PALISADE
CAPITAL

Our Market View in Summary

January 2024

To paraphrase a Mark Twain quote - Markets don't repeat, but they do rhyme. What worked in previous market cycles has not been as predictive through the current cycle. Various economic indicators that have preceded stock market weakness in the past have failed to produce a similar outcome this time around. Early in 2024 we have seen the widespread stock market strength that emerged in November and December revert back to the narrower market trends seen through much of 2023. Despite some weakness in traditional economic indicators, we continue to see the US economy grow faster than expected in the face of inflation and "higher for longer" interest rates. Ongoing strength in the US economy has been pulling up some Canadian stocks and if the strength continues, we expect to see more Canadian stocks and sectors join the party.

Report Summary:

- **Economic Indicators' Reliability:** Traditional indicators like the Leading Economic Indicators (LEI) and the ISM Manufacturing survey have shown limited predictive power in the current cycle, with the US economy growing despite negative readings.
- **Canadian Market Dynamics:** The S&P/TSX Composite Index has been rangebound, with recent highs suggesting potential for growth, though most stocks are still below their late 2021/early 2022 peaks. Further US strength will be an opportunity for Canadian stocks to break higher out of the range.
- **Manufacturing vs. Services Index:** The US ISM Manufacturing survey indicated contraction, but the larger consumer economy, as represented by the ISM Services Index, remains resilient.
- **Inverted Yield Curve:** Despite this traditional recession indicator being negative since summer 2022, the US economy has continued to exhibit strong gross domestic product (GDP) growth.
- While these historical data points traditionally point to market weakness, what we have seen this cycle is continued strength in US GDP and thus we see the stock market supported by consumer demand growth and the singular fact that the US is winning the economic race.

Near-Term Outlook:

- **Economic Resilience:** With the US economy growing, the prospect of a recession in the first half of 2024 seems slim, potentially benefitting the Canadian market.
- **Stock Market Scenarios:** The S&P 500's historical performance post-rate hikes indicates potential for market strength for at least a couple more years, barring a recession.
- **Canadian Market Potential:** A positive US economic outlook and a hopeful change in Canadian federal government could catalyze growth in Canadian stocks, particularly in sectors with US exposure.

The current Canadian market landscape, heavily influenced by the US economy, presents an opportunity via a catch-up trade as the US economy continues to grow. While traditional economic indicators may not be as predictive as in past cycles, the ongoing growth in the US economy offers a bullish outlook for the stock market. A combination of reasonable valuations, earnings growth and dividend yields portends the potential for attractive total returns in various Canadian sectors.

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

January 2024

Fellow Palisade Investor,

Please find attached the January 2024 Monthly Update and Fund Fact Sheets for the Palisade Funds. **This month's client conference call is scheduled for Tuesday, February 13th at 11am MT.** We will use Zoom for this call which will allow participants to connect either through their computers or by calling a phone number. The Zoom 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

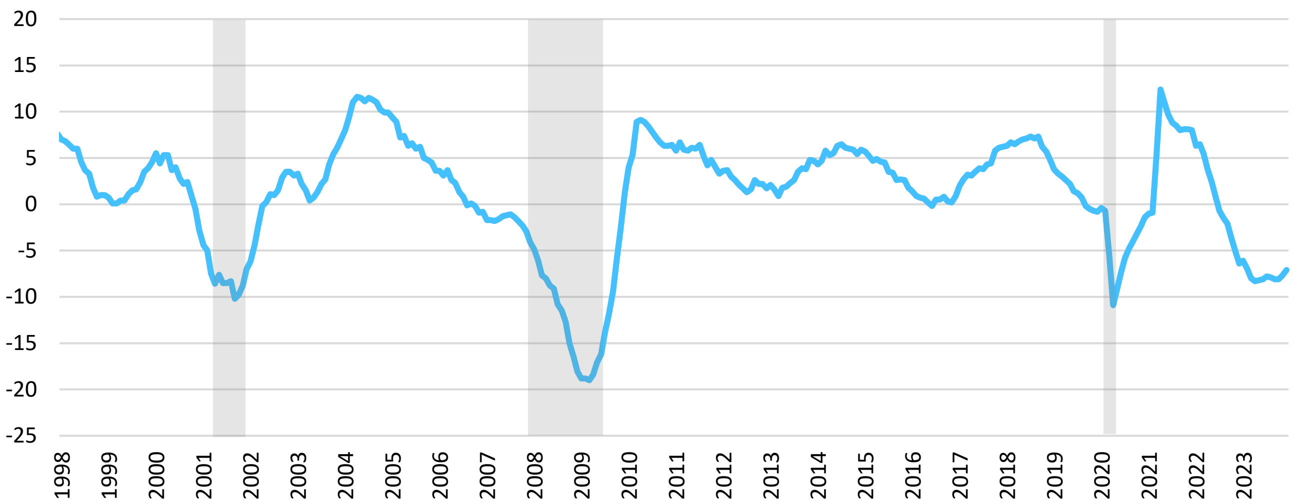
There's a quote from Mark Twain that is often referenced in relation to the stock market - "History doesn't repeat, but it does rhyme." This is used in the context of looking back at previous market cycles with similar characteristics to the existing environment and trying to use that past experience as a divining rod for the direction of the current markets. What has been unique in this cycle is how many tried and true economic guideposts have not worked over the last two years. It makes the job of forecasting that much more difficult, but also leads to aggressive headlines in the financial news. If an inverted yield curve has ALWAYS led to a recession in the past then it has to lead to one now, right? If Leading Economic Indicators turn negative, then that has to lead to a recession this time around, right? Even if US economic growth continues to come in ahead of expectations, it's just a matter of time before we fall off an economic cliff and into a deep recession, right? Well, our answer to such questions is…maybe??

