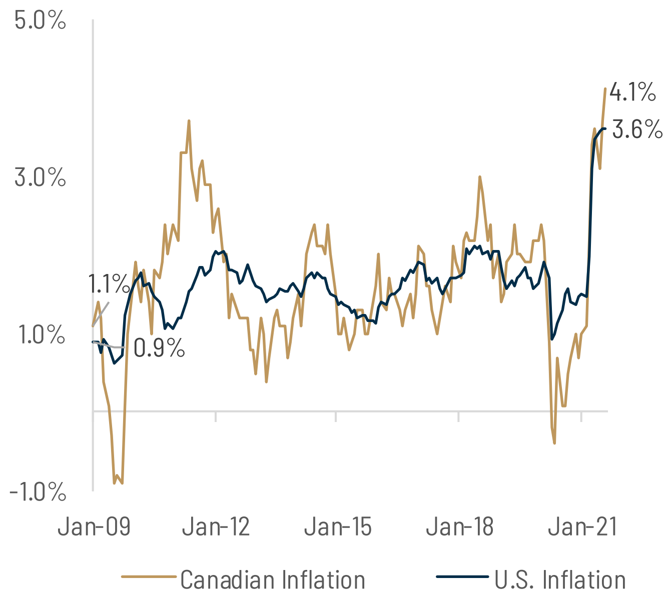
Quarterly Macro Overview Q3 / 2021

MATCO FINANCIAL

Investment markets have performed well through the first three quarters of 2021. However, September observed increased volatility and a modest down trend for equity markets. Signs of decelerating economic growth, worries of persistent inflation, COVID-19 delta variant concerns and the possibility of tightening financial conditions are weighing on the minds of market participants. Nevertheless, the economy continues to grow, and opportunities remain.

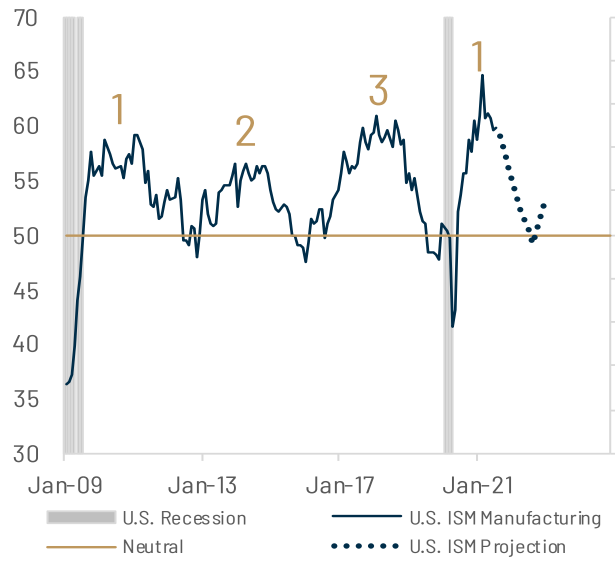
The wall of worry seems to be building as we head into 2022. Investors are hanging their hats on a laundry list of concerns, causing equity markets to pause and volatility to increase.

