Fourth Quarter 2023 Review

GLOBAL EQUITY AND INTERNATIONAL STRATEGIES

2023 Review:

After a tumultuous year in 2022, a year in which both stocks and bonds fell by double digits, stocks came roaring back in 2023. There are several factors that drove global equities higher in 2023 including low expectations, the absence of a global recession, and a faster than expected decline in the rate of inflation. Going into 2023 there was widespread fear about a recession on the back of surging inflation that had not been seen in decades. In response to this inflationary phenomenon, most central banks around the world raised interest rates aggressively during 2023. Given this backdrop, the consensus view was that the global economy was going to tip into a recession. The United States was front and centre as part of this recession call. In fact, the U.S. Conference Board's recession probability model called for a 99% chance of a U.S. recession at the beginning of 2023. However, and as we all know, a recession did not materialize. Not only did a recession not occur, but inflation started falling at a very rapid pace towards the end of the year. Given these developments, global equity market generated attractive gains in 2023 as seen in the chart below.

Index	Geographic Region	Currency	2023 Price change	2023 Total return with dividends
MSCI World	Global	US$	21.8%	24.4%
S&P 500	United States	US$	24.2%	26.3%
Euro Stoxx 600	Europe	Euro	12.7%	16.6%
Topix (Japan)	Japan	Yen	25.1%	28.3%

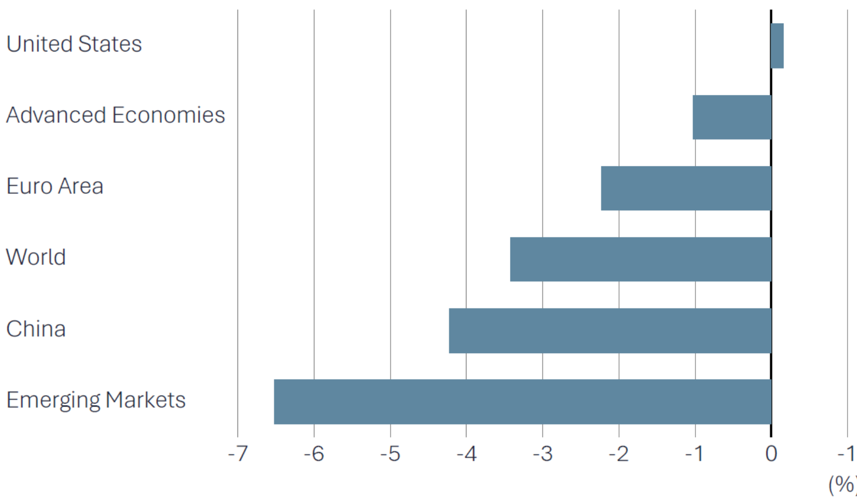
As noted above, the U.S. economy proved to be far more resilient in 2023 relative to expectations at the beginning of the year. The U.S. has also proven to be more resilient than most countries around the world. Some of the key factors that have led to this resilience include a robust labour market, the substantial stimulus that was deployed in the aftermath of the COVID pandemic, and landmark pieces of legislation such as the Inflation Reduction Act and the CHIPS Act.

Stimulus bills approved by Congress in 2020 unleashed the largest flow of federal money into the U.S. economy in recorded history. As a result of this stimulus, approximately $5 trillion was distributed to consumers and businesses to help them get through the Covid-19 pandemic. These stimulus measures have been widely credited with helping the U.S. economy recover much more quickly than it otherwise would have. A speedy economic recovery ensued, and the economy has been resilient in the years that followed.

Landmark pieces of legislation that were enacted in 2022 have also contributed to the growth in the U.S. economy. The Inflation Reduction Act and the CHIPS Act have led to a renewed capex cycle whereby incentives in the hundreds of billions of dollars have been provided to manufacturers to produce in the United States. These legislative bills have also led to significant job creation, which has reinforced the strong labour market dynamic that currently exists in the United States.

Taken together, we believe the stimulus bills and the government incentives have contributed to the outperformance of the U.S. economy relative to other countries and regions around the world. As seen in the chart below, the United States is the only major economic region that came out ahead in 2023 relative to pre-pandemic projections made by the International Monetary Fund for Real GDP in 2023.

