PALISADE CAPITAL

Our Market View in Summary — June 2024

The recent increase in the Canadian capital gains inclusion rate, from 50% to 66.67%, had a negative impact on the Canadian stock market in June. This policy change, part of the Federal Government's budget announced in April 2024 and separately voted on in June, created a deadline of June 25th for investors to crystallize gains at the lower tax rate. As a result, greater than average selling activity resulted in pronounced volatility and divergence in the performance of Canadian stocks compared to their US counterparts through most of the month. In related stock market action, oil and gas stocks also significantly underperformed the price of crude oil throughout the month, likely as a result of similar selling pressure on winning positions.

Key Highlights:

- Federal policy changes increased the capital gains inclusion rate from 50% to 66.67%, causing a short-term wave of selling from investors wanting to crystallize gains at a lower tax rate
- Canadian inflation data came in slightly higher than expectations, which caused bond yields to go up and interest sensitive stocks to go down
- These factors caused a meaningful divergence in performance between US and Canadian stocks in June
- Once selling started to slow down as the June 25th deadline neared, we saw a meaningful bounce in Canadian stocks leading into month-end
- Canadian stocks don't have to follow US stocks in lockstep, but it was notable that through the first three weeks of the month, Canadian stocks were down most days while US stocks were up most days
- The S&P/TSX Capped Energy Index was down 5.5% in June while the price of WTI crude oil was up almost 6%

Near-Term Outlook:

- We believe that this is a buying opportunity for oil and gas stocks due to strong crude prices now that the tax-related selling pressure has dissipated
- Canadian stocks appear attractive post-selloff, especially if potential federal government changes favor lower taxes and improved economic policies
- Economic data in Canada has been a little soft in recent months, so we would expect the Bank of Canada to continue cutting interest rates over the next year
- Valuations in certain interest sensitive sectors like telecom are near or at COVID lows

The declines in the Canadian markets in June don't change our outlook for Canadian stocks through the balance of the year. In particular, interest sensitive and economically sensitive stocks should benefit as the Bank of Canada continues, and eventually the US Federal Reserve starts, to lower interest rates. As we get closer to the Canadian federal election, investors may also start to anticipate benefits that may come from a change in government. We have used the pullback, particularly in oil stocks, to buy more at current levels as we expect a catch-up trade through the summer.

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

June 2024

Fellow Palisade Investors and Friends,

Please find attached our June 2024 Monthly Update, as well as the 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, we are always happy to answer questions about the markets, so 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

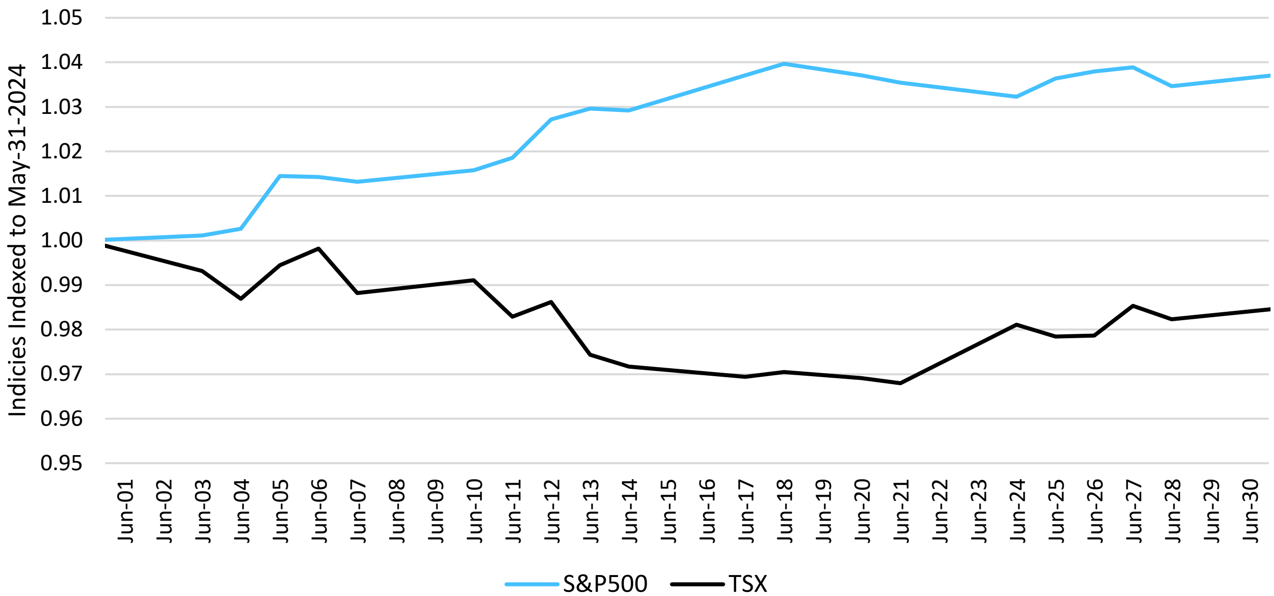
There have been many federal government policy decisions over the last nine years that have driven investors and capital away from Canada, but it would appear that the decision to increase the capital gains inclusion rate from 50% to 66.67% had a very tangible effect on the Canadian stock market in real time during the month of June. The deadline for crystallizing capital gains before being subject to the new inclusion rate was set for June 25, 2024. Capital gains realized after that date would be subject to the higher inclusion rate.