One tenet of our monthly updates and conference calls is the objective of trying to cut through some of the loud and scary financial headlines and focusing our clients on what seems to matter now. What's working and what's not. It doesn't mean that we're always right and it doesn't mean that something bad and scary couldn't be around the corner, but we are trying to use the trends we see in front of us to give a little insight into where stock market sectors *MIGHT* trend in the next six to 12 months. This month's commentary largely started with a brief review of economic indicators and us noting how many of them don't seem to have had much predictive power with regards to the stock market. Before we jump into a few examples, it is worth noting a key caveat in that we are largely referring to the US markets in comparing the economic data with stock market performance.

Canada can, and has, drafted behind the US markets in the past, but it's been more difficult in recent years due to the lower amount of technology stocks in our market and what we see as a federal government overhang in general. At this point, it feels like a change in federal government could be the best possible thing for Canadian investors. It would certainly lift some dark clouds from the commodity and financial sectors. The S&P/TSX Composite Index ("TSX") has been rangebound for the last two to two and a half years, and as we write this, the TSX is at a high for the last year and returned 8.1% in 2023 on a point-to-point basis. That said, most Canadian stocks are still well below their highs from late 2021/early 2022.

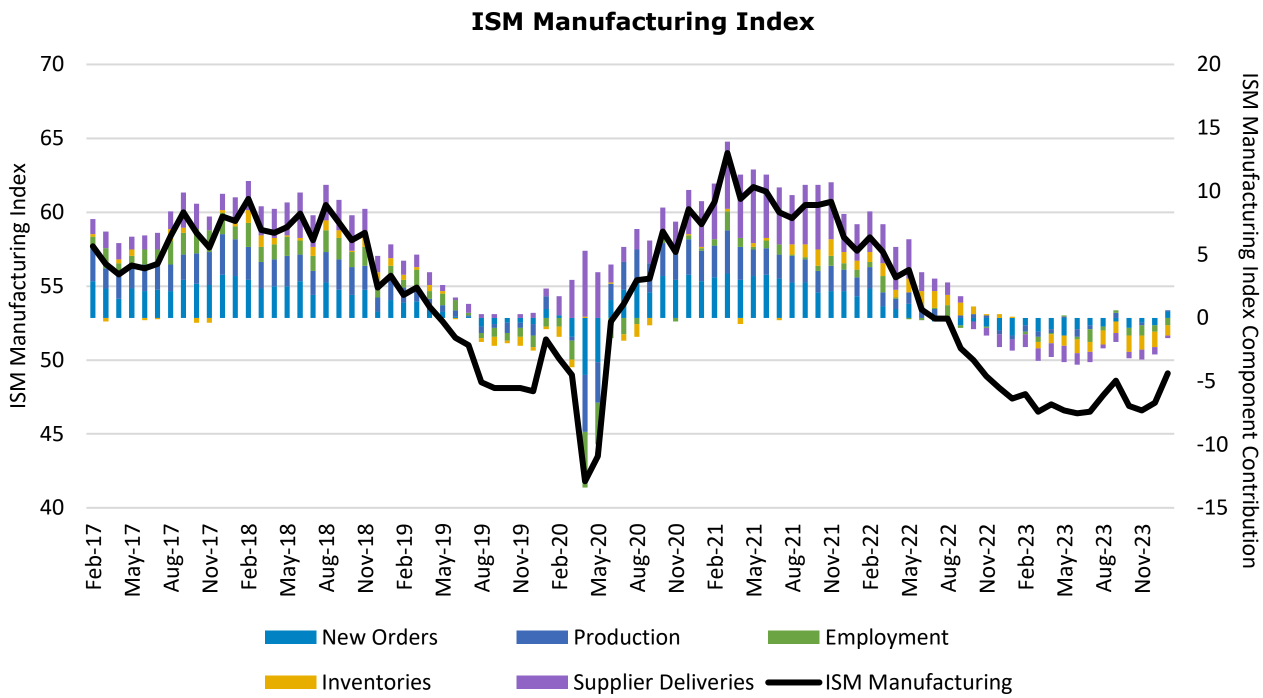
Below is a chart of Leading Economic Indicators ("LEI") in the US. As the name implies, this is a collection of economic data points that are supposed to give an indication about the future direction of the economy. As you can see, LEI turned negative in mid-2022 and has been negative ever since, resulting in over a year and a half of negative leading economic indicators. As you can see, in the last two recessions, the LEI turned negative between four and 12 months before a recession kicked off. Because these are "leading" economic