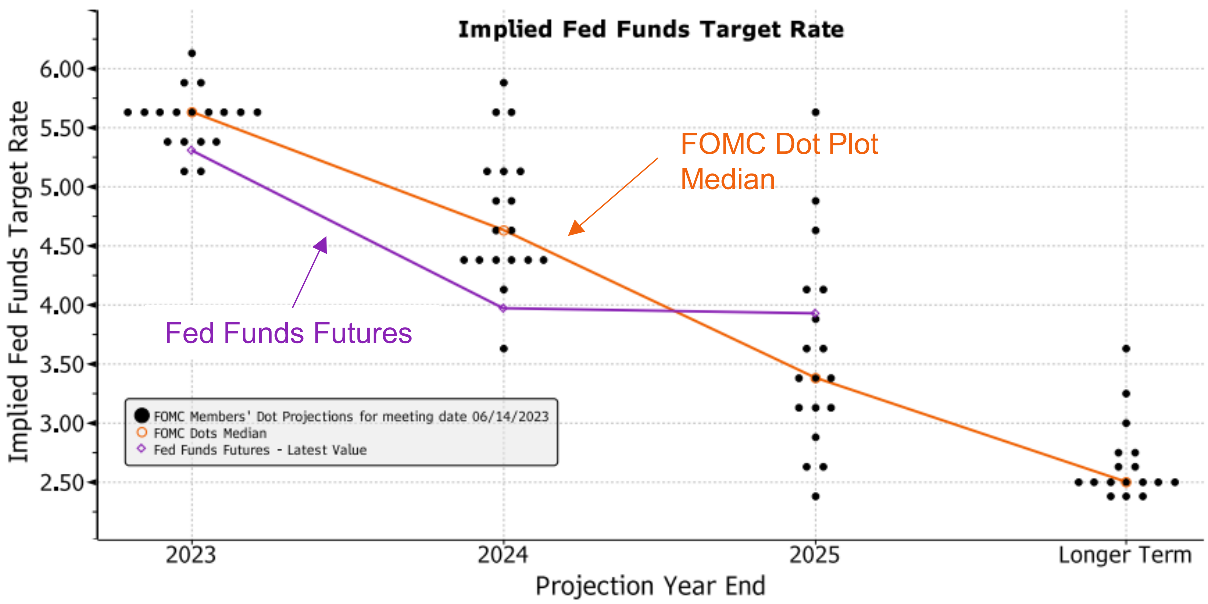
Exhibit 1: FOMC Summary of Economic Projections

Percent

Variable	Median[1]			
	2023	2024	2025	Longer run
Change in real GDP	1.0	1.1	1.8	1.8
March projection	0.4	1.2	1.9	1.8
Unemployment rate	4.1	4.5	4.5	4.0
March projection	4.5	4.6	4.6	4.0
PCE inflation	3.2	2.5	2.1	2.0
March projection	3.3	2.5	2.1	2.0
Core PCE inflation[4]	3.9	2.6	2.2	
March projection	3.6	2.6	2.1	
Memo: Projected appropriate policy path				
Federal funds rate	5.6	4.6	3.4	2.5
March projection	5.1	4.3	3.1	2.5

Source: Federal Open Market Committee (FOMC), Summary of Economic Projections, June 14, 2023

Exhibit 2: FOMC Implied Fed Funds Target (Median Dot Plot)



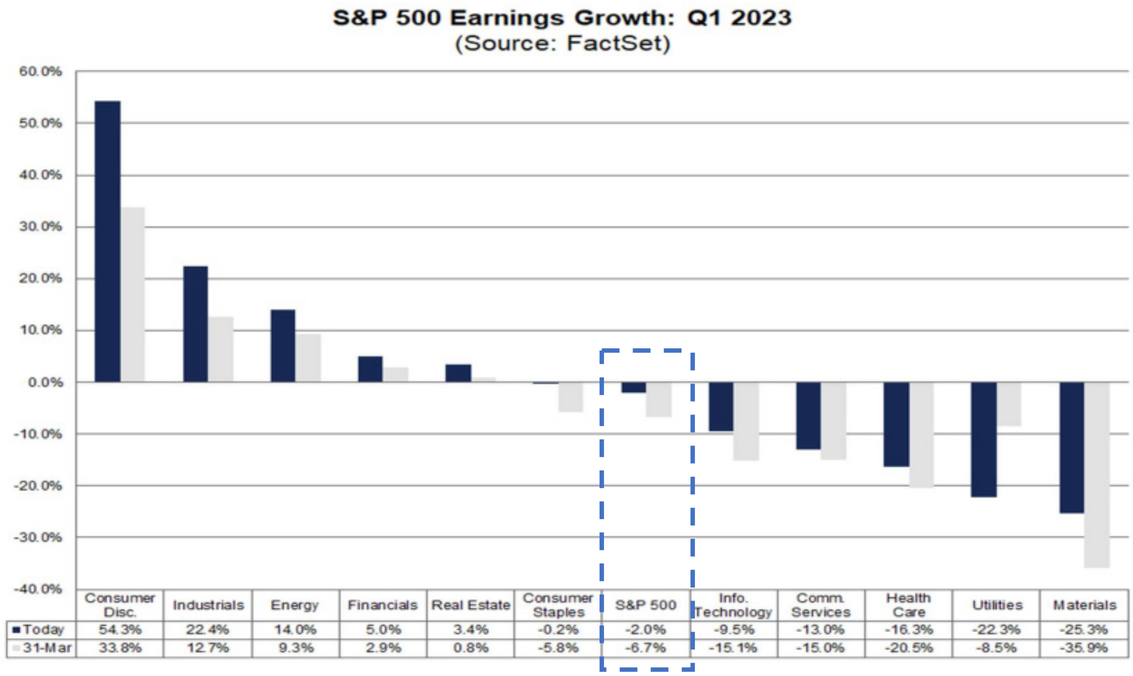
Source: @TheTerminal, Bloomberg Finance L.P. Daily Shot

