First Quarter 2024 Review

GLOBAL EQUITY AND INTERNATIONAL STRATEGIES

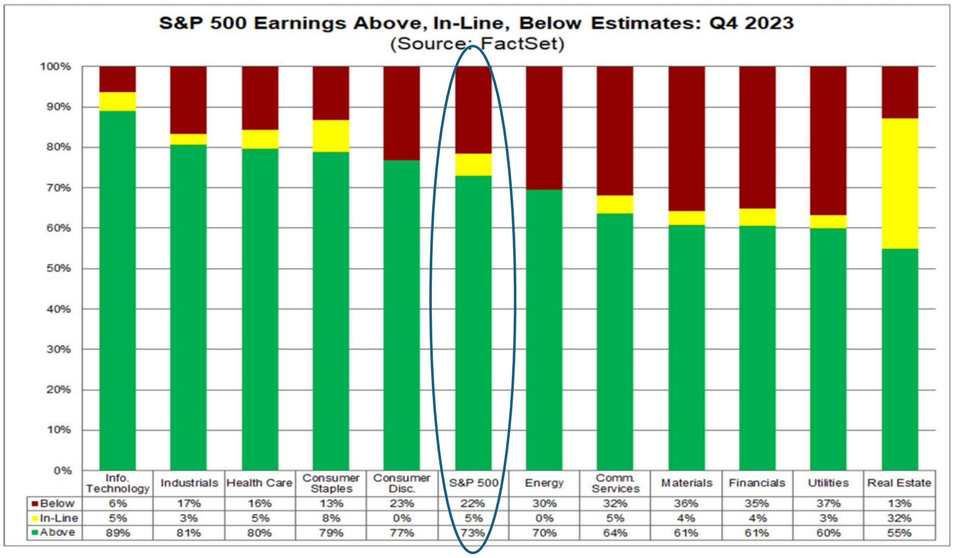
Q1 2024 Review

After delivering robust returns in 2023, global equity markets started off 2024 with a bang. Some of the key factors driving the returns included strong corporate earnings, an expectation of interest rate cuts in 2024, and a turn in investor sentiment with investors abandoning their recession calls. Given this backdrop, stock market returns were not only strong, but also widespread across geographic regions as seen in the chart below.

Index	Geographic Region	Currency	Price change	Total return with dividends
MSCI World	Global	US$	8.4%	9.0%
S&P 500	United States	US$	10.2%	10.6%
Stoxx Europe 600	Europe	Euro	7.0%	7.9%
Topix (Japan)	Japan	Yen	16.2%	17.3%

Corporate earnings for Q4 2023 were very respectable as profits surprised to the upside across several parts of the world. For the S&P 500, Q4 earnings were up 7.9% versus the prior year quarter. This was considerably better than the 1.3% increase for Q4 earnings growth that was expected by consensus at the start of earnings season. As seen in the chart below, 73% of companies in the S&P 500 generated earnings ahead of consensus during Q4. Not only did earnings come in ahead of expectations, but the earning beats were widespread across many sectors as seen in the chart below with the percentage of beats highlighted in green.

