PALISADE CAPITAL

Our Market View in Summary — December 2023

Since the US Federal Reserve pivoted its outlook to one of managing the business cycle, rather than fighting inflation, we've witnessed significant shifts in the Canadian market landscape. This pivot has had a notably positive impact on several underperforming sectors in Canada like telecom stocks, financials, utilities and REITs, which outperformed the broader market nicely in December. We expect these trends to continue in 2024.

December Summary:

- The S&P/TSX Composite Index ("TSX") demonstrated a significant turnaround, moving from a 52-week low in October to a 52-week high by the end of December. While the timing of the year-over-year returns looks decent for the TSX, it should be noted that the Canadian markets have been largely rangebound for over two years, so lower interest rates and a stable economy (particularly in the US) could act as a catalyst to move markets higher and out of the range
- Banks, utilities, and real estate have shown a notable bounce back, benefiting from the central banks' shift in policy. To highlight this improvement, it is noted that the S&P/TSX Canadian Dividend Aristocrats Index was up 6.0% this month in comparison to the S&P/TSX Composite Total Return Index up 3.9%
- Capital inflows into these recovering sectors came partially from sales of previously outperforming Canadian stocks and from cash reserves in GICs and money market funds that accumulated due to attractive interest rates on these products in 2023. More flows out of money market funds in 2024 could be a further catalyst for higher stock prices
- The aggressive run-up in stock prices over the last two months could indicate a short-term overbought situation. That said, we think the pullback we have seen in the US during the first week of 2024 is buyable, especially if it were to continue a little lower from here
- Technology was the best performing sector in Canada in 2023 with an approximate 50% increase, driven by significant gains in Shopify and Constellation Software. Oil and gas remained volatile, ending the year basically flat. However, under the surface the median oil and gas stock was down, with the energy index buoyed by strong performance from Canadian Natural Resources, which is the largest company in the energy index

Near-Term Outlook:

- Sectors that lagged in 2023, like telecom, utilities, and real estate (three of the four worst performing sectors), should continue to offer catch-up opportunities
- While small cap has underperformed large cap for many years, 2024 might offer an opportunity to close the gap if capital flows into the stock market, the economy grows modestly and valuation multiples expand
- Oil and gas, along with other commodities, could see improved performance, especially if economic conditions and demand remain strong. This will be dependent on OPEC+ maintaining production cuts and US production leveling out after a strong uptick in 2023

Interest rates will continue to be the story in 2024. If we see steady declines in rates, as the market now expects, we should see continued outperformance from interest rate sensitive and economically sensitive sectors, which sets up well for Canadian markets.

Contacts:

Investment Matters:

James Anderson
Managing Director
(403) 531-2677
james@palisade.ca

John McAleer
Managing Director
(403) 531-2678
john@palisade.ca

Dan Zhigatov
Research Associate
(403) 531-2674
dan@palisade.ca

Operations and Administration:

Denise MacINNES
Corporate Secretary & Director
(403) 531-2671
denise@palisade.ca

Marni Friesen
Administrator
(403) 531-2673
marni@palisade.ca

Edna Barcelina
Wealth Management Administrative Assistant
(403) 531-2675
edna@palisade.ca

Jamie Duguay
Wealth Management Associate
(403) 531-2670
jamie@palisade.ca

Business Development:

Blair McDermid
Director of Business Development
(403) 803-0107
blair@palisade.ca

December 2023

Fellow Palisade Investor,

Please find attached the December 2023 Monthly Update and Fund Fact Sheets for the Palisade Funds. **Per our schedule of holding two client conference calls per quarter, we are not planning a call for this month. That said, the Canadian stock market has been volatile in 2023, so if you have any questions, please feel free to reach out at any time**.

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.