Regarding the earnings outlook for the S&P500, on March 31st, Q1 earnings growth was expected to be down -6.7% but once companies reported, earnings were down only -2.0% according to FactSet. As indicated in **Exhibit 3**, earnings in every sector of the S&P500 rose more or fell less in the first quarter than the market anticipated, except for the Utilities sector, which makes up only 2.8% of the S&P500 index weight.

Exhibit 4 shows the earnings growth expectations for Q2. It now looks like earnings will bottom this quarter (Yardeni agrees) and return to growth in Q3 with high single digit growth of 8.2% expected in Q4 according to FactSet. While the tech heavy Communications Services, Consumer Discretionary and Information Technology sectors dominate that growth in Q4, as outlined in **Exhibit 5**, it is also important to note that 9 of the 11 sectors are expected to report year-over-year earnings growth, with the only exceptions being materials and energy. In our opinion, this level of earnings growth breadth should be supportive of the soft-landing camp.

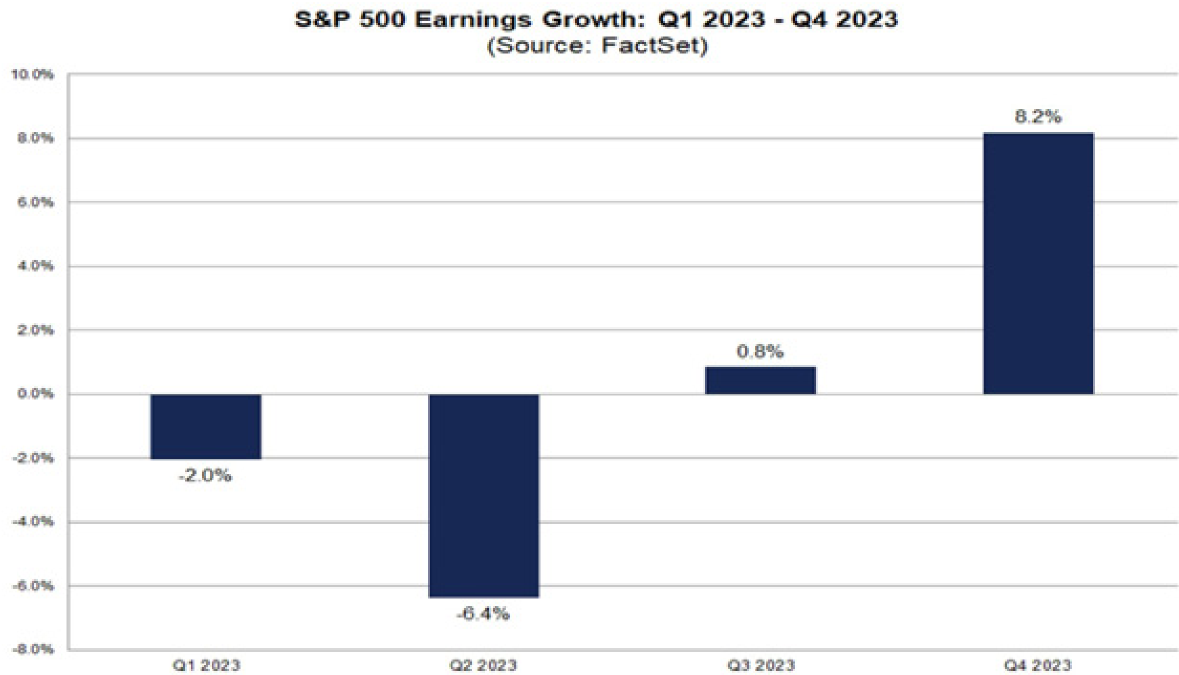
One of the biggest concerns in the market during the second quarter was that we were amid an extreme “Mega-Cap Divergence” in performance from a market breadth perspective (**Exhibit 6**). Essentially, this means that the market was being held up by a few very large companies, mostly in the Technology sector, while the rest of the companies struggled. How these divergences are resolved depends on the market breadth going forward. Until recently, breadth had tracked right in line with negative resolutions implying the market would go lower if tech companies began to fade unless market breadth improved and other companies could pick up the slack. And in fact, a dramatic improvement in breadth recently has seen the percentage of S&P 500 stocks above their 200-day moving average, increase from 38% to 53% in four trading sessions in June as shown in **Exhibit 6** and currently sits at 62% as of the time of writing this report. Once again, we think this is supportive of the soft-landing camp.