Canadian and U.S. Inflation



Source: Bloomberg

U.S. ISM Manufacturing PMI

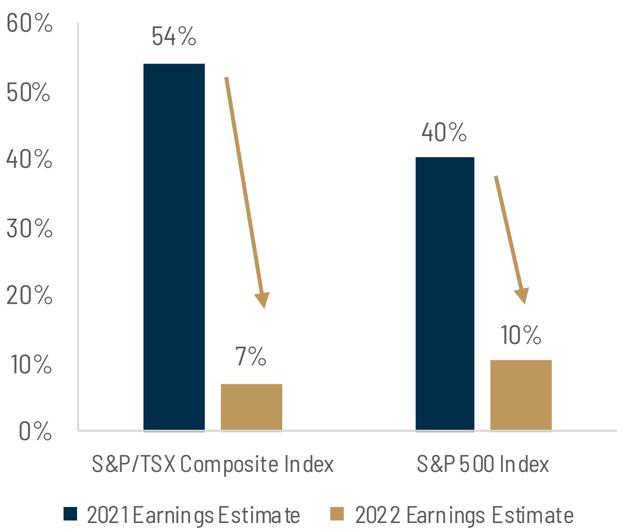


Source: Bloomberg

By way of example, inflation concerns earlier this year were viewed as an issue that would not persist into 2022. Although we continue to believe this to be the case, some investors are becoming wary. Similarly, although it was very likely that central banks were going to begin tightening financial conditions in 2022, investors are now hyper-focused on the potential impact this may have. A critical part of our role as an investment manager is to sift through the data and determine what is meaningful, and what is noise. To do so, some context as to where we are in the investment cycle can be beneficial. With that in mind, there are several data points that provide a strong indication that we are still in the early stages of the economic expansion. However, we may be nearing the first cyclical peak. What exactly does this mean? Through a long-term economic expansion, which have historically lasted between 5 and 11 years, there is often between 2 and 4 small cycles. If one were to look at U.S. Manufacturing data, it seems apparent that manufacturing has reached a peak, and may begin to moderate over the next 12 months to 18 months. Is this cause for concern?

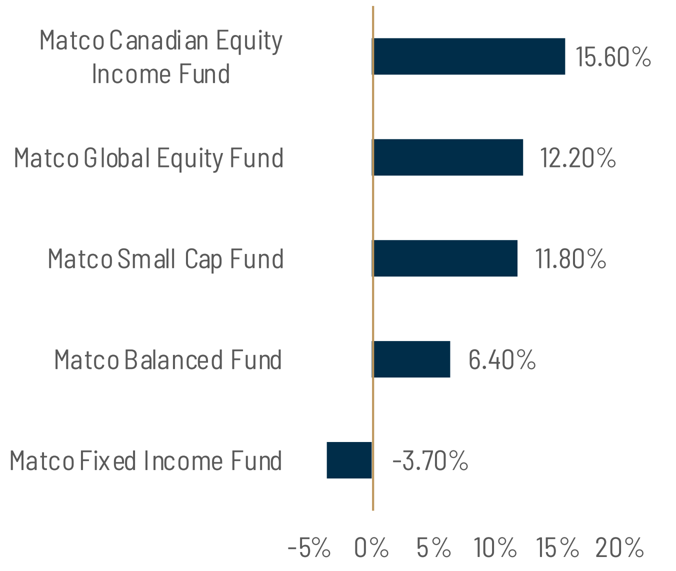
By examining past economic expansions, we can see that this is a very normal occurrence. More importantly, although growth and manufacturing activity will moderate several times through the full cycle, the economy will continue to grow, companies with strong businesses will continue to turn profits leaving investors with opportunities for investment returns. Through the periods of decelerating growth, equity markets will have pauses and modest corrections, but ultimately the economy will re-accelerate, paving the way for further growth. Like the manufacturing data, corporate earnings growth, the amount companies grow their earnings from one year to the next, also follows a similar pattern. To be more specific, earnings growth rebounds very aggressively coming out of a recession, the same way manufacturing activity does. In fact, corporate earnings in Canada and the U.S. are poised to expand by 54% and 40% this year. This is well above the average annual trend of 14%. Looking out to next year, company earnings will continue to expand, but at a more modest pace of 7% to 10%. Is this cause for concern? Although we would prefer to see exceptional earnings growth every year, it's simply not a realistic expectation. Historically speaking, earnings growth follows a pattern of deceleration and acceleration 2 to 4 times through the full expansion.

Earnings Growth Declaration



Source: CPMS Morningstar

Matco Performance YTD



Source: Matco Financial Inc.

So, what does this mean for our outlook over the next 12 months? As an investment manager, we are not dismissing the economic risks on the horizon. We continue to monitor inflation, corporate earnings growth, estimate revisions, leading economic indicators, and manufacturing activity very closely. However, maintaining perspective on where we are in the investment cycle can provide a better understanding as to how the data is likely to evolve and how to manage portfolio risk accordingly. Anticipating mid-cycle deceleration over the next twelve months means focusing on sectors that are poised to produce above market earnings growth. Doing so in a decelerating growth environment can help maintain the growth trajectory of our investment platform. In addition, Matco's M-Factor investment process focuses on very specific investment fundamentals that help us select the companies we invest in. This disciplined approach ensures our ability to avoid market noise and investment fads. Over the next twelve months, we remain focused on this consistent approach to build portfolios that protect and grow capital on behalf of our investors, while avoiding unnecessary risk in the marketplace. Process, discipline, execution; that's what helps us stand apart throughout the full economic expansion.

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Sector allocation, top 10 holdings, and country allocation based on percentage of portfolio assets

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