While this change was actually included in the federal government budget announced in April 2024, the changes for the inclusion rate were tabled for a vote separately and individually on June 10th. Leading up to this vote there had been many questions and concerns voiced, but the motion did pass due to the support agreement between the Liberals and NDP in Parliament.

The prospect of a higher tax rate on Canadian capital gains seems to have driven a wide divergence in stock price performance between US and Canadian stocks in June. We also saw a fairly wide divergence in the prices of oil and gas stocks and the direction of oil prices. While it's hard to pinpoint the relationship with 100% certainty, it is notable that US stocks went up most days during the month, while Canadian stocks went down most days until June 24th, when Canadian stocks staged a dramatic bounce a day before the deadline to make sales. By that time, anybody that wanted to sell would have already made the sale and would not have waited until the very last minute to hit the sell button.

The chart below shows the performance of the S&P/TSX Composite Index in Canada and the S&P 500 in the US for the month of June. As you can see, Canadian stocks underperformed US stocks quite notably during the month. If an investor was likely to sell a stock at some point in 2024, it made sense to make that sale before June 25th in order to pay lower capital gains tax. Those "forced" sales would seem to have had a notable impact in the month, which creates a buying opportunity in our minds.

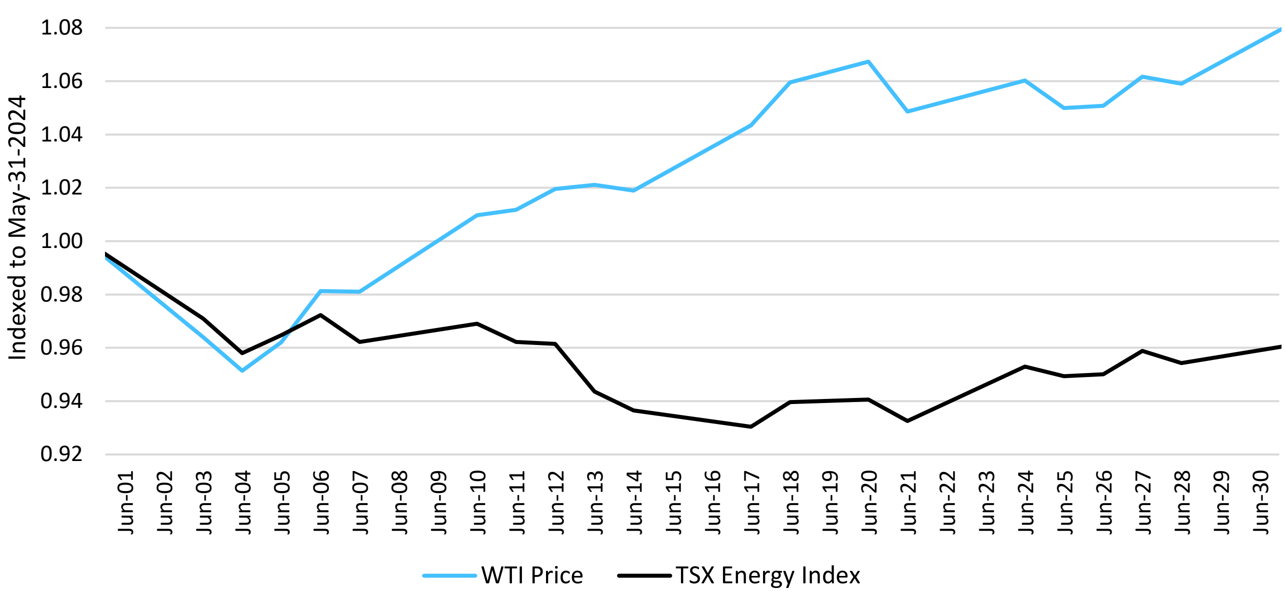
Performance of S&P 500 and S&P/TSX Composite in June 2024



Source: Bloomberg

Similar to the chart above, Canadian oil and gas equities underperformed the price of oil quite dramatically during the month. The price of WTI crude was <u>up</u> 5.9% in June, while the S&P/TSX Capped Energy Index was <u>down</u> 5.5%. Admittedly, the US Energy Index ETF "XLE" was also down 2.2%, but the Canadian names still performed much worse than their US counterparts and the price of the commodity. Oil and gas stocks have been steadily selling off since their short-term peak on April 10th, so the added pressure from forced selling due to the tax deadline will likely have established a market low as that selling pressure is removed, assuming that commodity prices hold firm.