Difference between Countries' 2023 Real GDP and the IMF's Prepandemic Projections



Source: International Monetary Fund

Although the U.S. economy has been strong over the last few years, there are still many questions as to whether the good times will last. Bearish commentators point out that recent economic data suggests that the U.S. economy is slowing and that consumers will feel more pressure now that the pandemic stimulus has been depleted. Furthermore, monetary policy works with long and variable lags. U.S. Central Bankers estimate that it can take up to 18 months for monetary policy to reach its full impact on the real economy. In other words, we are only just now approaching the tipping point where much higher interest rates could have a negative impact on the economy.

Despite these concerns, the current state of the U.S. economy can be described as steady based on recent data. The labour market has added an average of more than 200,000 jobs per month in 2023, which is above the level required to maintain a stable unemployment rate and to keep the economy growing. The unemployment rate fell to 3.7% during the month of November, which was down from 3.9% in October. The current unemployment rate remains near the lowest level in the last 50 years. In terms of consumer spending, recent data suggests that consumers continue to spend at a healthy clip. On Black Friday, consumers spent $9.8 billion in U.S. online sales, up 7.5% from a year ago. Cyber Monday was even better as e-commerce spending in the U.S. totaled $12.4 billion, up 9.6% year over year. According to Mastercard, U.S. retail sales were up 3.1% between November 1st and December 24th. From our perspective, the U.S. economy appears to be steady although we are cognizant of the risks that lie ahead.

Portfolio Review:

During the fourth quarter, we established several new positions in our Global and International portfolios. In our Global strategy, we established new positions in Amazon.com, TFI International, and Walmart. In the International strategy, we initiated new positions in Keyence, Partners Group, Sage Group, Universal Music Group, and Wolters Kluwer. A brief description of each new holding can be found in the **Appendix.**

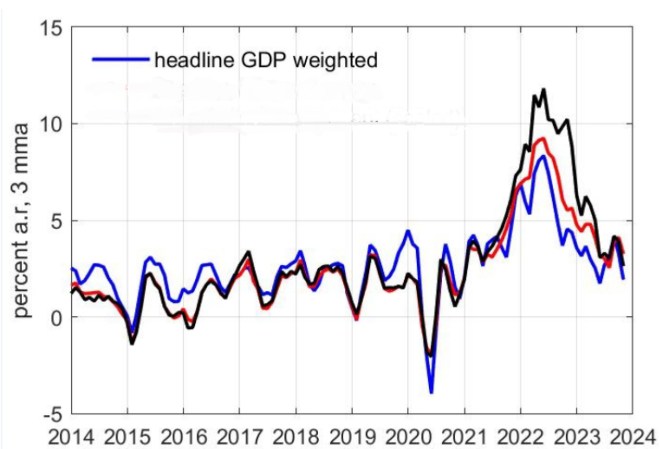
Outlook for 2024:

While the U.S. and the global economy avoided a recession in 2023, there is a wide range of viewpoints in terms of what will materialize in 2024. Given recent economic data, we believe that the probability of a soft landing in 2024 has increased, so we are cautiously optimistic as 2024 gets underway. Our optimism is driven by the resilience in the world's largest economy (USA), a decline in the rate of inflation around the world, and a recent signal from the US Federal Reserve that it will be cutting interest rates during 2024.

One of the most important factors that will determine whether a soft landing can be engineered is the rate of inflation. Recent data has been encouraging on this front with inflation slowing faster than expected. On December 22nd, the personal consumption expenditures (PCE) inflation data was released for the month of November. The PCE data is the Fed's preferred measure of inflation and it declined month-over-month for the first time in over three years. On a year-over-year basis PCE inflation was +2.6% so it's not quite at the Fed's long-run target of +2% but moving in the right direction after peaking above +7% in mid-2022. The core PCE inflation data, which excludes food and energy has also shown significant progress. For the month of November, the core PCE price index fell 0.1%. Over the last 3 and 6 months, core PCE has increased by an annual rate of 2.16% and 1.87% respectively. What this means is that if current trends continue, the Fed has essentially reached its goal of getting inflation back down to 2%. Given this progress, the U.S. Federal Reserve is now in a position to pivot from interest rate hikes to interest rate cuts. This was recently communicated to the market at the Federal Open Market Committee (FOMC) meeting that took place in December. The change in the tone from the Fed versus the prior meeting came as a surprise to the stock market and the bond market. Upon the release of the commentary from the FOMC, additional interest rate cuts were immediately priced into the forward curve. U.S. stocks surged ahead shortly after the Fed released its commentary and continued to rise for the next 2 weeks.