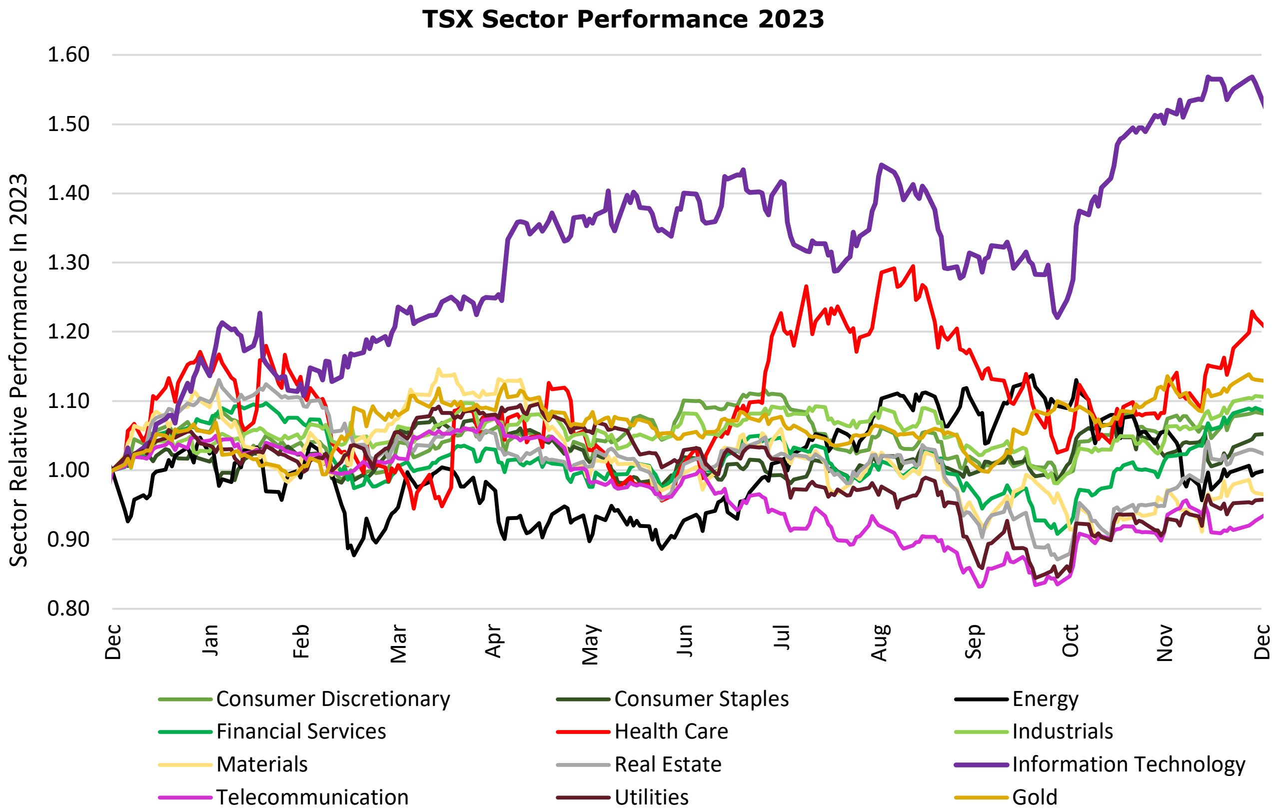
MARKET COMMENTARY

The last two months have brought a recovery for some of the underperforming sectors in Canada, as we have seen clear signs of a pivot from both the Bank of Canada and the US Federal Reserve. The goals for central banks have shifted from beating back inflation to managing the economic cycle. With that pivot, and an expectation for lower interest rates coming in 2024, we have seen a bounce back for sectors such as banks, utilities and real estate. Some of the capital used to buy those sectors has come from selling outperforming names in Canada. Some has come from the significant amount of cash built up by investors attracted to higher interest rates paid by GICs and money market funds in 2023. The investment themes that we have discussed for the last few months remain the same priority for the first half of 2024 based on a core platform of stable economic data (particularly in the US), slowly declining interest rates and capital moving into stock markets from GICs and money market funds.

That said, we are mindful that stocks have run up fairly aggressively in the last two months and have become a little overbought in the short term. As markets have pulled back to start the new year, the nature of the pullback will be particularly telling. Which sectors outperform while the market pulls back? Do correlations between stocks/sectors versus interest rates and the US dollar remain intact? Does Canada outperform the US due to a higher degree of sectors catching up in Canada? Do oil prices hold support and continue to have a generally negative correlation to the rest of the stock market? Will we see further evidence of underperforming sectors continuing the mean reversion trade that has been ongoing since the US Federal Reserve pivot on November 1st?

To highlight the mean reverting sectors, and thus the opportunities we see in the early part of 2024, below we show a chart of the twelve sectors that make up the S&P/TSX Composite Index ("TSX") for the year 2023. As you can see, many sectors traded sideways in a volatile range throughout the year. Just when it looked like we might enter a recovery mode the stocks pulled back, and just when it looked like things might unwind further (such as during the US regional bank insolvencies in the spring) stocks would bounce. The last two months of the year saw the TSX move from a 52-week low at the end of October to a 52-week high by the end of December.

As we've mentioned before, it doesn't look like markets discount future expectations as much as they used to. It took a very clear signal from the US Federal Reserve in real time on November 1st to reverse markets from the significant slide that started in the summer. No expectation of a pivot in central bank policy was priced into stock markets leading up to that meeting. Current market expectations are now focused on four or more interest rate cuts in 2024, ongoing improvement in inflation readings and a soft-landing economy for the year. We should see some differentiated performance across these sectors in 2024 based on how the data comes out versus these expectations. We would expect some of the underperforming sectors from 2023 to outperform, regardless of the performance of the leading technology names and their response to the ongoing economic data points.