Exhibit 3: S&P 500 Earnings Growth: Q1 2023



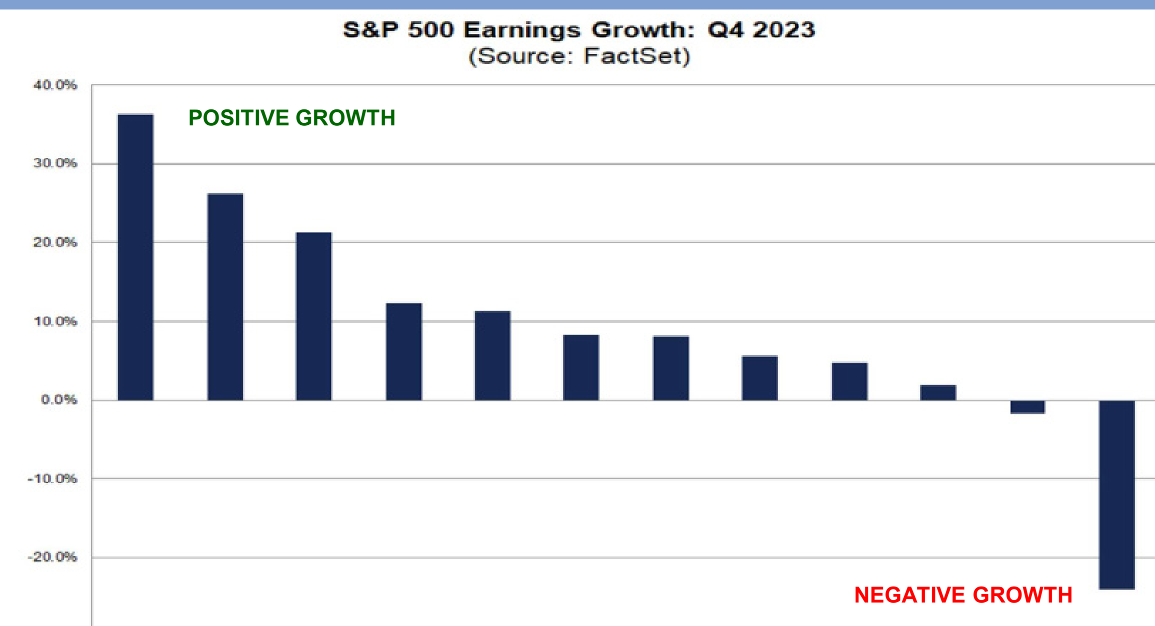
Source: FactSet, Earnings Insight

Exhibit 4: S&P 500 Earnings Growth Q1 2023 – Q4 2023



Source: FactSet, Earnings Insight.

