Our Market View in Summary — May 2024

There have been a couple of noteworthy news events from the first few days of June that warrant specific commentary given that they impact all of the Palisade Funds and Palisade Portfolios, and the broader Canadian stock market in general. Below, and in our full monthly commentary, we summarize our thoughts on the beginning of an interest rate cutting cycle in Canada and the prospect of OPEC+ starting to remove its previously announced production cuts.

Key Highlights:

- **Bank of Canada (BoC) Interest Rate Cut:** The BoC reduced its policy rate by 0.25% to 4.75% on June 5th, which was expected by investors but should still be seen as a positive signal given lower borrowing costs for consumers and increased capital flows into dividend-paying stocks.
- **OPEC+ Production Decision:** OPEC+ maintained current production cuts but put forward a plan to bring some production back online starting in October 2024. Most importantly, they acknowledge that the plan to bring barrels back could be changed at any time due to market conditions. This messaging from the eight key members of OPEC+ leads us to believe that nothing has changed and that they continue to manage supply to ensure an attractive and stable oil price.

Near-Term Outlook:

- **Interest Rates:** Further rate cuts anticipated in Canada within the next year, potentially lowering by a full percentage point, contrasts with a more conservative rate cut expectation for the US.
- **Oil Market Dynamics:** Recent bearish inventory builds in the US have put some pricing pressure on the commodity over the last couple of months, but as we enter into driving season and higher levels of demand we expect to see the inventory picture change for the positive in the near future. OPEC+ will continue to manage supply, even if that means bringing on some incremental production, because they continue to benefit from an attractive and reasonably stable commodity price.
- **Canadian Market Potential:** With the interest rate cut and a steady oil market, Canadian stocks may see increased capital inflows, particularly in sectors like utilities, telecom and financials, which could benefit from broader economic stability and lower interest rates. The spread in valuation between the Canadian and US stock markets is near a 20-year high. Canadian stocks are right around their average valuation, while those in the US are much closer to recent highs. With fundamental factors like interest rates starting to move in a direction that will benefit more sectors and stocks in Canada, we would expect to see that valuation gap narrow.

While general market strength and breadth peaked out around the middle of March, we think the underlying trends will continue to provide attractive gains for investors through the balance of the year. Canadian stocks should be the beneficiary of changing macro-economic factors that are moving in a direction that most benefit sectors like real estate, telecom, utilities and other economically sensitive sectors, of which there is an abundance in Canada. There are also select benefits to certain consumer discretionary and financial companies due to an increase in purchasing power and lower financing costs. If we could add a change in federal government to the forecast for Canada, we should be in a good investing environment for the next few years.

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May 2024

Fellow Palisade Investors and Friends,

Please find attached our May 2024 Monthly Update, as well as the Fund Fact Sheets for the Palisade Funds. **This month's client conference call is scheduled for Wednesday, June 12th at 11am MT.** The Teams meeting details will be provided the morning of the call. In conjunction with this call, we will be emailing out a presentation that contains data and charts to further detail our thought process and outlook. We look forward to speaking with you then and answering any questions you may have.

All Fund performance figures are shown net of fees and expenses and include changes in security values and distributions paid. They do not assume the reinvestment of distributions. The Palisade Vantage Fund currently pays a regular quarterly distribution of $0.11 per unit, or $0.44 per unit per year. The Palisade Select Fund and Palisade Absolute Fund pay irregular annual distributions for years in which taxable net income is positive.

MARKET COMMENTARY

In just the past few days we've seen a couple of notable news events that have an impact across all Palisade Funds and Palisade Portfolios, so we'll address them in quick fashion:

1) The Bank of Canada cut interest rates on June 5th by 0.25% to get to a level of 4.75%

   Implication: While this cut was largely expected by investors, it's still a positive to see the cycle of lower rates *actually* begin. While it would be more impactful if it was the US Federal Reserve cutting rates, this should still be viewed as an incremental positive. Canada has generally led the US in its rate decisions through this cycle, but that doesn't necessarily have to mean that the US will cut rates shortly.

   From a Canadian perspective, the positives would be slightly less tension in the economy with incrementally more buying power and slightly less interest payment burdens on companies and individuals. This takes time to work through the system though. In the very short-term, the positive might be more capital flowing to dividend paying stocks as money market funds and GIC rates become less attractive.