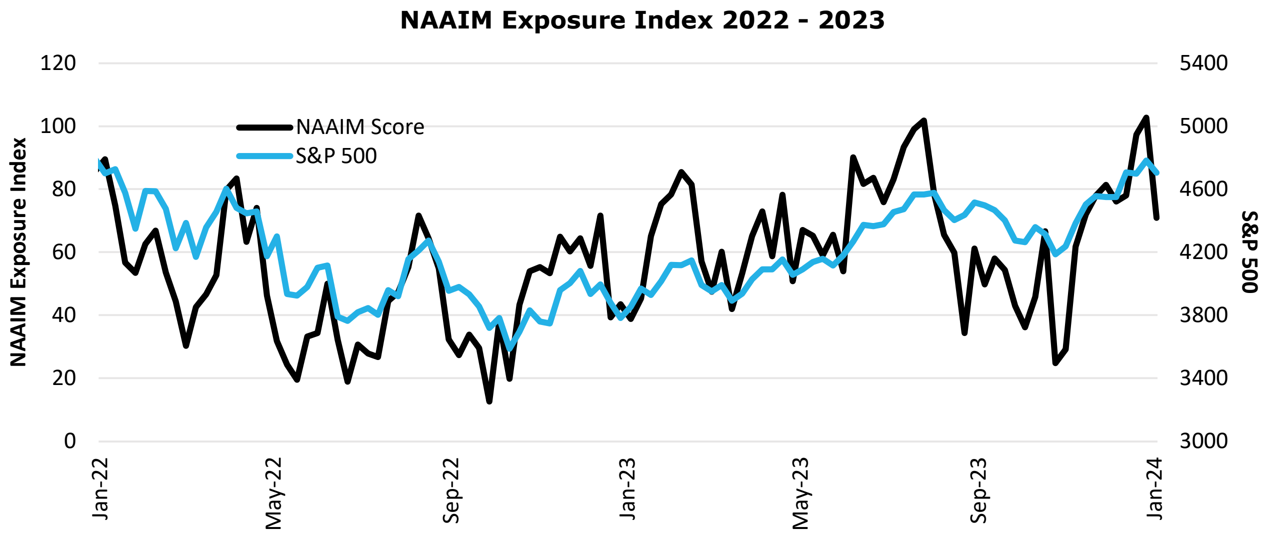


Source: Bloomberg

Some observations from this chart of 2023 performance:

- Technology was the best performing sector (up approximately 50%), driven largely by Shopify (up 119%) and Constellation Software (up 55%).
- Oil and gas (black line) had a highly volatile year but finished basically flat in 2023. In the spring it was the worst performing sector, rallied to be the second-best sector in the fall, and finished middle of the pack by the end of the year.
- Importantly, the oil and gas index performance was heavily influenced by the strong performance of Canadian Natural Resources (up 15%), which is also the largest company in the space. On balance, the median oil and gas stock was down for the year, partially due to underperformance in natural gas prices and partially due to reduced interest in the midcap producers in an environment where the crude oil price was volatile and down about 11% year-over-year.
- Within oil and gas, the best performing subsector was oilsands stocks, while the worst performing names were closer to pure plays in natural gas.
- Cannabis stocks (the red line representing the Healthcare sector) rallied in the back half of the year on expectations of wider legalization in the US. We likely will never be invested in cannabis stocks, but it is interesting to point out that it was the second-best performing sector in the Canadian stock market in 2023.
- Gold was the third best performing sector but wasn’t necessarily a rip roaring space at times. For example, in December the price of gold was up, but most of the company stocks were down slightly.
- Despite the strong performance in the last two months, three of the bottom four performing sectors were telecommunications, utilities and real estate. We think there are further opportunities for these sectors to catch up in 2024, which would benefit the Palisade Vantage Fund.

The chart below is in reference to our earlier comments about the markets being a little overbought in the short term. It shows a tried-and-true sentiment gauge that we have referenced many times over the years. The NAAIM Exposure Index measures the percentage exposure to equities for a basket of active fund managers. While all sentiment indices are more actionable on a short-term basis when indicating extremely bearish readings (i.e. maximum fear creating an attractive buying opportunity), as you can see below, when this index has been above 80% during the last two years it has typically led to a short-term pullback in equity markets. At the end of 2023 the reading was over 100% and so far in the first week of 2024 we have seen a pullback in US equity markets. There could be room for a further pullback, but we think that is a buying opportunity. Notably, the first NAAIM reading in 2024 had already pulled back to 70%, so the bullish froth from year-end has already been cleared out. Given the change in market sentiment and expectations for interest rates, we shouldn't see this reading revisit the more panicky levels between 20 and 40 that we have seen over the last two years.