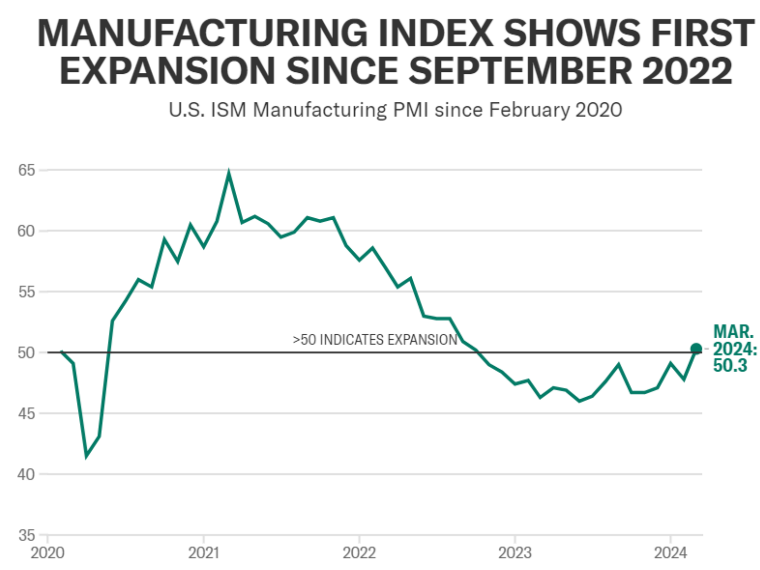
Q4 2023: Scorecard



With regards to interest rate cuts, officials from Federal Open Market Committee recently affirmed their view for 2 to 3 interest rate cuts later in 2024. These officials confirmed their view even as they upgraded the economic outlook for the U.S. economy and after seeing a rise in key inflation data for both January and February. Federal Reserve Chairman, Jerome Powell, did not sound very concerned about the recent inflation data. He shrugged it off somewhat by saying that the recent data is just further proof of inflation's nonlinear path downwards. He went on to say that recent data points haven't really changed the overall story, which is that of inflation moving down gradually on a sometimes bumpy path towards 2%.

In terms of investor sentiment, there has been a colossal change in the mindset of economists and investors. About a year ago, many were forecasting a U.S. recession due to the impact of stubborn inflation and higher interest rates. In March of 2023, approximately 65% of economists polled by Bloomberg were convinced the U.S. economy was headed for a serious downturn within 12 months. This widely held viewpoint has completely reversed. Given the resilience of the U.S. economy and a significant decline in inflation, economists and investors have largely abandoned their recession predictions. Not only have they abandoned their hard landing forecasts, but some investors have also abandoned the prospect for a soft landing. A soft landing occurs when inflation fades but economic growth weakens. Instead, 45% of investors now believe the U.S. economy is headed for a "no landing" scenario where inflation falls towards the Federal Reserve's 2% target and economic growth remains firm. This data comes from Deutsche Bank's March Global Markets Survey. Some 38% of respondents to Deutsche Bank's survey still expect a "soft landing," and only 17% expect a recession or "hard landing".

Recent data on the U.S. economy backs up the viewpoint of investors who now see a low likelihood of a hard landing. For the month of March, the Institute for Supply Management's (ISM) manufacturing PMI index indicated that the manufacturing sector moved into expansion mode for the first time since September 2022. The ISM's manufacturing PMI index generated a reading of 50.3 in March, up from 47.8 in February, and above consensus at 48.3. Readings above 50 for this index indicate an expansion in activity while readings below 50 indicate contraction. The ISM's report also showed an uptick in new orders. This data appears to be much more consistent with a soft landing or no landing scenario.



Outside of the United States, the global economy is growing, although it remains sluggish across many parts of the world. Having said that, recent data points emerging from some of the largest economic regions are encouraging. In Europe, recent inflation data was better than expected. For the month of March, headline inflation in Eurozone eased to 2.4%, which was lower than consensus at 2.6%. The core rate of inflation, which excludes items such as energy and food, cooled from 3.1% to 2.9%. This was also below expectations. This is setting the stage for interest rate cuts with the markets now expecting the European Central Bank to begin cutting rates in June. Interest rate cuts should stimulate the economy and help the recovery across the Eurozone.

In China, the economy has been weak for quite some time. However, during the month of March, China's factory activity expanded by its strongest pace in more than a year. The Caixin/S&P Global China manufacturing purchasing managers index generated a reading of 51.1 in March, which is the strongest reading since February 2023. According to a private-sector survey, China's services activity also accelerated in March as new business rose at the fastest pace in 3 months. Taken together, the manufacturing and services surveys are providing evidence that China is gaining some economic momentum.

There has also been some good news coming out of Japan. During its March policy meeting, Japan's central bank raised interest rates for the first time since 2007. This put an end to the world's only negative interest rate regime. The end of negative rates is being viewed as a sign that Japan may have finally won its fight against deflation with prices now rising consistently for the first time in decades. During the final quarter of 2023, the country's economic output recovered to full capacity for the first time in about 4 years. Japan's output gap, which measures the difference between an economy's actual and potential output, stood at +0.02% in the final quarter of last year. This was the first positive reading in 15 quarters. The output gap is one of the data points the Bank of Japan watches closely in determining whether the economy is expanding strongly enough to propel a demand-driven rise in inflation. Overall, we are seeing some encouraging signs across the largest economic regions outside of the United States.