indicators, there would typically be a delay between turning negative on the LEI index and a pullback in the economy, however in the most recent economic cycle the LEI has been negative for over 18 months and yet the US economy grew by 3.3% in Q4 2023 and 4.9% in Q3 2023. The current estimate of Q1 2024 GDP growth according to GDPNow is 4.2%! So far, we haven't seen much of an economic slowdown despite the long standing negative position of the LEI. Interestingly, in previous cycles, when the LEI starts turning up from negative levels it usually occurs right near the end of the recession. Today we are seeing a slight improvement in the LEI, which in years gone by should indicate that we're coming out of a recession, not at risk of going into one.

Leading Economic Indicator Index



*Grey areas represent NBER defined recessions
Source: Bloomberg

The second data point we're highlighting this month is the ISM Manufacturing survey. This provides an indication of whether manufacturing companies are growing or shrinking based on actual conversations with executives at manufacturing companies around the US. A reading above 50 indicates that manufacturing is growing and below 50 would point to potential shrinking. This reading has been below 50 for the last 14 months going back to November 2022. In the past we have noted that manufacturing is only 30% of the economy, so it's not as impactful on a broad basis. However, in economic cycles gone by it wouldn't have been crazy to see weakness in manufacturing show up in other areas of the economy in general, but again, that doesn't seem to be happening this time. Interestingly, ISM Manufacturing dipped below 50 in the spring of 2019, well before anybody was concerned about something called COVID-19 and the massive negative impact it would have less than a year later.



Source: Bloomberg

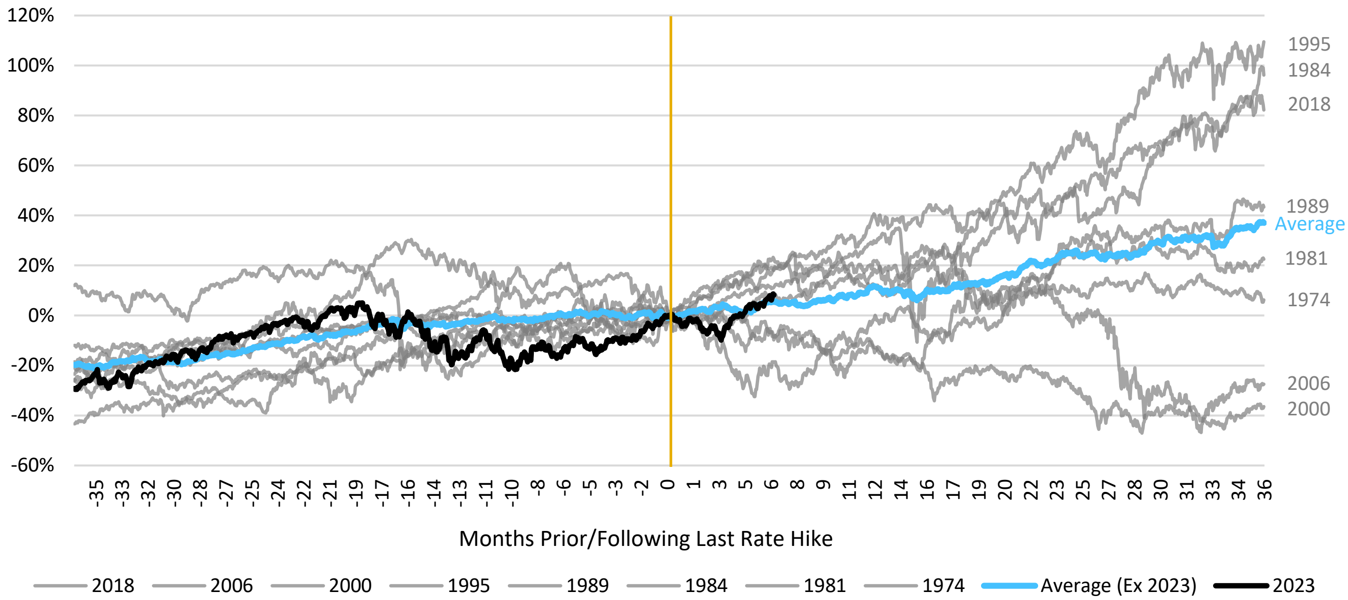
The other 70% of the economy, which is covered by the ISM Services Index, continues to show resilience, with a slight bounce in the data this month to sit at a level of 53.4, up from last month's reading of 50.5. So far, weakness in manufacturing hasn't shown up in the broader economy.