   Lastly, it is very noteworthy that investors are currently expecting more rate cuts to happen in Canada over the next 12 months. A year from now we could see interest rates a full percentage point lower than today. This is in stark contrast to the US where there is only one rate cut expected this year, with that cut not expected until the Fall.

2) OPEC+ maintained its production cut guidance, but opened the door to the idea of tapering those cuts starting in October 2024

   Implication: At the end of the day, it comes down to trust and motivations. Does OPEC+ want to create an oversupply situation? No. Has stability in OPEC+ relationships, and generally speaking the oil price, over the last few years been a net benefit to OPEC+? Yes. In its press release, OPEC+ implies that bringing production back online will only happen if oil prices are reasonable and the demand exists to meet that supply. Below is an excerpt from the OPEC+ press release with the specific commentary:

   > "Moreover, these countries will extend their additional voluntary cuts of 2.2 million barrels per day, that were announced in November 2023, until the end of September 2024 and then the 2.2 million barrels cut per day will be gradually phased out on a monthly basis until the end of September 2025 to support market stability… This monthly increase can be paused or reversed subject to market conditions."

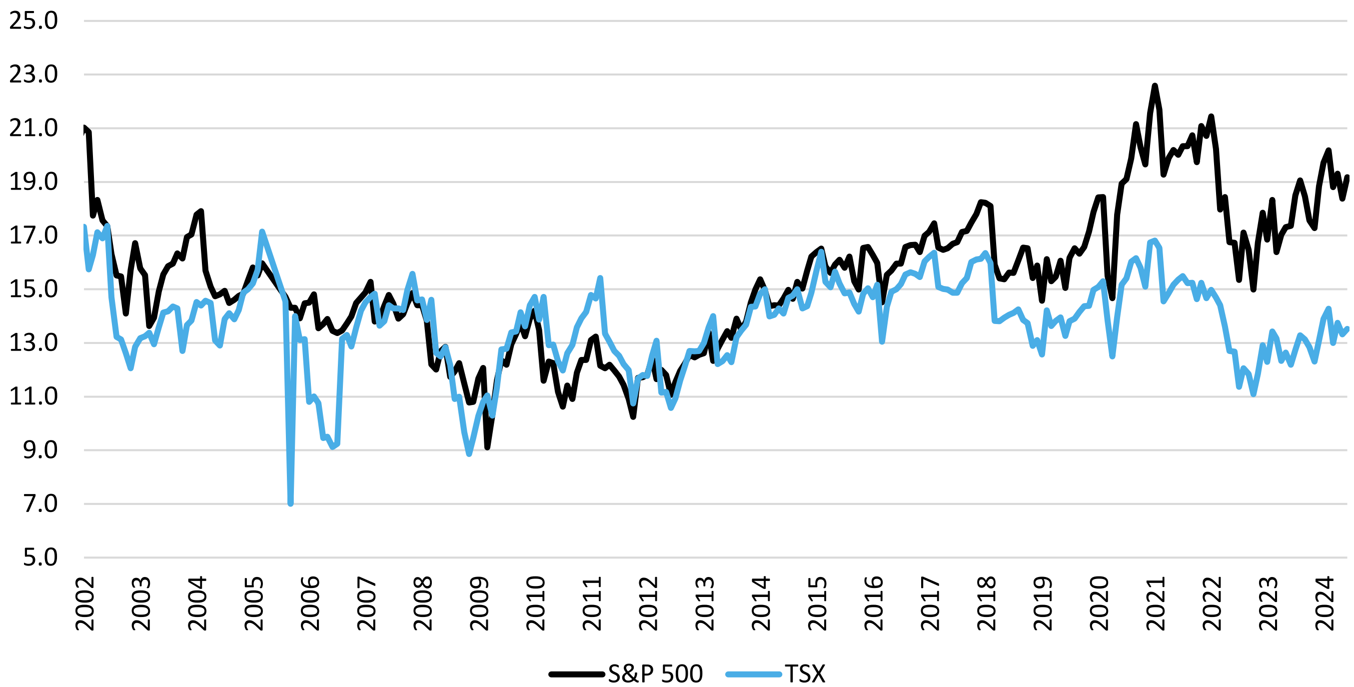
We have been relying on OPEC+ to manage production appropriately since COVID and given the wording of that statement, we will continue to rely on them to manage price in the near term. The wording appearing to be different than the status quo caused some investors and traders to sell down the price of crude fairly significantly on June 3rd. West Texas Intermediate crude traded down over US$3 per barrel and the S&P/TSX Capped Energy Index lost 4.4% that same day. In our view, this is overdone. Nothing has materially changed.