Source: NAAIM

Overall, we think the trajectory for markets in the short to medium term has been set by the US Federal Reserve's pivot to lowering interest rates through 2024. While we will have some bumps along the way, we expect continued catch-up opportunities in Canada in general, but more specifically in financials, utilities and real estate investment trusts ("REITs"). We would also expect to see improved performance in oil and gas and other commodities, assuming that demand remains strong and potentially surprises to the upside if economic performance continues on a firm footing.

PALISADE FUND COMMENTARY

The **Palisade Select Fund** ("PSF") was down 1.2% in December. The S&P/TSX Capped Energy Index ("Energy Index") was down 5.6% and the WilderHill Clean Energy Index (NYSE: ECO) was up 12.9% for the month.

We mentioned in last month's update that PSF was close to 20% cash in the first part of December due to weakness in commodity prices from warm weather and higher than expected inventory builds in the crude oil markets. In the middle of the month, we started to see a change in crude inventory trends, stock prices at technical support levels and near record levels of bearish positioning in crude oil futures markets, so we began to pick away at high quality oil weighted names. Purchases largely stayed within the framework of oil, and more specifically the oilsands exposed names such as Canadian Natural Resources, Cenovus and MEG Energy. We also picked away at a couple of existing energy technology names.

Cash in PSF currently sits at 9.5% and energy technology and renewables are at 13% of PSF assets. Energy tech will be interesting to monitor as we have seen a recovery bounce following some tax loss selling and an overall sell-off from highs, almost three years ago, of over 75%. These names clearly supported PSF this month as oil and gas continued to march to the beat of its own drummer.

The **Palisade Absolute Fund** ("PAF") was down 0.8% in December. This month's performance is a little hard to comprehend in that there were just very few winners across the names held in the Fund. As we mentioned in last month's update, we had sold many of our oil and gas names early in the month and covered more short positions to the extent that the Fund was nearly 60% net long at points during the month. When we look at a detailed attribution analysis for December, there are no large losing positions - the issue was that there were very few winners. The remnant oil and gas names declined slightly and our growth screen names largely took a breather as we saw outperforming names across the board pull back slightly while underperforming names continued to rally. As mentioned earlier, the price of gold went up, but our positions in gold producers went down slightly. Previous winners like WSP Global, Descartes Systems Group, Kinaxis and Dollarama all took a breather this month. Many other names were "flattish" in December and didn't contribute a material amount of gains. Our positions remain in high quality companies that we expect will perform in time. We added more financials and REITs in the middle of the month, but the gains in those names were not material over the subsequent two-week period.

We've mentioned over the last few months how we have been making some changes with regard to some growth and short screens that we have implemented - these had been adding value and keeping PAF flat while the markets declined in the fall. We remain highly confident in the screens and their ability to add returns over time. We are also developing new factor screens to supplement the growth and short screens, which will be helpful in identifying short term trends, especially if we were to remain in a choppy market in Canada. We expect these changes to improve returns in 2024.

The **Palisade Vantage Fund** ("PVF") was up 6.1% in December compared to a gain of 3.9% in the S&P/TSX Composite Total Return Index. For a further frame of reference, the S&P/TSX Canadian Dividend Aristocrats Index was up 6.0% for the month. The extension in the gains that we saw in interest sensitive stocks in November continued through the balance of December. This provides further proof that we should continue to see investors allocate capital to these sectors as valuations still look reasonably attractive and there could be room to the upside for earnings expectations if we see a stable economy and lower interest rates.

Notable winners in PVF through November and December include CN Rail, Rogers Communications, Royal Bank, Nexus Industrial REIT, Brookfield Infrastructure Partners, Chartwell Retirement Residences and Granite REIT. This group is a reasonably diverse, but interest sensitive collection of names indicative of the types of stocks that we expect to outperform in 2024.

Regarding stocks that have run up significantly, we have trimmed some exposure in Rogers Communications, PHX Energy Services and Algoma Steel this month. The last two holdings justify a slight highlight given that they are not the typical names that we refer to in PVF. PHX is an oil services stock that focused on substantial dividend payments in 2023 and was able to post strong stock price returns despite weakness in the rest of the sector, in large part due to its shareholder friendly dividend policies. Algoma is a small cap steel company with a very strong balance sheet and a small dividend yield that has benefited from M&A in the US steel market and improved cash flows due to a recovery in steel prices. This name is a little outside the norm for PVF, but we felt that the combination of fundamental stability, low valuation and the other factors mentioned above could add some differentiated returns to the Fund. With the recent run-up in the stock price, we will likely look to sell more shares in the coming weeks.

We expect Canadian stocks to do well in 2024 and they may have an opportunity to make new highs after doing very little for almost two and a half years. If we were to see an election this year, that could really spark a positive change in investor expectations! Fingers crossed.

As always, we are happy to answer any questions you may have. Please feel free to reach out at any time. Best wishes for all of your endeavors in 2024!

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.