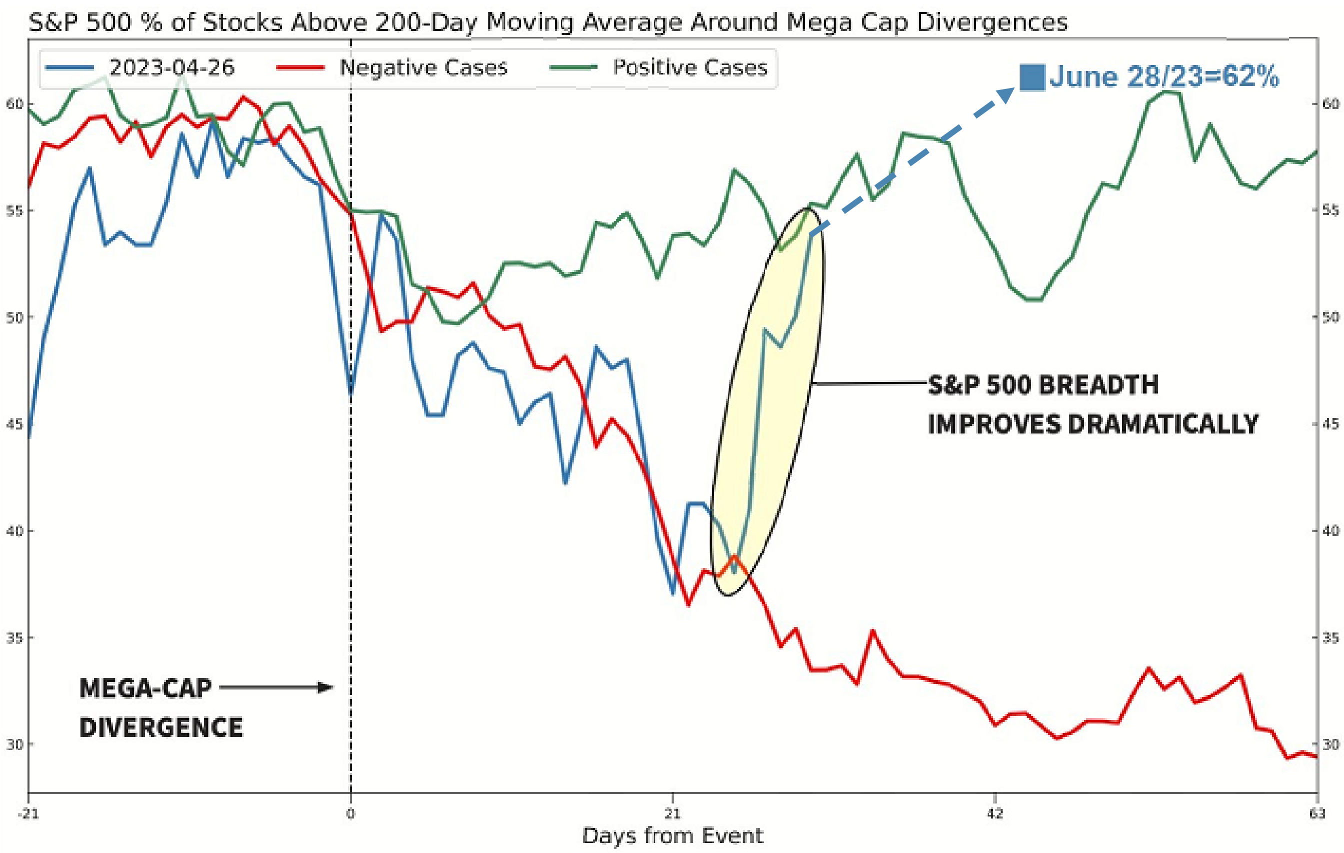
Exhibit 5: S&P 500 Earnings Growth by Sector Q4 2023



	Comm. Services	Utilities	Consumer Disc.	Info. Technology	Financials	S&P 500	Industrials	Consumer Staples	Real Estate	Health Care	Materials	Energy
Earnings	36.3%	26.2%	21.3%	12.4%	11.2%	8.2%	8.0%	5.6%	4.8%	1.9%	-1.7%	-24.1%

Source: FactSet, Earnings Insight.

Exhibit 6: Historical Mega Cap Divergences & Market Breadth Event Study.
S&P500 % of stocks Above 200-Day Moving Average Around Mega Cap Divergences.



Source: 3FOURTEEN Research, Bloomberg

Switching to valuation, **Exhibit 7** compares the average forward price to earnings multiple (P/E) over the past two decades (dashed lines) to the current forward P/E multiples (solid lines) for the S&P500, the TSX and the benchmark for Europe (red, yellow and grey lines respectively).

