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Canadian Equity Strategy

Key Takeaways

- ▶ For Canada, tariffs and related measures, highlighted by early April Liberation Day levies, are anticipated to reduce the pace of economic activity, which could be significant depending on the scope and duration of the trade conflict. Despite a market rebound following tariff delays, uncertainty around their duration and impact continues to weigh on consumer and business confidence.
- ▶ Strength in Canadian equities was broad based with new all-time highs reached by seven of 11 sectors. The Strategy underperformed through this rally off tariff lows, primarily due to weakness in IT, materials, energy and utilities, as well as an underweight to the outperforming financials sector.
- ▶ By adding cyclical on weakness and reducing defensiveness on strength, the net effect of our active repositioning through elevated volatility was adding risk to the Strategy at attractive prices and on our terms, increasing its beta above the middle of our targeted range of 0.8 to 0.9.

Market Overview

Canadian equities advanced in the second quarter despite heightened global trade tensions inflicted by the U.S. administration's "Liberation Day" tariff announcements, in addition to intensified geopolitical risks in the Middle East. In fact, the S&P/TSX Composite Total Return Index jumped 8.5%, hitting new all-time highs in late June — particularly impressive considering the initial 9.6% swoon for the S&P/TSX Composite TRI in the initial days of the quarter.

Strength in Canadian equities was broad based in the second quarter with new all-time highs reached by seven of 11 sectors: energy, materials, industrials, consumer discretionary, consumer staples, financials and utilities. Notably absent from the list were information technology (IT), which is still well below its Nortel-induced 2000 highs, health care, which is below former Valeant-induced 2015 highs, as well as the communication services and real estate sectors, which have struggled to produce strong total returns in recent years.

Due to the cross-border nature of many Canadian equities, a notably weak U.S. dollar — down 5.4% against the Canadian dollar to \$1.36 CDN/USD, marking its worst quarter since 2016 — was a defining feature of the second quarter. A weaker U.S. dollar typically reduces the translated value of U.S.-sourced earnings, but it can also have a multifaceted impact on Canadian equities through impacts on commodity prices, such as gold or copper. Trade policies that

undermine the U.S. dollar's "safe haven" appeal have also contributed to investor caution regarding U.S. fiscal deficits and debt.

For Canada, tariffs and related measures are anticipated to reduce the pace of economic activity, which could be significant depending on the scope and duration of the trade conflict. Canadian GDP contracted slightly in April, unemployment remains elevated and inflation is relatively tame. On both sides of the border, some of these data points fostered expectations that monetary policy might ease — typically viewed as a positive for stocks. While both the Federal Reserve and Bank of Canada stood pat in the second quarter, the Bank of Canada has cut rates seven times this cycle to a neutral level of 2.75%, intending to bolster consumption and housing demand. The outlook for further cuts is complicated by inflation concerns tied to tariffs.

Canada's federal election, represented another significant event in the second quarter, reaffirming the mandate of the incumbent Liberal government, led by Prime Minister Mark Carney, and offering continuity and stability during a period of national strain. Economic policy is front and center, including streamlining regulations and permitting (especially for resource and infrastructure projects), accelerating infrastructure investment, defense spending increases and removing interprovincial trade barriers. These policies could be a boon for sectors such as energy, industrials and utilities, with easier approvals and faster permitting of projects as well as the free movement of consumer goods and labor.

IT (+14.2%), consumer discretionary (+14.1%) and financials (+12.1%), were the three best-performing sectors, while energy (+1.3%), communication services (+2.6%) and health care (+3.1%) were the three worst performers. Indications of increased OPEC+ production and uncertainty around the Israel-Iran war in the Middle East created volatility in crude oil and natural gas prices that ended the quarter at US\$65.11/bbl (West Texas Intermediate) and US\$3.49/mmbtu (NYMEX), representing 9% and 16% declines, respectively.

Exhibit 1: Tariff Risks Sparked Roller Coaster Ride Across Sectors

Sector	Total Returns (2025)		
	March 31 – April 8 Trough	April 8 Trough – June 30	March 31 – June 30
Information Technology	-13.3%	31.8%	14.2%
Consumer Discretionary	-8.0%	24.0%	14.1%
Financials	-8.1%	22.0%	12.1%
Materials	-11.2%	21.8%	8.1%
Industrials	-6.9%	16.2%	8.1%
Real Estate	-8.4%	14.5%	4.9%
Utilities	-5.7%	11.2%	4.8%
Consumer Staples	-2.8%	7.6%	4.6%
Health Care	-14.0%	19.9%	3.1%
Communication Services	-7.5%	10.9%	2.6%
Energy	-14.3%	18.2%	1.3%
S&P/TSX Composite TRI	-9.6%	20.1%	8.5%

As of June 30, 2025. Source: ClearBridge Investments, FactSet.

Performance Overview

In IT, not owning the outperforming Celestica — a rare Canadian AI play (hardware oriented) — was the largest detractor from relative performance as the stock surged as spending on data center infrastructure and demand from hyperscalers created tailwinds. Additionally, holdings CGI and Descartes Systems both declined as CGI's more traditional IT services model resonated less with investors while Descartes faces a global trade slowdown and resulting softness in organic growth.