The last old school market forecasting device to mention is an inverted yield curve. This is often trumpeted in the financial press as a sure-fire indicator of a future recession. There are different ways to look at it, but for the sake of this commentary we'll look at a standard basis of 10-year government bond yields less the yield on 2-year government bonds. This difference became negative in the summer of 2022, and here we are a year and a half later with the US economy still churning out GDP growth between 3% and 5% over the last three quarters (including the estimate for Q1 2024). In the past, there have been occasions when it took almost two years to get to a recession after the yield curve inverted, so there is still potential risk in this statistic, but so far the prospect of a recession in the first half of 2024 looks very slim.

This isn't to say that we are out of the economic woods. Is it possible that wage growth remains elevated and inflation becomes stubbornly entrenched around the 3% mark? Possibly. This would keep interest rates near current levels and would disappoint investors in the short term. This would also push out our Canadian investment thesis of broadening market participation and outperformance of small cap and interest sensitive stocks for a period of time. Could weakness in China spill over? Possibly, but China has been weak for a while and we have yet to see an impact in the US. There are other reasons that would make us cautious, but so far the economy continues to look through traditional predictors of potential weakness. The US keeps winning, which should pull Canada along for the ride…especially if a change in Canadian federal government became expected in 2025.

The chart below kind of summarizes the stock market scenarios for investors in 2024 and through 2025. The vertical line in the middle of the chart delineates the date at which the US Federal Reserve stopped raising interest rates in previous cycles. The lines are the S&P 500 index during the various rate cycles going back to 1974. Looking to the right of the vertical line, it shows that the S&P 500 rallied after the last rate hike, unless we saw a recession like in 2001 and 2008. It could really be that simple - enter a recession and the stock market will sell off. If the economy can shrug off the rate hikes and continue to grow, then the market should go higher. So far in this cycle, the last rate hike happened in July 2023 and the US economy continued to grow, therefore the stock market continued to rally (acknowledging that at times that rally has been pretty narrow). In the current environment we have largely seen traditional warning signs shrugged off and the US economy continues to grow. Until there is more evidence of slowing economic data in the US, we'll continue to be biased to the bullish side of the ledger. The blue line in the chart is the average stock market trend following the last US Fed rate hike over the last eight cycles. The black line is where we find ourselves today. If we can avoid a recession, there should be lots of running room for higher markets in the years to come.

S&P 500 Pre and Post the Last US Fed Interest Rate Hike (Yellow Line)



Source: Bloomberg

Again, we recognize that this analysis is skewed largely to the US markets, but our view remains that if the US avoids a recession and grows nicely over the next few years, then it will open the door to Canadian stocks breaking out to the upside due to the positive economic knock-on effects. More importantly, it will lead to an environment where investors will be looking for other sectors to allocate money to, and any Canadian company that has a material amount of exposure to the US will benefit as a result. Large cap US technology valuations are almost as expensive as they were at the peak in 2021 when interest rates were zero. It's just a matter of time before profits are taken in those names and rotated into other parts of the stock market. The Canadian markets bounced strongly in November and December last year because stocks had become very cheap and the interest rate outlook changed. Going forward, there is still room to the upside on valuation in most sectors, which when combined with a little earnings growth and a healthy dividend, should create an attractive total return for many sectors in Canada.