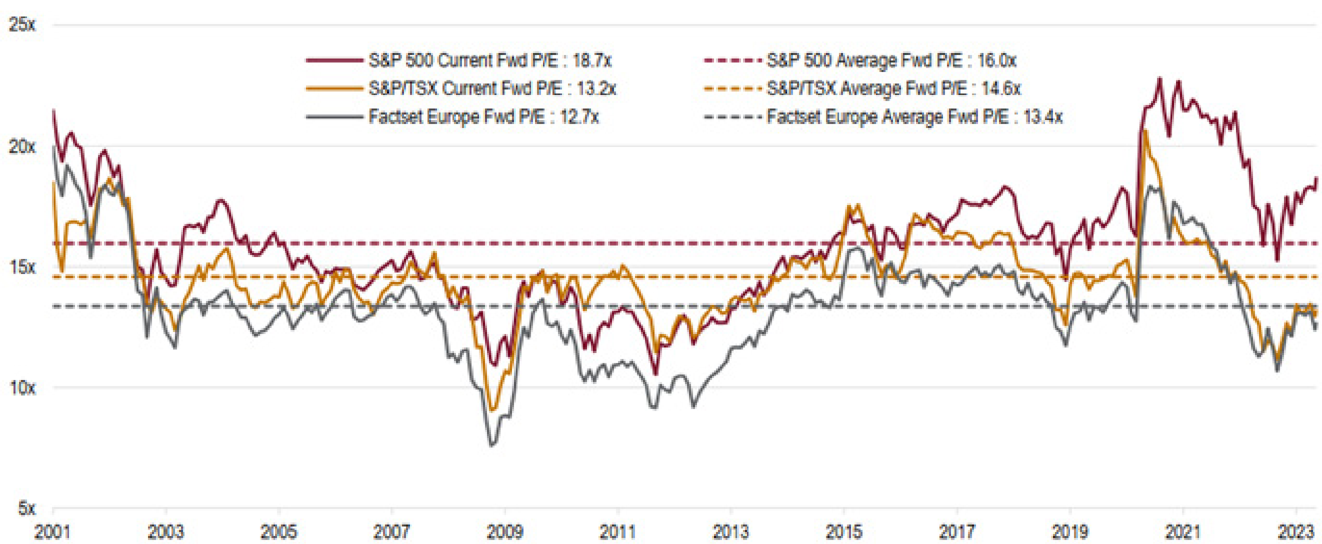
The historical average for the S&P500 is 16.0x, the TSX 14.6x and the benchmark for European equities is 13.4x. Given the fact that many of the top performing global growth companies are domiciled in the US, it is not surprising that the S&P500 average multiple is higher than the other markets.

Comparing the historical to the current forward P/E multiples, we see that both the TSX currently at 12.7x and the FactSet European index currently at 13.2x, trade at a 10% and 5% discount respectively, to the 20-year average suggesting they are cheap, at least relative to historical measures. On the other hand, the S&P500 looks expensive at 18.7x relative to the historical average of 16.0x. Clearly this valuation multiple has been skewed upward by the heavyweight mostly technology stocks in the S&P500, which typically trade at higher multiples reflecting their superior earnings growth rate and share price performance. **Exhibit 8** shows the ten largest securities in the S&P500 by weight, their corresponding valuation and last 12 months (LTM) share price performance. As indicated in the chart, these stocks have outperformed by a factor of almost 4x as they are up 26% compared to 7% for the S&P500.

Currently, we own five of the ten stocks on this list (Apple, Microsoft, Alphabet, Facebook and United Health Group), which are not the most expensive on the list of ten, but trade at higher valuations than the market. We are still comfortable with the valuations, as evident in **Exhibit 5** above, these sectors are where the bulk of the earnings growth in the latter half of 2023 and 2024 is coming from. We also balance this allocation to these more growth-oriented names by owning many value-oriented stocks that trade at lower multiples on next year's earnings with attractive upside potential such as GM (6.1x), Elevance Health (12.0x), Royal bank (10.5x) and Rogers Communications (10.7x). The one commonality here is that all of our companies, whether growth, value, cyclical or non-cyclical, have a history of higher-ranking return on equity (ROE) or return on invested capital (ROIC), both of which are characteristics associated with superior total returns.

Exhibit 9 shows the same average forward P/E chart as **Exhibit 7** comparing valuations for the top ten weighted companies (yellow line) to the S&P490 (S&P500 minus the 10 largest companies; red line). Removing the top ten stocks, the valuation for the S&P490 at 16.4x is more in line with the historical average multiple of 16.0x suggesting the S&P500 excluding this top ten group is not that expensive.