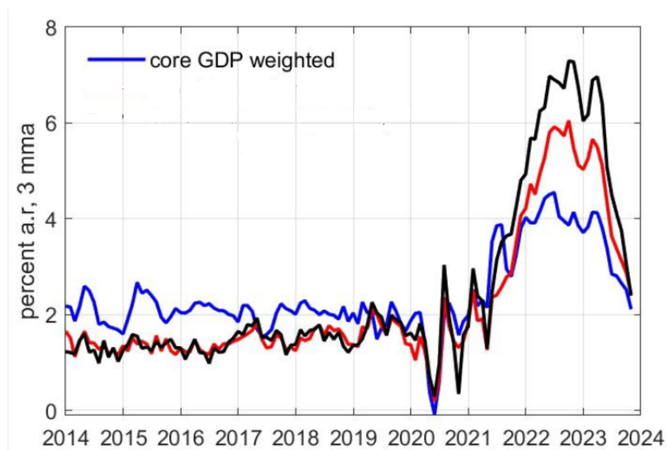
The good news about inflation is that the decline in the rate of inflation is not only happening in the US but also on a global basis as seen in the charts below.

Figure 1: Global headline inflation - monthly annualized run-rate



Source: UBS, Haver

Figure 2: Global core inflation - monthly annualized run-rate



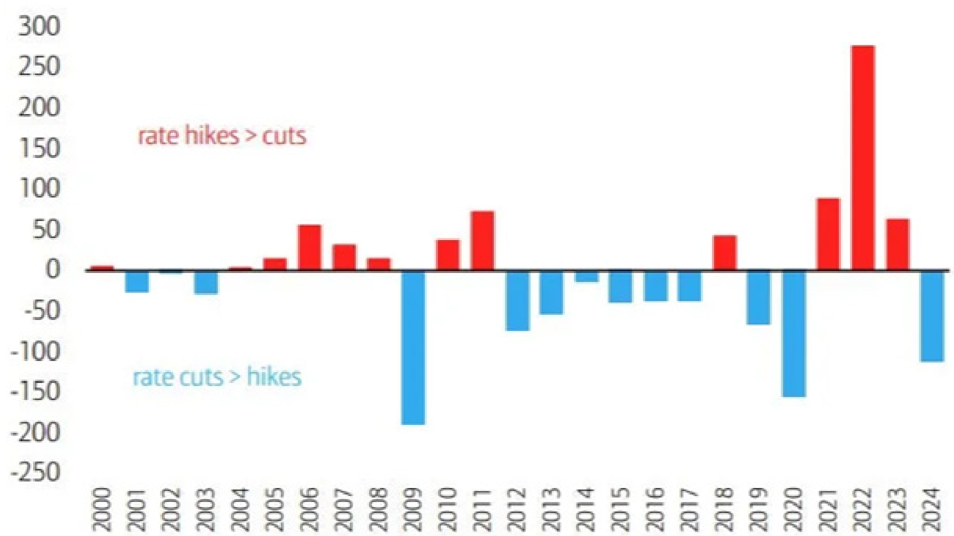
Source: UBS, Haver

The charts above track inflation across 47 countries including 26 developed markets and 21 emerging markets up to November of 2023. Whether one looks at the headline or the core inflation figures, these charts illustrate that global inflation is quickly returning towards pre-pandemic levels.

Given the retracement in the rate of inflation, most central banks around the world will be cutting interest rates in the quarters ahead. According to Bank of America, 2024 is set to be the first year since 2020 where there will be more interest cuts than interest rates hikes. This is illustrated in the chart below.

Chart 4: 2024 set to be 1st time since 2020 that cuts > hikes

Global central bank rate hikes vs cuts (annual)



Source: BofA Global Investment Strategy, Bloomberg. 2024 projections based on BofA Global Economics team's forecasts.