We have seen some slight improvement in sentiment and the interpretation of the message from OPEC+ in just the last 48 hours, but this certainly highlights how the oil markets are on a knife edge, especially when there is such a large amount of capital focused on just trading the commodity on a short-term basis. The oil market is the most liquid commodity market in the world, but with that comes a lot of short-term money that is not necessarily focused on nuance. Crude pricing has held in over the last few days despite the risk of follow through weakness from the OPEC+ statement and a bearish US oil inventory report on June 5th, so we think that we've worked through potential near term weakness as we head into driving season and likely some better US inventory reports through the summer.

That said, we do have to be mindful that the supply/demand dynamics of the oil markets are solely controlled by the willingness of OPEC+ to manage production to an appropriate level where everyone gets to win a little (at least in the short-term). We have mentioned this in previous commentaries, but to reiterate it here – oil demand continues to grow, and will continue to grow for many years into the future, oil companies (but not so much their natural gas oriented counterparts) have generally been more disciplined about production growth (especially the public companies), global crude oil storage levels are low, the inventory of drilled but uncompleted wells has been worked down and some would argue that the best wells have already been drilled in the Permian and other resource basins. This is all positive for the sector for the long-term, but in the short-term OPEC+ still has 3 to 4 million barrels per day of spare production capacity that can be used to meet incremental demand and manage price beyond the 2.2 million barrels per day of production that they are considering bringing back online starting in the Fall.

This doesn't mean that we are any less positive on the companies in the energy sector – they are largely well run, generating meaningful positive cash flow, buying back shares and focused on strategies to maximize the return for shareholders. Canadian Natural Resources was able to trade up to an all-time high in this environment with OPEC+ managing supply. As long as OPEC+ continues to play ball and manages production, there should be upside for investors as we wait for the supply/demand dynamics to tighten due to ongoing economic growth and the realization that "green energy" is not going to be able to meet those demand requirements in the short term.

Finally, to tie these two news events together, the chart below highlights the equity market valuation discount between Canada and the US, which has been widening since 2017, and is now at a level that we haven't seen in over 20 years. With the start of an interest rate cutting cycle upon us and hopefully a continued "steady as she goes" oil market ahead of us, while some sectors and individual stocks are trading anywhere from 5% to 15% off of their recent highs, this should create the environment to see capital flow into Canadian stocks across a wide variety of sectors from utilities and telecom, to financials and oil and gas. The winds should be blowing in Canadian equity investors' favor as the Bank of Canada continues to cut interest rates.



Source: Bloomberg

Looking back over the last 22 years, Canadian stocks are right around their average valuation, while US stocks are well above average. Obviously, there is nuance necessary when considering why this valuation gap exists (more technology in the US, higher profit margins, more business friendly environment, etc.) but the degree to which the gap exists will not be justified if interest rates come down, the economy holds together and companies with more exposure to interest rates and economic growth benefit as capital flows away from highly valued growth and money market funds having less attractive returns, towards sectors like telecom, financials, real estate, etc. While the broad Canadian market is around average valuation levels, there are stocks within sectors that are noticeably beaten up, like TD and BMO in the banking sector, or Rogers within the telecom sector, that may provide above average returns going forward.

PALISADE FUND COMMENTARY

The **Palisade Select Fund** ("PSF") was up 2.8% in May. The S&P/TSX Capped Energy Index ("Energy Index") was up 2.1%. The WilderHill Clean Energy Index ("ECO") was up 12.4% for the month. The strong performance of the energy technology and renewables sector this month brings it back to where it was a month earlier before it took a 12% dive in April. While it has been quite the rollercoaster recently in the energy tech sector, we continue to largely sit on the sidelines with regard to deploying new capital into those names. In the US, we have seen some interest emerge in non-regulated electricity producers as expectations for much higher electricity demand are coming from corporate conference calls when discussing the requirements for wide scale artificial intelligence (AI) development. Technically, this should also be a positive for natural gas demand. If electricity demand is going higher because of the computing power required to develop AI applications, that power has to come from somewhere and the alternatives in the short term aren't as quick (i.e. nuclear) or clean (i.e. coal) or scalable (i.e. green energy) as natural gas.