So with strong corporate earnings, forthcoming interest rate cuts, and a much lower likelihood of a recession, is there anything that we should be worried about? Some of our concerns include the very strong performance by global stock markets and the fact that valuations for some markets are ahead of their historical averages. Since reaching a bottom in October of 2022, the MSCI World Index is up approximately 50% while the S&P 500 is also up about 50% through to the end of March. These are very robust returns for an 18-month period. We believe that some form of market consolidation will occur in the weeks or months ahead. While it's always difficult to predict the timing of these occurrences, market corrections are normal and they are part of the stock market cycle. In fact, since 1990 the average annual peak-to-trough decline for the S&P 500 has been approximately 14.0%. Although market corrections are painful while they are happening, they can provide opportunities to buy high quality stocks as the babies are often thrown out with the bath water during market drawdowns. We will be ready to act as opportunities are presented to us.

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 Alimentation Couche-Tard, Mastercard, O'Reilly Automotive, and Vertex Pharmaceuticals. In the International strategy, we initiated new positions in Icon, Inditex, Itochu, Mastercard, and Shin-Etsu. A brief description of each new holding can be found in the **Appendix.**

Outlook for 2024

In terms of our outlook, we continue to have a cautiously optimistic view. First, the global economy continues to show resilience and concerns about an economic recession have dissipated. Second, inflation has fallen enough to set the stage for interest rate cuts later in 2024. Third, corporate earnings have been strong and have surprised to the upside in many markets around the world. For all these reasons, we continue to have a favourable outlook for global equity markets.

Phil D'Iorio
Lead Manager,
Cumberland* Global and International Equities
April 2, 2024

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

Alimentation Couche-Tard - Couche-Tard is a global leader in the convenience store industry. The company operates more than 10,000 stores across Canada, Europe, and the United States under various banners including Couche-Tard and Circle K. The company sells food, hot & cold beverages, road transportation fuel and charging solutions for electric vehicles. Couche-Tard has been one of Canada's most successful business stories over the last few decades. A core aspect to the company's success is related to its acquisition strategy. Management has been very disciplined with respect to the price that it pays for its acquisitions, and it has been very successful when it comes to the integration of the acquired businesses. Although the company occasionally makes large acquisitions, it is a highly cash generative business which enables it to maintain a strong balance sheet. Even though Couche-Tard recently closed its largest acquisition ever for €3.4 billion, we estimate that the company has the capacity to spend an additional $10 billion on acquisitions.

Mastercard - Mastercard is a high-quality business that is benefiting from the structural shift of payments away from cash to mobile, online, and contactless transactions. Mastercard operates a payment network with integrated solutions that links consumers, banks, merchants, and merchant acquirers. The network business is a duopoly with Visa and is protected by a network effect as merchants are more likely to subscribe given that a large number of consumers carry Mastercard cards; and consumers are more likely to carry a Mastercard because many merchants can process it. Mastercard's competitive positioning will allow it to continue to earn excess returns that won't be competed away for the foreseeable future. The company has historically generated attractive growth and we believe this will continue in the years ahead. In 4 of the last 5 years Mastercard has generated double digit revenue and operating income growth. The only exception was 2020 when the COVID pandemic brought the global economy to a halt.

O'Reilly Automotive - O'Reilly owns and operates automotive part distribution warehouses and retail stores predominantly in the United States, but also in Mexico and Canada. O'Reilly serves both the do-it-for-me (pro) market, through speedy distribution of parts from its warehouses and stores to garages, as well as the do-it-yourself (consumer) markets through its network of 5600 stores. O'Reilly's main advantage is its warehousing and store strategy, with 30 distribution centres located in 30 major cities which it uses to ship directly to customers as well as to replenish stores. It has used its distribution advantage to build out a large pro-business, which now makes up 45% of its total revenue. The company's best in class distribution model has enabled it to generate better inventory turns, working capital management, and higher returns on invested capital compared to most of its peers.