Performance of WTI Crude and S&P/TSX Capped Energy Index in June 2024



Source: Bloomberg

There are two takeaways for us in this regard. First, the dip in the stocks, especially the oil stocks, should absolutely be bought here. The price of oil continues to be supported by OPEC+ and the fundamental supply/demand story continues to develop bullishly. The short-term pressure from investors selling to lock in a lower capital gains tax rate has now been removed and there exists a near term opportunity for a bounce in the stocks to better reflect the strong crude price. The second takeaway is that Canadian stocks overall look attractive after this sell off, especially if you want to look out a year and hope that existing polling numbers hold into the next Canadian federal election. If this capital gains tax hike were to be reversed, along with the carbon tax and other productivity-reducing policies, we would see that as a catalyst to drive Canadian stocks higher, along with lower interest rates and a (hopefully) improved economy.

PALISADE FUND COMMENTARY

The **Palisade Select Fund** ("PSF") was down 2.1% in June. The S&P/TSX Capped Energy Index ("Energy Index") was down 5.5%. The WilderHill Clean Energy Index ("ECO") was down 11.5% for the month. While PSF was down during the month, it showed notable outperformance versus both indices. Part of this was due to trimming that we executed in some of our remnant energy technology names in the middle of the month, which we rotated into beaten up oil and gas names, which then bounced in the last week of the month. The most notable purchase was adding to our position in Canadian Natural Resources, which is now a 10% position in the PSF.

We maintained our exposure to a small group of energy technology and renewables names that have been performing relatively well, including Quanta Services and NextEra Energy, but overall energy technology and renewables now make up only around 8% of the Fund. We have been noting for many months that we think there will ultimately be real investing opportunities in this sector given that the ECO index is down over 85% from its peak in early 2021, but we continue to largely watch from the sidelines, in part due to "higher for longer" interest rates and also due to extreme volatility in the sector.

Oil and gas is now almost 90% of the invested capital in PSF. We think that the pullback that we've seen over the last two months in the space (S&P/TSX Capped Energy Index peaked on April 10th) provides a particularly compelling opportunity to allocate more capital to oil and gas names because the fundamental supply/demand thesis continues to play out, while OPEC+ continues to manage short term supply. In addition, as mentioned earlier, oil and gas stocks were down notably in June while the price of oil actually increased 5.9%. We believe that this gap will be closed by oil and gas stocks going up to catch up to the price of oil.

The **Palisade Absolute Fund** ("PAF") was up 0.9% in June. Although the gains were small, we're happy to see positive performance when the Canadian markets were down (S&P/TSX Composite Total Return Index was down 1.4% for the month). As we've been discussing over the last few months, we have fully committed to our new screens covering Canada, the US and for short ideas in both countries. The Fund is moving somewhat separately from the broader markets. This is what we want to see - that the companies on both the long and short sides of the Fund are moving due to factors unique to their business and their sectors, rather than just moving with the broader markets.

The screens bring forward companies across a wide spectrum of sectors in both Canada and the US. The names in Canada are fairly consistent month-to-month and include companies such as Constellation Software, Hydro One, Canadian National Railway and Chartwell Retirement Residences. Companies that have come in and out of the screens regularly include Dollarama and Stantec.

In the US screens, the names rotate a little more regularly, but some current examples across different sectors include Netflix, Moody's, Domino's Pizza and Motorola Solutions. We've also seen industrial names such as Eaton Corp and industrial-adjacent software company PTC Inc. flow in and out of the screens in the last few months.

Given the change in makeup of much of the Fund, we want to give it some time to determine the level of success of this incremental strategy. As mentioned previously, the back-tested data for the screens over the last ten years looks very attractive (high teens annualized returns with below average volatility) and the quality of the companies is consistently very high. As such, we believe the outlook is positive, but it needs a little time to play out.

The **Palisade Vantage Fund** ("PVF") was down 0.7% in June. For the month, the S&P/TSX Canadian Dividend Aristocrats Index was down 0.3% while the S&P/TSX Composite Total Return Index was down 1.4%. We believe that PVF-oriented stocks were under selling pressure during the month for the reasons outlined above, but they've seen a bit of a relief rally in the last couple of weeks. During the month, Canadian inflation data came in a little higher than expected (2.9% vs 2.6% expected) which put upward pressure on bond yields and thus downward pressure on dividend-oriented stock prices. We see this data as a statistical blip. Inflation readings have been coming in below expectations consistently in 2024, so having one come in higher doesn’t change our expectation of inflation normalizing through the balance of the year and interest rates continuing to decline, which would be constructive for the PVF holdings.

We continue to believe that Canada is entering into a compelling period of the investment cycle that may be enhanced if we were to see a change in federal government next year. Steadily lower interest rates, an improved economic outlook and (hopefully) clearer economic policy should make the June dip look like a bump in the road to higher Canadian stock prices over the next year.

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.