PALISADE FUND COMMENTARY

The **Palisade Select Fund** ("PSF") was down 1.8% in January. The S&P/TSX Capped Energy Index ("Energy Index") was up 0.7% after a wild ride during the month that saw the index both up and down a material amount at various points. The WilderHill Clean Energy Index "(ECO") was down 20.3% for the month. We note an important point regarding the clean energy stocks from just the last couple of days. Enphase Energy (NASDAQ: ENPH), a bellwether stock in the solar energy space and a holding in the PSF, commented during their quarterly conference call that they think Q1 2024 will be the bottom for solar equipment demand and noted a positive turn in outlook in Europe and North America outside of California, while stating that California should also improve but on a slightly slower timeframe. November and December saw positive contributions from the green energy stocks in the PSF, which then returned to being a drag in January. Our exposure to this sector has been around 13% for the last few months and won't be changed in the short term, but a company like Enphase seeing signs of a bottom and a broad index (ECO) that's down over 80% from its highs warrants keeping a close eye on the space.

In oil and gas, we feel the need to take a breather and look to the middle of the year for positive catalysts in the space. In the last few months, we have seen continued warm weather and ongoing natural gas supply growth in the US drive down the commodity price to a level that should cause some production shut-ins. The US Henry Hub natural gas price is down to US$2.00 at the time of writing. Going back the last ten years, we have only seen prices lower than this during COVID in 2020 and for a brief period in early 2016. Producer cash flow is under pressure as a result and shareholder return of capital strategies are delayed for some names. The stocks are technically "cheap" in the mid-cap and small-cap space, but there needs to be some sign of production being shut in or a second wave of cold before winter ends to clean up the supply overhang in gas markets before investors will come back to the names.

On the crude oil side, we need to see oil actually flowing through the Transmountain Expansion to convince investors that it's actually happening and that there are no other surprise delays lurking around the corner. At this point, oil as an investment theme looks more attractive than natural gas, especially given that even with incremental delays in Transmountain we will see it online in the near term and there should be positive price impacts for Canadian producers. The sentiment is currently poor across the board in energy and the stock prices reflect that. With a little light at the end of the tunnel from the Transmountain Expansion, we should see some investors circle back to the beaten up names in the coming months. Companies that can buy back stock will be rewarded and flexible investors will benefit in the medium term. The PSF is positioned for that development.

The **Palisade Absolute Fund** ("PAF") was up 0.2% in January. Net exposure was trimmed further from 60% in December to around 20% currently. The key holdings in the PAF are focused on quality growth-oriented winners in Canada on the long side, with a collection of company-specific shorts and index exchange-traded funds on the short side. We took the net exposure down because many growth names have become overbought in the short term and the risk of interest rate cuts in the US being pushed out even a few months may act as a momentum drag in the short term. Breadth in markets over the last few weeks has narrowed dramatically and we are back into a world where a handful of stocks are driving the indices, so we felt it was prudent to lower our exposure in the short term. This doesn't change our overall positive view on the markets as we expect to increase the weight in many names, especially if we saw prices dip for a few weeks.

When we refer to "quality growth" names in Canada, we're talking about companies like Dollarama, QSR International, Stantec, Thomson Reuters, WSP Global and TMX Group, to name a few. We've currently supplemented such core names with other growth companies like Shopify, ASML Holdings, Coveo and Descartes.

The **Palisade Vantage Fund** ("PVF") was flat in January after significant gains in the last two months. The S&P/TSX Composite Total Return Index was up 0.6% in January. The S&P/TSX Canadian Dividend Aristocrats Index was down 0.5% for the month.

After a PVF gain of 14.1% over the previous two months, some of the macro drivers behind the stocks in the Fund took a breather this month. In particular, interest rates went up during the month of January. Interest rates on 10-year Canadian bonds went up marginally from 3.11% to 3.35% in the month after falling from a high of 4.25% in the previous three months. This decline provided a nice tailwind for dividend-paying stocks into year-end. As we've mentioned in the past, we think the Bank of Canada will be forced to lower interest rates more quickly than the US Federal Reserve. This should be a further catalyst for Canadian dividend-paying stocks in 2024. We see the pause in PVF this month as a short-term breather during a longer-term trend of positive momentum for the types of stocks in PVF.

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.