Exhibit 7: Regional Indices-Forward Price/Earnings, 2001 to Current



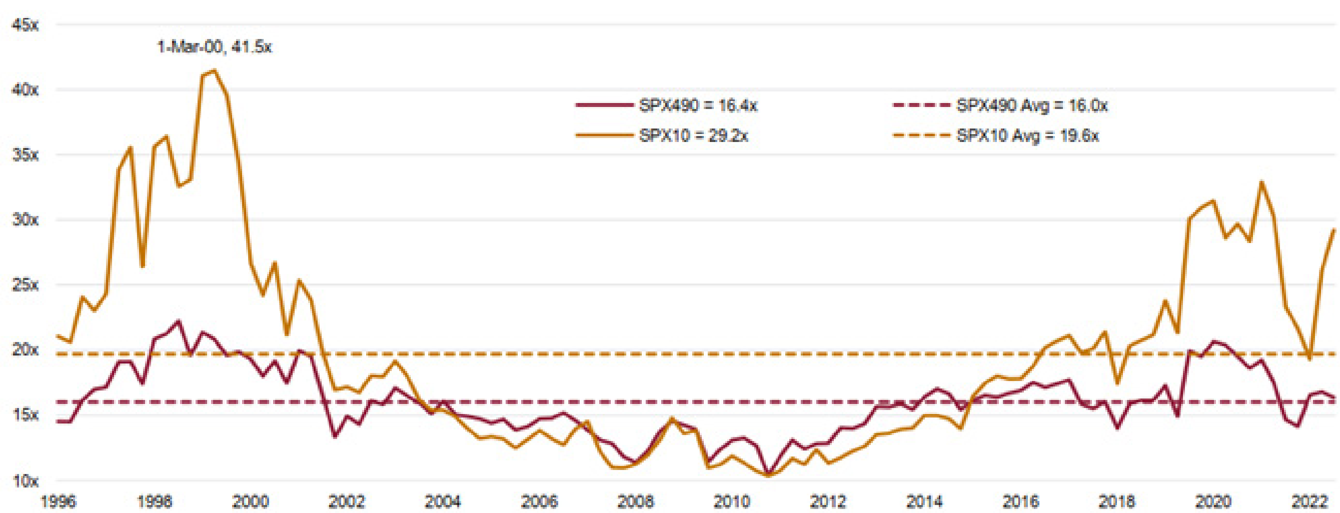
Source: CIBC Capital Markets, FactSet.

Exhibit 8: S&P 500 – 10 Largest Securities, Forward P/E, Weight, Performance.

Company Name	Forward P/E	Weight	Weight of Top 10	LTM Performance
APPLE INC.	28.2x	7.6%	25.3%	27.6%
MICROSOFT CORPORATION	29.8x	6.5%	21.6%	24.6%
AMAZON.COM, INC.	60.4x	3.4%	11.3%	6.3%
NVIDIA CORPORATION	46.7x	2.6%	8.5%	115.0%
ALPHABET INC. CLASS C	21.1x	2.3%	7.5%	6.4%
ALPHABET INC. CLASS A	20.9x	1.9%	6.5%	6.9%
TESLA INC	61.1x	1.8%	6.1%	2.0%
FACEBOOK, INC. CLASS A	20.3x	1.6%	5.2%	44.0%
UNITEDHEALTH GROUP INCORPORATED	18.7x	1.2%	4.1%	2.2%
BERKSHIRE HATHAWAY INC. CLASS B	20.5x	1.2%	3.9%	8.5%
Total (Weighted Average for P/E and Performance)	29.2x	30.0%	100.0%	26.6%
S&P 500	18.7x			7.0%

Source: CIBC Capital Markets, FactSet, (06/07/2023).

Exhibit 9: S&P 500- Top 10 and Ex-Top 10 Weighted Securities, Forward P/E, 1996 to Current



Source: CIBC Capital Markets, FactSet.

Portfolio Review

Asset Allocation for our North American Equity Strategy As of June 30, 2023	
Equities	94%
Fixed Income	0%
Cash	6%

During the quarter, our overall equity exposure was unchanged at 94%. Our US equity exposure increased from 40% to 42% while our Canadian exposure decreased from 54% to 52%. Cash was unchanged at 6%. It is important to note that many of our clients' portfolios are invested in our North American plus International Equity strategy, meaning that the actual weights of US and Canada within their equity holdings will be proportionately less than this given the allocation to international companies.

Currently our portfolio is positioned toward value-oriented stocks (including financials, consumer discretionary, industrials, energy and materials) making up 58% of the portfolio, however this has declined from 63% on December 31st while exposure to growth stocks (including healthcare, information technology and communication services) increased to 34% up from 29% on December 31st. During the quarter we added new positions in Novo Nordisk ADR (healthcare) a leading drug provider in diabetes and obesity care, semiconductor maker Applied Materials (information technology), which is committed to accelerating the delivery of improved chips for artificial intelligence (AI) and Quebecor Inc (communication services), which through the acquisition of Freedom Mobile has the potential to become Canada's fourth national wireless player. Staples (2%), which we don't classify as either growth or value, make up the balance of our equity exposure. A complete review of the business and fundamental outlook for new companies purchased during the quarter can be found in Appendix 1.

Closing Comments and Outlook

On June 8th, the S&P500 closed more than 20% from its 52-week low of 3577.03, which occurred on October 12th, 2022. According to BMO Capital markets, once this 20% threshold has been met, that low signaled the beginning of a new bull market in 10 of 13 occasions since 1950 (**Exhibit 10**). And on average, the S&P 500 has historically jumped an additional 10.1% and 17.5% in the following six- and twelve-month periods respectively, with a 71% and 92% probability of occurring.

