

NEI Canadian Small Cap Equity RS

Q1 2024 Commentary



Performance

The Fund (Series I) underperformed the benchmark for the quarter.

The markets shrugged off persistent inflation data and lower expectations of rate cuts from central banks. This has contributed to a broad rally, with the tech-heavy S&P 500 leading the way, growth outperforming value in North America, and assets like Bitcoin increasing ~61% over the past quarter. Commodity price increases in oil and gold also contributed to rapid appreciation within the resource centric Canadian small cap space.

Returns

Fund	3 months	6 months	YTD	1 year	3 years	5 years	10 years	Since inception ¹
NEI Canadian Small Cap Equity RS I	4.33	14.64	4.33	15.64	11.32	11.82	8.51	N/A
NEI Canadian Small Cap Equity RS A	3.66	13.13	3.66	12.59	8.36	8.85	5.59	N/A
NEI Canadian Small Cap Equity RS F	3.96	13.81	3.96	13.97	9.70	10.19	6.90	N/A
<i>Benchmark 1: S&P TSX Small Cap Index</i>	7.92	14.37	7.92	8.22	3.99	7.82	4.44	N/A

¹Source: Morningstar. As of March 31, 2024. Since inception is only provided for Funds with less than 10 years of performance.

Portfolio commentary

The Fund underperformed on a relative basis due to significant strength in resource related equities late in the reporting period. Materials and energy sectors contributed ~70% of the benchmark's return. If gold and oil prices continue to be elevated, this could result in relative underperformance, chiefly attributable to the Fund's focus on more durable businesses both in business model and capital structure. The resource exposure includes packaging, royalty and distribution-oriented businesses, along with well capitalized businesses which may offer less torque (and downside) to various commodity price levels. Positive security selection within the consumer discretionary and real estate sectors provided some offset on a relative basis.

The top contributing investments in the quarter were Information Services, Secure Energy Services, and Aritzia. The largest detractors were Richelieu Hardware, Canadian Western Bank, and Enghouse Systems.

During the quarter, Sleep Country Canada was introduced into the Fund. Sleep Country is the leading retailer of mattresses and sleep accessories in Canada. The company owns a national distribution footprint, good brand awareness through both brick-and-mortar stores and ownership of e-commerce banners like Endy and Casper, and has a good track record of growth and profitability. Near-term results may continue to be weaker for the company as mattresses are large-ticket items that can be deferred to an extent; however, this demand is likely delayed rather than destroyed, and should resume as economic conditions improve. Moreover, the sub-advisor believes there is a sufficient margin of safety here both in valuation and in a conservatively managed balance sheet.

Funding for the above addition largely came from exiting both Logistec and Neighbourly Pharmacy as they were both taken private. Logistic was a long-term holding for the fund, as a provider of essential marine services at ~60 ports across North America through its terminal network. The company had high insider ownership and a good record of compounding through cycles. The takeout offer was at ~50% premium to pre-announcement price allowing the Fund to realize some of the underappreciated value that the shares were trading at previously.

Outlook

Recent North American equity gains have most likely been driven by multiple expansion, as the market takes comfort in the increasing narrative of a soft landing or minimal economic turbulence in the upcoming quarters. While the markets are "forward looking", predicting economic conditions consistently or relying on continued multiple expansion seems less

sustainable and reliable than investing in undervalued franchises with attractive compounding potential and dividend/income generation flexibility.

As a result, the Fund continues to seek to minimize risk of permanent capital loss, while increasing the odds of capturing business and earnings growth from some of Canada's leading franchises. Currently the sub-advisor estimates 5/10 Canadians will purchase mattresses through Sleep Country/Leon's Furniture, 9/10 overnight packages in Canada delivered by Cargojet and 4/10 utility poles in North America to be sourced through Stella Jones. While in the short-term Canadian consumers may be pressured, looking through the valley, they believe it is probable that each of these businesses will reflect higher earnings power and stable or increased market shares over the next 5-10 years. Over the upcoming year(s), they will continue to add to the roster of leading franchises in the Fund, and benefit from holdings such as Pet Valu, Definity Financial, and Canadian Western Bank continuing to grow the Fund's share of consumer and commercial customer's wallets. Importantly, the Fund will continue to strive to maintain lower balance sheet and valuation risks relative to the average Canadian small cap company.

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