Desjardins Canadian Equity Fund

Desjardins Wealth Management Investments

QUARTERLY COMMENTARY AS OF DECEMBER 31, 2020

PORTFOLIO MANAGER:
Desjardins Global Asset Management

INCEPTION DATE:
November 28, 2016

CIFSC CATEGORY*:
Canadian Equity

Canadian stock market

The Canadian and US stock markets continued to advance in the fourth quarter. The total return of the S&P/TSX index was +9%, while the S&P 500 was at +12.1% and the NASDAQ at +15.7%. From its low of March 23, the S&P/TSX index bounced back by 56%, the S&P 500 by 70% and the NASDAQ by 94%. Spurred by the outcome of the US presidential elections and the Pfizer (PFE) and BioNTEch (BNTX) announcement about the high efficacy of their vaccine in development, global markets saw a new wave of optimism about the economic recovery in 2021. Following this news, investors started rotating to more cyclical sectors such as energy, basic materials and financials. Similarly, the Russell 2000 (the main US small-cap index) saw its best month since its creation in 1978, with an increase of 18.3% in November.

Despite the volatility and flow of generally negative news, a number of securities, sectors and themes stood out in 2020. There was the spectacular performance of the newest member of the S&P 500, Tesla (TSLA), which was up 743% in 2020, for an increase in its market capitalization of almost US$600B. The electric car manufacturer was not alone in having a record year. Investor appetite for renewable energies such as hydrogen, solar and wind power helped the iShares Global Clean Energy ETF (ICLN) —a fund of 30 companies involved in the energy transition—grow by 140%. At the opposite end of the spectrum, the main Canadian energy sector index (STENRS), composed mainly of companies producing or transporting oil and gas, plunged 31% to begin the new decade. Another theme that we observed was the continued outperformance of popular IPOs relative to the market overall. With an increase of 107%, the Renaissance IPO ETF (IPO), which invests only in new listed issues, performed better than the S&P 500 and NASDAQ by 91% and 64%, respectively. Potential explanations include the strength of the technology sector and internet-linked communication stocks, low interest rates and the huge increase in the number of retail investors in 2020 on free platforms like Robinhood and Wealthsimple.

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Canadian stock market (cont'd)

In Canada, 9 of the 11 sectors were up at the end of the quarter. The healthcare sector had the best return of 2020 but finished the year at -23%. After Biden's election, cannabis stock prices made a strong comeback due to the Democrats' pro-legalization stance. In second place, the consumer discretionary sector increased 21%, in large part due to the strong performance of auto parts manufacturers Magna International (MG) and Linamar (LNR), up 48.9% and 70.6%, respectively. The decrease in banks' credit loss provisions and the increase in interest rates, while relatively low, allowed the big Canadian financial sector to post a quarterly gain of 16.7%.

In negative territory for the last 3 months of the year, the materials (-3.7%) and consumer staples (-5.6%) sectors posted the index's worst performances. After reaching a peak of $2075 an ounce in August, gold closed the year at $1898 an ounce, thereby putting downward pressure on the gold sector. The leading grocers, including Metro (MRU) and Loblaw (L), had a difficult quarter, pulling back 10.8% and 9.5%, respectively. Their business model's defensive aspect and the rotation of investors to more cyclical sectors of the economy were the main causes.

Key factors to monitor:

- The evolution of COVID-19 and of the second variant that was recently identified;
- The global rollout and efficacy of the vaccine to fight the pandemic in 2021;
- The transition of power from the Republicans to the Democrats;
- The continued weakness of the US dollar in the past few months and the impact on commodities (e.g., gold, copper and oil);
- The economic recovery expected in 2021 and the impact on the performance of the various sectors (rotation of investors between cyclical and defensive sectors and between small-cap and large-cap securities);
- Based on the strength of the economic recovery, the variation in interest rates and the impact on the bond market and stock indexes.

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Outlook for the S&P/TSX Composite Index

The various stock indexes are trading at historically high price-earnings multiples with the strong recovery of North American markets from last March's low. However, as we mentioned in our last publication, the lack of an investment alternative caused by low interest rates is forcing investors to hold or increase their position in Canadian and US equities, causing upward pressure on valuation multiples. To begin 2021, the TSX is ahead, trading at 17x earnings for the next 12 months compared with nearly 22.6x for the S&P 500 and 33x for the NASDAQ. With an expected increase of about 56% in earnings per share for TSX member companies in 2021, cumulative profitability should exceed the 2019 pre-pandemic level by 3%. Also note that estimated profit growth for 2022 is currently around 13%. To wrap up this note, it will be interesting to see if the technology sector will be able to stay in the lead this year, and conversely, whether the energy sector will restore investor confidence.

Portfolio positioning

The portfolio positioning is shared between defensive and cyclical securities. We continue to favour quality, large-cap securities. Amid continued uncertainty despite a strong rebound by the North American markets, we are deploying our cash in order to purchase securities with a significant competitive edge.

In a world seeing constant change, which has been amplified by COVID-19, the markets are now more optimistic about an economic recovery and a gradual return to normal life with the arrival of the vaccine. Given the few investment options caused by low interest rates, we are staying invested but cautious given the valuations.

The fourth quarter was marked by a rebound in value-style securities, which had underperformed since the onset of the pandemic. We noted a rotation of investors toward cyclical sectors, such as consumer discretionary and energy. The anticipated economic recovery is likely to benefit these sectors' securities.

We therefore boosted our exposure in the automobile sector in anticipation of the return of volumes and demand for vehicles. We initiated a position in Magna International, a car parts supplier. The low levels of car inventories in the United States will create opportunities for Magna to increase its production to meet demand.

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Portfolio positioning (cont'd)

In addition, Magna's involvement in the production of equipment for hybrid and electric vehicles will allow the company to benefit from growing demand for clean tech products.

Magna is trading at a low valuation multiple and offers a very attractive risk-adjusted return potential. The portfolio is still strategically positioned in this sector.

On the energy side, we maintained our overweighting in renewable energy, which is benefiting from the energy transition and the ESG theme. We also increased our position in the financial sector, which should benefit from the recovery and higher interest rates. We are staying agile in order to adjust our position as needed.

Contributors to performance

The following sectors contributed positively to the fund's performance: utilities (+0.10% compared with the benchmark), financial services (+0.07%) and communications (+0.04%).

Within these sectors, we note a few securities that contributed to the portfolio's added value.

First, in the utilities sector, Brookfield Renewable Partners LP saw an 18.56% return, adding 10 basis points to the overall portfolio. In second place was Element Fleet Management Corp., which grew 21.36%, adding 10 basis points due to our overweighting.

Detractors from performance

Conversely, the materials and energy sectors contributed negatively to the fund's relative performance (-0.23% and -0.17%, respectively).

First, in the materials sector, Lundin Mining Corp. (+52.69%) reduced the fund's performance by 11 basis points given our underweighting. In second place, Imperial Oil Ltd. (+53.04%), helped bring down the fund's performance by 8 basis points due to a lack of shares in our portfolio.

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Major changes to portfolio in the period

→ The 4 main transactions that occurred over the quarter were:
- Purchase of 0.66% of Toronto-Dominion Bank shares
- Purchase of 0.63% of Canadian Tire Corporation Ltd. shares
- Sale of 0.83% of Power Corp. of Canada shares
- Sale of 0.81% of WSP Global Inc. shares

*CIFSC refers to Canadian Investment Funds Standards Committee. The CIFSC has the mandate to standardize the classification of mutual funds in Canada. http://www.cifsc.org/.