Economists at Bank of America are forecasting 152 interest rate cuts from global central banks in 2024. If this materializes, this will represent the highest amount of rate cuts since 2020, when the Covid-19 pandemic led central banks to unleash an unprecedented amount of monetary easing.

Although the U.S. economy has remained resilient as previously discussed, the rest of the world is more of a mixed picture with economic softness currently seen across Europe and China while Japan appears to be in a better place.

Given its high dependence on imports and exports, the Eurozone economy has been struggling given the softness in the global economy and China in particular. Although the Eurozone avoided a technical recession in 2023, stagflation has led to lacklustre growth for the economy over the past year. The good news is that inflation appears to have already peaked. The bad news is that their economy continues to flirt with the possibility of a recession. Germany's economy contracted during the third quarter of 2023, which is worrisome given its status as the largest economy in the Eurozone. Germany's vast manufacturing sector has been struggling in the face of weak demand from China, elevated energy costs, and significantly higher interest rates. Although economic activity remains subdued as 2024 gets underway, the Eurozone economy should gradually pick up in 2024 as consumption recovers on the back of robust wage growth and as inflation continues to ease. The manufacturing sector should also recover at some point in 2024 as inventories get rebuilt and as the global economy recovers.

Going into 2023, expectations for China were high as it re-opened its economy following the rolling COVID lockdowns that crippled the economy for over two years. However, the optimism faded quickly as concerns about the country's real estate problems resurfaced. The real estate sector in China is massive as it accounts for approximately 25% of the company's GDP. Some of the key concerns include debt defaults by property developers and a decline in home prices across the country. According to Bloomberg, as many as 34 of the 50 property developers with the most outstanding dollar bonds have missed payments on their debt. In addition, home prices in China have fallen anywhere from 15-30%. These developments do not bode well for consumption by consumers or for confidence from the business community. In addition to these headwinds, the economy is also struggling with deflationary forces. Although we expect China to remain weak as 2024 begins, we believe that the economy is in a bottoming process. In recent months China's government has announced a series of stimulus measures and we believe there will be more on the way as the government tries to stabilize the economy.

Japan was a bright spot for global equity investors during 2023. Japan appears to have emerged from three decades of economic stagnation as the economy expanded at an above trend pace in both nominal and real terms during 2023. As other central banks hiked interest rates in 2023, Japan kept its interest rates low. This allowed inflation to drift upwards, which was a welcome development after a long period of deflation in the country. Furthermore, the country is also seeing benefits from corporate reform. We are very encouraged to see that the government in Japan is making changes to rectify decades of corporate neglect when it comes to shareholder returns. To be more specific, The Tokyo Stock Exchange has urged publicly traded companies trading below 1.0x book value to implement corporate changes to encourage higher returns. Given that approximately 50% of public companies in Japan are trading at less than 1.0x book value, there is substantial room for share price appreciation as companies improve their capital efficiency and profitability. We are optimistic about the prospects for Japan going forward.

In terms of the risks to our outlook, there are a number of things that could go wrong and trigger volatility in global equity markets. While the lagged effects of monetary policy and geopolitics are front and centre, other things can also go wrong. Historically, it can take up to 18 months for the impact of monetary policy to be fully realized in the real economy, so there is still a risk that higher interest rates could have a negative impact on various economies around the world. In addition, there's always a possibility of an escalation in geopolitics whether it be in Israel, Taiwan, or Ukraine. At the moment, we are seeing the war in the Middle East disrupting shipping in the Red Sea, which could lead to supply chain disruptions and a resurgence in inflation. It's also possible that the U.S. Federal Reserve could wait too long to cut interest rates and unintentionally cause a recession. Alternatively, inflation could resurface and surprise to the upside, which could keep rates higher for longer and potentially lead to a reversal in interest rate cuts that are being priced into the bond market.