Exhibit 10: S&P 500 Price Performance Following 20% Gains Off Bear Market Lows (Bear Markets since 1950)

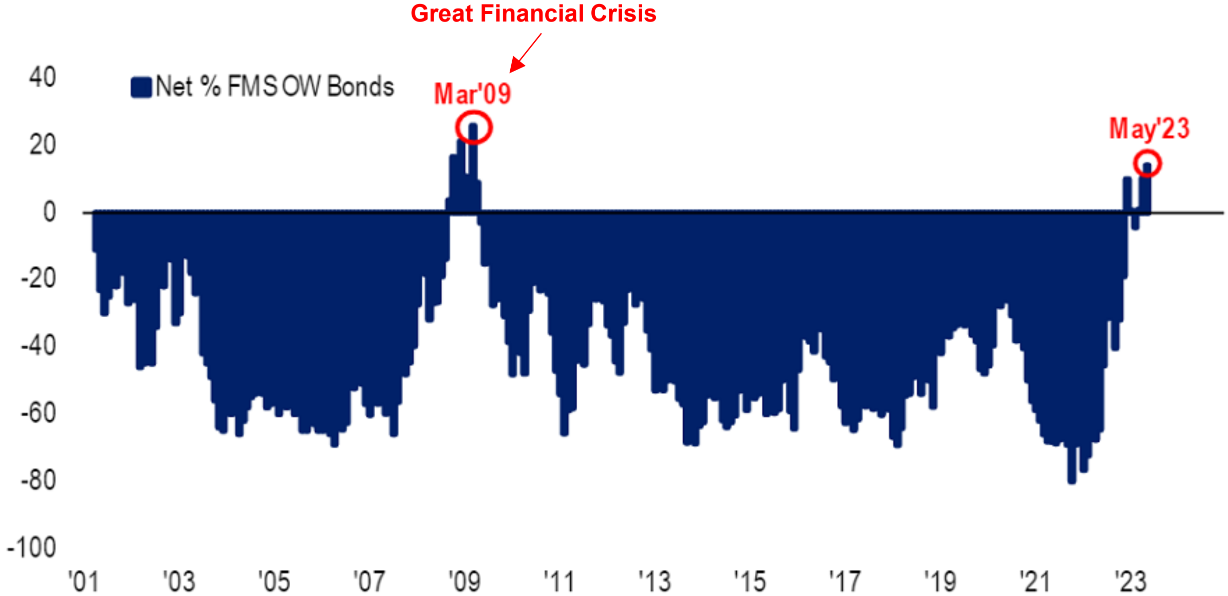
Start of Bear Mkt	Bear Mkt Low	Actual Bear Mkt Low?	Price % Decline	Date of 20% Gain From Bear Mkt Low	+3-Mos	+6-Mos	+12-Mos
8/2/56	10/22/57	Yes	-21.6%	7/25/58	8.2%	19.2%	27.0%
12/12/61	6/26/62	Yes	-28.0%	12/5/62	2.9%	12.1%	18.1%
2/9/66	10/7/66	Yes	-22.2%	2/14/67	6.0%	7.3%	2.2%
11/29/68	5/26/70	Yes	-36.1%	9/24/70	7.9%	18.7%	17.2%
1/11/73	10/3/74	Yes	-48.2%	11/5/74	5.1%	19.9%	18.7%
11/28/80	8/12/82	Yes	-27.1%	9/14/82	11.6%	22.5%	34.3%
8/25/87	12/4/87	Yes	-33.5%	3/8/88	0.8%	-1.3%	9.1%
7/16/90	10/11/90	Yes	-19.9%	2/6/91	6.1%	9.1%	15.6%
3/24/00	9/21/01	No	-36.8%	12/5/01	-2.1%	-10.3%	-22.5%
3/24/00	7/23/02	No	-47.8%	8/22/02	-3.3%	-11.9%	3.2%
3/24/00	10/9/02	Yes	-49.1%	11/21/02	-9.2%	-1.1%	10.9%
10/9/07	11/20/08	No	-51.9%	12/8/08	-24.9%	3.2%	20.0%
10/9/07	3/9/09	Yes	-56.8%	3/23/09	8.8%	28.9%	42.7%
2/19/20	3/23/20	Yes	-33.9%	4/8/20	15.3%	25.3%	49.0%
1/3/2022	10/12/22	???	-25.4%	6/8/23	???	???	???
				Average	**2.4%**	**10.1%**	**17.5%**
				Prob of Gain	**71.4%**	**71.4%**	**92.9%**

Source: BMO Capital Markets, FactSet.