As for oil and gas, earlier in this commentary we discussed the impact of OPEC+ and the path forward if they were to choose to bring production back to global markets. At the end of the day, while their wording has changed, we think the bottom line for OPEC+ is status quo. For the last few years, the oil market has been stabilized by the actions of OPEC+ and we expect that they will continue to manage the market to their benefit. They'll bring back barrels if the demand for those barrels exists, and they won't bring them back if the demand isn't there. It should be that simple.

The PSF remains effectively fully invested with the vast majority of assets focused in oil, natural gas, infrastructure and service stocks. Energy technology and renewables comprise 9% of the fund. This mix could change as the energy tech and renewables stocks bounce along the bottom after a multi-year bear market, but for now we are comfortable that being overweight oil and gas is the best exposure for returns in 2024.

The **Palisade Absolute Fund** ("PAF") was up 0.6% in May. Although some individual short positions moved against us this month, overall we are comfortable that our screens continue to integrate quality names in targeting our medium and long term performance objectives. Some new positions include the return of Thomson Reuters to the portfolio among Canadian names and Motorola Solutions in the US. We also covered some shorts in Magna International and Mullen Group during the month. We are seeing a core set of names in Canada rotate into and out of the portfolio as the markets evolve around interest rate expectations. Canadian Pacific Kansas City (CP) is a good example of a name that had screened well, then was dropped from the screen at higher prices, and is now back in the screen at lower stock prices. There is a core group that includes CP, Canadian National Railway, Thomson Reuters, Brookfield Business Partners and WSP Global that have cycled through the Canadian screens based on their balance of potential return and risk over the last six months. These companies will continue to be core holdings in the PAF.

The **Palisade Vantage Fund** ("PVF") was up 3.2% in May. For the month, the S&P/TSX Canadian Dividend Aristocrats Index was up 1.3% while the S&P/TSX Composite Total Return Index was up 2.8%. As noted above, we think that the weakness that has beset the interest rate sensitive stocks and high dividend paying stocks in the last few months is an opportunity. To pursue that opportunity, we have taken our cash position from the 15% level that we mentioned last month to 3% at the time of writing this note. We have purchased Dream Industrial REIT (5.6% yield), Russel Metals (4.3% yield) and added to our NextEra Energy (2.5% yield) position as examples of where we have deployed that capital in the last month. We have also increased our existing position in Fortis (4.2% yield), in part because it has shown up well on our growth screen.

We think that Canada is entering into a compelling part of the investment cycle that may be enhanced if we were to see a change in federal government next year. The macro factors are changing to the benefit of a large swath of economically sensitive and interest sensitive stocks, which make up a majority of the investment opportunities in the country.

If you have any questions, please feel free to reach out at any time.

All the best,

THE PALISADE CAPITAL MANAGEMENT TEAM

Please note that it is the responsibility of each investor to inform Palisade Capital of any changes to the information provided to us on the most recently completed Know Your Client ("KYC") information form or subscription agreement. Please contact Marni Friesen at (403) 531-2673 or marni@palisade.ca to provide any such updates. If you no longer wish to receive the Monthly Update, please send an email to info@palisade.ca.

All Palisade Fund performance figures are shown net of fees and expenses and include changes in security values and distributions paid. They do not assume the reinvestment of distributions. Income taxes would have reduced returns. The Funds are not guaranteed. Performance of the Funds will fluctuate and past performance may not be repeated. To establish relative performance yardsticks for the Palisade Funds, we provide comparative references to the S&P/TSX Composite Total Return Index ("TSXTR"), the S&P/TSX Capped Energy Index ("Energy Index") and the WilderHill Clean Energy Index ("ECO Index"). Those indices are relevant to our portfolio content however the TSXTR, Energy Index and ECO Index data is provided for general reference purposes and their content should not be construed as directly comparable to the content of the Palisade Funds.