Despite the risks highlighted above, there are many reasons why we have a cautiously optimistic view as the New Year gets underway. First, the global economy has proven to be more resilient despite facing a massive interest rate shock during 2023. Second, inflation has fallen significantly in recent months in both the U.S. and abroad. This backdrop has set the stage for interest rate cuts in 2024. Finally, we believe that the types of companies we own are very well positioned for the current environment. The companies we own have stable earnings and resilient cash flows, as well as low financial leverage and therefore have self-funding sources to grow their business. They are in a great position to take advantage of competitors who face significant refinancing risks. This is an ideal environment for financially strong companies to gain market share from their competitors or to take them out via an acquisition. One of our holdings in our Global strategy did exactly that when TFI International acquired a competitor (Daseke) with a weak balance sheet in the week prior to Christmas. The response by the market was very positive for TFI's share price. While there are risks to our outlook, we are very confident in the ability of our companies to manage through these risks. In a span of just 4 years our companies have experienced a global pandemic and a wave of inflation not seen in 40 years. With the benefit of hindsight, we can say that our companies managed these shocks very well, and proved to us that they are very adept when facing adversity and that they can emerge stronger on the other side.

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January 4, 2024

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Appendix A
Company descriptions for new positions added to the Global Strategy

Amazon.com

Amazon is a dominant player in its largest businesses including e-commerce and cloud services. In e-commerce, Amazon is by far the largest player in the United States with approximately 38% market share. Walmart is the next largest player with approximately 7% share. In cloud services, Amazon Web Services (AWS) is the largest cloud service provider in the world with approximately 32% market share. The next largest competitor is Microsoft's Azure with 22% market share. These dominant market positions give Amazon significant economies of scale relative to its competitors. Outside of e-commerce and the cloud, Amazon is experiencing significant growth in other segments such as Advertising, Third Party Seller Services, and Subscription Services. In addition to strong revenue growth, we are excited about the significant margin inflection that we see unfolding in the years ahead. In 2020, Amazon decided to invest heavily in its fulfillment network to deal with the large increase in e-commerce orders during the pandemic. These heavy investments had a negative impact on the company's operating margin and led to a period of disappointing earnings from the company. However, this period of heavy investments is now largely over and we are beginning to see a positive inflection in the operating margin of the company. We believe that we are in the early innings of this development and that the company is set to deliver strong earning growth for the next several years.

TFI International

TFII International, Inc. provides freight transportation and logistics services. It operates through 4 segments: Package & Courier, Less-than-Truckload ("LTL"), Truckload, and Logistics. Since the acquisition of UPS Freight (now T-Force Freight), the LTL segment is roughly 40% of EBITDA and is their fastest growing segment. LTL is less competitive than general trucking, which requires a large real estate footprint with distribution facilities to compete well. And the market has just become less competitive with the recent dissolution of Yellow – a large competitor that was trying to take share with disruptive pricing. With Yellow gone, TFII should gain volume and be able to increase prices. Further, we've bought TFII while the shipping industry is weak. Any recovery in general volumes will also be accretive to earnings.

Walmart Inc.

Walmart is one of the world's largest retailers selling a diverse range of products including groceries, apparel, electronics, and household goods at low prices. In our view, Walmart wins in almost any economic environment. Consumers turn to Walmart during inflationary times to stretch their purchasing power. But as inflation subsides, Walmart will lead in lowering prices, which should drive increased traffic and unit growth. Over the last five years, Walmart has invested in store automation, logistics, e-commerce, and building its advertising business. The company is now at an inflection point where those investments will start to translate into higher profitability.

Appendix B
Company descriptions for new positions added to the International Strategy

Keyence

Founded in 1974 in Osaka, Japan, Keyence is an innovative global leader in the development and manufacturing of industrial automation and inspection equipment worldwide. In fact, the company has garnered much attention as 70% of the company's products feature the world's first or industry's first technology. Japan's leadership in robotics and factory automation has been built on a long history of technological leadership in manufacturing, and today Japanese automation companies such as Keyence are benefiting from strong growth in demand for their products. Since 2010, the number of industrial robots manufactured worldwide has more than tripled. Industrial automation around the world is expected to continue growing over the next several years. With the increasing adoption of automation in industries including pharmaceutical, chemicals and materials, oil and gas, and manufacturing, opportunities abound for key companies that can produce high-quality, reliable products. Demographics is also playing a role in the growth of industrial robots. In Japan, the country's aging population is a major concern for the government given that more than a quarter of the population is 65 years or older. This number is expected to surge to 40% by 2050. Therefore, robots are expected to play a pivotal role in assisting the workforce. Aging demographics are not just limited to Japan. This is occurring in many countries around the world and it is especially noteworthy in China. This will present an opportunity for Keyence and other industrial automation solution providers.