During the quarter, the Federal Open Market Committee (FOMC) voted not to raise the Federal Funds Rate at its June 14th meeting. For 2023, the Fed raised its economic forecast for real GDP growth, reduced their target unemployment rate and lowered their PCE inflation forecast. This more optimistic economic forecast also appears to be supported by the earnings outlook for the S&P500, where estimates for Q2 2023 now suggest earnings will bottom and return to growth in the second half of 2023. Collectively, we think these two factors reinforce the soft-landing versus recession camp.

Yet, according to the latest research from the Bank of America Global Fund Managers Survey, fund managers continue to grow more pessimistic on the outlook for the global economy and as shown in **Exhibit 11**, they are reducing risk in portfolios by increasing their exposures to bonds. Fears of a credit crunch and global recession have continued to drive bond allocations up to the largest over-weight since the great financial crisis in March 2009. Of course, that marked the bottom of the last major bear market, which started the 11-year run in equities right up to the COVID induced stock market meltdown in January of 2020. To the extent fund manager pessimism may be a contrarian indicator, it may create more performance opportunity on that rotation back into equities when so many people eventually reallocate their portfolios.

Exhibit 11: Bond overweight continues to increase toward Great Financial Crisis levels.



Source: Bank of America Global Fund Manager Survey-May 2023

In closing, we remain constructive on the equity market notwithstanding the recent rise in prices. While we can never rule out a technical correction as is common amid an ongoing bull market, we believe the underlying economic fundamentals should limit the downside. The earnings outlook looks to be improving and with economic growth slowing but likely not negative, interest rates should be closer to a peak than a trough, suggesting valuation is also less of a headwind going forward.

Peter Jackson
Chief Investment Officer
June 30, 2023

APPENDIX 1

NEW EQUITY INVESTMENTS:

NORTH AMERICAN EQUITY MANDATE

CANADA

Quebecor Inc.

Quebecor, with the acquisition of Freedom Mobile, opened a large avenue of growth for a company that has been traditionally restricted to the province of Quebec, thus limiting their future potential. Based upon their wireless success in Quebec, where Quebecor already had an established share prior to the acquisition and grew its share from essentially 0 to 23% in just over a decade, with the attractive deal they made with Rogers during negotiations for the Rogers/Shaw merger, we see a long runway ahead for Freedom that is not reflected in the present Quebecor share price.

UNITED STATES

Novo Nordisk ADR

Novo Nordisk is the leading diabetes & obesity pharmaceutical company in the world with a market capitalization of approximately US$360bn. This therapeutic area enjoys stable growth given the high incidence of the disease and the dominant positions of the top two players. Novo Nordisk maintains this leadership position through constant innovation. Its Ozempic drug is the most prescribed GLP-1 product, and which requires only a once weekly injection with superior hypoglycemic control compared to insulin, which is often injected multiple times daily. It is approved for type 2 diabetes but used off-label for weight loss. Ozempic also comes in a daily oral format under the brand Rybelsus. Novo Nordisk has moreover won FDA approval for a higher dose, injectable version of Ozempic specifically for use in obesity under the brand name Wegovy, which should support further adoption for this indication. Wegovy in clinical studies has shown the ability to help patients achieve weight loss of -15%. Such obesity therapies are still in the early days of adoption and are estimated to be a $50bn opportunity or higher. The Company also has numerous other candidates in various therapy areas to sustain growth in the long term. Strong growth and disciplined management have enabled the company to enjoy high margins and FCF, and in turn maintain a ~45% dividend payout and some buybacks while continuing to invest in its drug pipeline.

Applied Materials Inc.

Applied Materials is a leading supplier of advanced equipment, tools, inventory, and related maintenance services to logic (leading and trailing edge CPUs, GPUs, and microprocessors), memory (DRAM and NAND), and analog (sensors and power related) semiconductor companies. It is one of a handful of companies that the semiconductor industry relies on to enable next generation technologies. We believe there are several catalysts supporting our investment in Applied Materials. First, the entire semiconductor industry is growing due to key trends such as digitization, automation, and artificial intelligence. The companies manufacturing semiconductors rely on equipment companies, like Applied Materials, to provide the materials science, innovation, and advanced equipment to reduce transistor sizes, reduce power consumption, and increase performance in their chips. Second, and more specifically, Applied Materials will benefit from increased demand for semiconductors as generative AI applications become more prevalent. Third, geopolitical tensions surrounding China and Taiwan have resulted in Western countries building new semiconductor supply chains, which will require new equipment and ongoing maintenance from Applied Materials. Fourth, weakness in the memory market has likely bottomed and will likely improve in the coming quarters, which will cause memory companies to resume their capital spending plans with Applied Materials. Applied Materials has a strong balance sheet, and a history of achieving high return on invested capital, which we believe will continue.