Vertex Pharmaceuticals - Vertex is a biotechnology company that focuses on discovering, developing, and producing innovative medicines for people with congenital disorders. The company's key focus is on cystic fibrosis (CF), a genetic disease that affects the lungs and other organs. Vertex has developed several drugs that target the underlying cause of CF, rather than just treating the symptoms. Vertex has a global monopoly on CF treatment with IP protection into the late 2030's. Vertex continues to innovate in CF, and currently has drugs in development to treat the ~10% of patients who currently cannot benefit from current CF treatment due to either efficacy / side effect tradeoffs. Outside of CF, Vertex is developing a non-addictive pain killer that has minimal side effects and thus high tolerability. The drug is being developed for both acute and neuropathic pain. In the acute pain indication, this drug could become an ideal replacement for highly addictive and less tolerable opioids.

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

Icon - Icon is a global leader in the Contract Research Organization (CRO) industry. Icon provides outsourced drug and device development and commercialization services to pharmaceutical, biotechnology, medical device companies, public health organizations, and government. Pharma and biotech companies have historically run a significant portion of their clinical trials in-house. However, as clinical drug trials have become more complex, pharma and biotech companies have increasingly outsourced their clinical trials to CRO companies such as Icon. In addition to having global scale, Icon offers its clients differentiated technology, including proprietary data gathering and analytics solutions that target inefficiencies in the clinical trial process. In particular, the company's unique network site strategy addresses two of the largest challenges in overseeing drug trials – the time needed to recruit patients and the generation of the clean data needed for submission to regulators.

Industria de Diseno Textil (Inditex) - Inditex is the largest apparel company by revenue in Western Europe and one of the largest in the word. Inditex is a global fashion chain that operates more than 5,500 stores under six key formats in more than 100 markets worldwide. The company operates several banners but is best known for its Zara brand, which has more than 1,800 stores around the world. Inditex is credited for being a pioneer in the fast fashion industry. Unlike most of its peers, Inditex does not completely outsource its production overseas. As a result of its vertically integrated supply chain, Inditex maintains control over design, manufacturing, logistics, and distribution. This unique supply chain allows the company to control the entire manufacturing process in a more timely manner, greatly reducing shipping times, and enabling a quick response to fashion as well as weather changes. Inditex's highly sophisticated supply chain has enabled the company to generate significantly higher operating margins than its peer group which includes Gap, H&M, and Fast Retailing.

Itochu - Itochu is one of the top five Japanese trading companies with its roots dating back to 1858. Initially operating primarily in the textile industry, Itochu has expanded its operating activities into machinery, energy, chemicals, and food. The Machinery Company is involved in Aerospace, Automobiles, Construction Machinery, and Industrial Machinery. This division develops businesses in a wide range of fields including water & environment related businesses, renewable energy, electric power generation, bridges, railways, and other infrastructure-related projects. The Energy Division handles trading of general energy-related products, including crude oil, petroleum products, LNG, natural gas and hydrogen. The Chemicals Division handles trading and develops projects for a wide range of products such as organic & inorganic chemicals, pharmaceuticals, functional food, synthetic resin, and electronic materials. The Power & Environmental Solution Division pursues next-generation power business including photovoltaic solar power generation and biomass power generation projects, electricity trading, and the energy storage cell business. The Food Division operates across the global food chain and has become the leading company in the global food industry.

Shin-Etsu Chemical - Shin-Etsu is a Japan-based company with roots dating back to 1926. During the 1960's the company became the first Japanese chemical company to expand overseas. Today, its overseas sales generate more than 70% of the company's total sales. Shin-Etsu operates its business across 3 key segments. The Infrastructure Materials segment manufactures polyvinyl chloride (PVC) for use in construction related end markets including water, sewerage pipes, vinyl window frames, and siding materials. The Electronic Materials segment manufactures silicon wafers that are used in the production of semiconductor chips. The company also produces photomask blanks that are the base material for photomasks, which are the templates used to form circuit patterns on the surface of silicon wafers during the semiconductor chip production process. The Functional Materials segment manufactures silicone resins that are widely used across a variety of industries including cosmetics, pharmaceuticals, food, and automotive applications.

Sources:

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Nearly half of all investors expect a 'no landing' scenario for the economy where inflation remains but there's no recession, Deutsche Bank survey shows
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Bank of Japan ends the world's only negative rates regime in a historic move, abandons yield curve control
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