Partners Group

Founded in 1996 in Switzerland, Partners Group is a large, independent investment firm that is dedicated to private markets. The company is fully aligned with its clients and provides bespoke solutions to institutional investors, sovereign wealth funds, family offices, and private investors globally. Partners Group has over 1,900 employees, including more than 550 private markets investment professionals, across 20 offices worldwide, and it has more than US$142 billion in assets under management. The company's global footprint is built on the deep experience and expertise of its local teams. Partners Group seeks to deliver sustainable performance across economic the economic cycle. Since inception, they have invested over US$200 billion in private equity, private real estate, private debt, and private infrastructure on behalf of its clients. By combining global reach with local expertise across private markets, and with a focus on responsible ownership, the company seeks to create lasting value in its investments. The company's successful entrepreneurial history of investing in private markets on behalf of its clients is based on long-term oriented partnerships with both employees and business partners that support its business strategy.

Sage Group

Sage is a global software company providing solutions for small and medium-sized businesses to help manage accounting, finances, human resources, and accounts payable. The software targets the professional user, typically an accountant or bookkeeper with an understanding of compliance and who is looking for additional functionality and tools to help drive efficiencies. Sage is supported by a global network of partners ranging from accountants to resellers to independent software vendors. The company also has strategic alliances with Microsoft, Salesforce, and Amazon to name a few. Over the last few years, the company has transitioned its business model away from a lumpy license-focused model to a more stable subscription-based revenue model. Given this transition, recurring revenue now makes up more than 90% of the company's revenue. Furthermore, the company has expanded its cloud product portfolio and has also added incremental capabilities through targeted acquisitions that were completed in recent years. The company also has an opportunity to expand its margins in the years ahead.

Universal Music Group

Universal Music Group (UMG) is one of the world's largest music companies. The company's largest business is recorded music, and UMG is the global market leader with approximately 32% market share. The company also has 8 of the top 10 global artists signed to its labels. Some of UMG's top artists include Taylor Swift, Drake, and The Weeknd. The music industry has undergone a significant turnaround following a decade of disruption. Between 1999 and 2013, the music industry lost approximately 45% of its value due to the rapid erosion of music sales as sales of CD's and Vinyl went through a decline. However, since 2015, the global recorded music market has experienced a significantly recovery. This recovery has occurred on the back of music streaming and rising smartphone penetration. Streaming platforms such as Spotify and Apple Music have enhanced the user experience by giving users access to a catalogue of tens of millions of songs through a paid subscription or an ad-supported service. Furthermore, content ownership in the recorded music business is highly consolidated, with the top three music companies (UMG, Sony, and Warner Music) owning approximately 75% of all music in circulation. This gives them a strong negotiating position with content distribution partners (i.e. Spotify), which is a part of the music market that is more fragmented.

Wolters Kluwer

With roots dating back to 1836, Wolters Kluwer is a global leader in professional information, software solutions, and services in the following sectors: health, tax & accounting, financial corporate compliance, and legal & regulatory. The company serves customers in over 180 countries, maintains operations in over 40 countries, and employs approximately 20,000 people worldwide. The company's mission is to empower its professional customers with the information, software solutions, and services they need to make critical decisions, achieve successful outcomes, and save time. The company's expert solutions combine deep domain knowledge with technology to deliver both content and workflow automation to drive improved outcomes and productivity for our customers. The company is committed to helping professionals improve the way they do business and solve complex problems with its range of digital solutions and services, which it continuously evolves to meet changing needs.

*Cumberland refers to Cumberland Private Wealth Management Inc. (CPWM) and Cumberland Investment Counsel Inc. (CIC). CIC acts as sub-advisor to certain CPWM investment mandates including the CPWM Global and International mandates with Phil D'Iorio as its lead Portfolio Manager. Phil D'Iorio is a Portfolio Manager at CIC.