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Canadian Dividend Strategy

Key Takeaways

- ▶ Strength in Canadian equities was broad based in the quarter, with seven of 11 sectors reaching new all-time highs.
- ▶ Financials holdings drove strong absolute performance in the quarter, although defensive positioning and select weakness in industrials and energy led the Strategy to trail its benchmark.
- ▶ As equity prices have risen despite continued uncertainty around global trade policy shifts and heightened geopolitical risk, our concern is that the impending economic impacts are being priced out of market valuations.

Market Overview

Following a sharp drop in equities at the beginning of the second quarter, with market tensions peaking immediately following "Liberation Day" tariffs announced on April 2, the S&P/TSX Composite Index staged a sharp recovery, finishing the period with a solid 8.5% gain. Strength in Canadian equities was broad based in the quarter, with seven of 11 sectors reaching new all-time highs.

Financials holdings drove strong absolute performance for the Strategy in the quarter, although our defensive positioning detracted from relative performance as the market rebounded, with consumer staples, utilities and communication services overweights and an information technology (IT) underweight weighing on results. These sector stances along with weaker stock selection in the industrials and energy sectors helped drive overall underperformance versus the benchmark for the quarter despite sturdy absolute gains.

Strength in financials was driven by Toronto-Dominion Bank (TD), which, helped by its strong relative capital position and stable franchise, outperformed Canadian banking peers following the tariff announcements. Royal Bank of Canada, Bank of Montreal and Bank of Nova Scotia all saw solid gains and were among top contributors as well. We trimmed our TD shares on this strength, having added to the position in prior periods when anti-money laundering risks were overly discounted. We now view the risk/reward as more balanced after recent gains. Our underweight to the underperforming Manulife Financial was also a relative contributor.

In energy, commodity price volatility and weakness resulted in poor overall sector performance with the Strategy's holdings lagging. While not owning the underperforming Suncor and TC Energy helped in the quarter, weaker overall performance from our natural

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gas-focused producers, ARC Resources and Tourmaline, as well as not owning the strong-performing Cameco (+70%) detracted as interest in nuclear and uranium-oriented equities surged.

In industrials, holding Canadian National Railway made positive but more modest gains than the sector overall. We continue to view the stock as one of the most attractive risk-adjusted return opportunities as its current valuation discounts macroeconomic risk but in our view ignores the pent-up operating leverage residing in the underlying business, which we believe will be a powerful earnings driver when volume recovers.

Portfolio Positioning

Turbulent markets through the quarter provided rebalancing opportunities. Specifically, the initial selloff in more cyclical sectors allowed us to build positions in some economically sensitive businesses at attractive valuations. In turn, we reduced exposure to some of our more defensive businesses which were commanding higher multiples. This recycling of capital, informed by our bottom-up research and valuation work, should be accretive in value to the portfolio over time. After Liberation Day, with the markets following a more risk-on trajectory, we are seeing some cyclicals trading higher, and we will be selective and opportunistic as we seek businesses with growth attributes (including dividend growth) at the right prices.

In consumer staples, we trimmed our position in Metro due to its recent strength, while we added to Alimentation Couche-Tard (ATD) on weakness. ATD shares have come under pressure since the company's proposal to acquire Seven & i Holdings, parent of 7-Eleven, a global convenience store operator with dominant market positions in Japan and the U.S. ATD possesses an enviable track record of successfully consolidating convenience store networks across key global jurisdictions, significantly fortifying its competitive stance while extracting outside synergies in the process. Recent share weakness, in our opinion, has provided an opportunity to add to a business that has historically compounded strong shareholder value over time.

Trading activity in the energy sector in the quarter reflected market dislocations and our continued preference for higher-quality, longer-duration assets. We increased our positions in Canadian Natural Resources and Cenovus Energy during early-quarter volatility, viewing the dislocation as an opportunity to add to two high-conviction oil producers. The former remains a standout in Canadian energy for its durable, low-decline assets and disciplined capital returns. Cenovus, meanwhile, continues to make progress on operational execution, with a turnaround in the downstream assets in focus and a clear plan on deleveraging and shareholder returns supporting our long-term view. In energy infrastructure, we added to Pembina Pipeline as shares lagged amid uncertainty over the Alliance Pipeline toll ruling. While timing remains unclear, we believe the market has priced in an overly

negative outcome. Pembina's integrated assets, diversified cash flow and sustainable dividend make it an attractive holding.

In materials we modestly reduced our position in Nutrien to reallocate capital toward higher-conviction ideas. This valuation-driven decision does not reflect any change in fundamentals. Nutrien remains a high-quality, vertically integrated agricultural business with strong free cash flow, a solid balance sheet and continued operational execution, particularly in its retail segment, which is on track to meet 2026 EBITDA targets and has made solid progress on cost savings.

Outlook

As equity prices have risen despite continued uncertainty around global trade policy shifts and heightened geopolitical risk, our concern is that the impending economic impacts are being priced out of market valuations. Although it appears some de-escalation of tariff policy will take some "worst-case scenario" analysis off the table for Canada in particular, the outcome remains unresolved, and the ultimate impact is already tangible. Many businesses have curtailed capital investments as management teams are forced to contemplate a strategic response in what remains a fluid situation. We continue to emphasize defensive positioning and dividends, aiming to provide predictability and downside protection while owning businesses with reasonable valuations. In our view, our consistent focus on long-term fundamentals and valuation puts investors on solid footing in what remains an unstable investing climate.

Portfolio Highlights

The ClearBridge Canadian Dividend Strategy underperformed its S&P/TSX Composite TRI benchmark during the first quarter. On an absolute basis, the Strategy generated gains across eight of nine sectors in which it was invested (out of 11 sectors total). The top-contributing sector was the financials sector, while energy was the sole detractor.

On a relative basis, stock selection and sector allocation detracted, with an IT underweight, utilities and communication services overweights and stock selection in the industrials and energy sectors detracting the most.

In terms of individual securities, the top contributors to relative returns were Toronto-Dominion Bank, Manulife Financial, Nutrien, CCL Industries and Enbridge. The main relative detractors were BCE, Canadian Utilities, Pembina Pipeline, Alimentation Couche-Tard and Keyera.

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