In materials, gold's "safe haven" status continued to shine with commodity price strength leading to strong returns from gold equities. Gold bullion continued its ascent in the second quarter, finishing at US\$3,308 per ounce, up 6% in the quarter and 25% year to date. The Strategy is underweight the gold subindustry, with sector holdings Agnico Eagle Mines and Franco-Nevada both strong performers year to date. However, Franco-Nevada lagged in the second quarter as uncertainty remains surrounding the restart potential of the Cobre Panama mine, accounting for a meaningful portion of the company's growth in the coming years. Meanwhile, the Strategy's non-gold-related names in the sector were generally solid and contributed to relative performance.

In energy, commodity price volatility and weakness resulted in poor sector performance with the Strategy's holdings lagging. While not owning the underperforming Suncor and TC Energy helped, weaker overall performance from our natural gas-focused producers, ARC Resources and Tourmaline, as well as not owning the strong-performing Cameco detracted as interest in nuclear and uranium-oriented equities surged. The primary beneficiary of this latter dynamic held in the Strategy was AtkinsRéalis, in industrials, with its booming nuclear backlog.

Portfolio Positioning

Trading activity in the Strategy was heightened as opportunities to both trim and add to positions were fruitful given the early-quarter market weakness and acute trade uncertainty. We opportunistically added to several out-of-favor cyclical names that came under intense pressure while concurrently trimming resilient defensive holdings (such as consumer staples and utilities), as well as a few of the market's deemed cyclical winners, on strength. Between adding cyclical names (higher beta) on weakness and reducing defensiveness (lower beta) on strength, the net effect was to add "risk" to the Strategy at attractive prices and on our terms, increasing the Strategy's ex-ante beta above the middle of the targeted range of 0.8 to 0.9.

We added to Keyera in the energy sector via subscription receipts and eliminated our remaining position in Brookfield Renewable as positive sentiment surrounding nuclear and renewable developments propelled

its share price higher. Keyera's subscription receipt financing is tied to its acquisition of Plains Midstream's Canadian natural gas liquids (NGL) assets. We believe the transaction enhances Keyera's scale, integration and long-term competitive positioning in Western Canada's NGL infrastructure industry. The financing offered an opportunity to increase our position at a compelling valuation and supports our view that Keyera remains well positioned to benefit from long-cycle energy infrastructure demand and incremental pipeline egress.

In energy, we rotated from ARC Resources into Tourmaline Oil after ARC materially outperformed. Tourmaline offers better relative value and remains a best-in-class operator with a strong balance sheet, low-cost reserves and robust free cash flow — supporting shareholder returns and downside protection in a volatile gas market. 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.

In financials, we trimmed Toronto-Dominion Bank following its relative outperformance versus Canadian banking peers post-tariff announcements. Having added to TD in prior periods when anti-money laundering risks were overly discounted, we now view the risk/reward as more balanced after recent gains driven by its strong relative capital position and stable franchise.

At quarter end, the Strategy's largest sector exposures were financials, industrials and energy. Relative to the benchmark, the Strategy is overweight the generally defensive/non-cyclical consumer staples and utilities sectors, as well as industrials. The Strategy is most underweight the typically value/cyclically oriented financials and materials sectors.

Outlook

In this unpredictable trade environment, many Canadian companies have opted to delay capital investments. However, select firms in the IT sector are benefiting from strong spending driven by AI. As business use cases for AI become increasingly tangible, equity markets have positively responded to companies involved in AI development, hardware manufacturing and solutions. Software providers are already leveraging AI to enhance developer productivity. Notably, Shopify has mandated the use of AI by employees, positioning it as an essential tool, and has paused hiring unless it is demonstrated that AI cannot perform the required tasks.

Across the broader economy, businesses are beginning to realize the meaningful productivity improvements and benefits of AI. Applications such as telecommunication company TELUS's AI-powered chatbots, allowing it to respond to customer inquiries efficiently and accurately, are enabling businesses across industries to scale operations, improve decision making and reduce costs without proportionate increases in labor. This is particularly evident in data-rich industries such as financial

services, where AI is being used to enhance pricing precision in home and auto underwriting for property and casualty insurance and in banking to detect fraud, automate compliance processes and improve credit risk assessment. Even companies with significant fixed assets are using AI to streamline production lines, optimize inventory and supply chains and reduce waste.

These productivity gains can translate into higher revenue growth (capturing more sales with the same workforce) or better operating efficiency (higher output per unit cost), or a combination of both. Given the widely acknowledged productivity issues of recent decades, Canada is potentially a prime beneficiary of these productivity improvements. The broader implications of AI adoption are significant, particularly in a global environment marked by rising trade frictions where AI has the potential to enhance resilience and competitiveness. However, it is important to approach this opportunity with discipline. While emerging technologies often inspire strong market optimism, it remains critical to apply valuation discipline to ensure investment decisions are grounded in fundamentals rather than driven by momentum or speculation.

In times of market turmoil, such as the environment in early April, it is essential to maintain a long-term perspective. Avoiding short-term distractions and remaining decisive in the face of both risks and opportunities is key. This includes a disciplined perspective surrounding valuation, as determined through discounted cash flow analysis, prioritizing equities trading at a meaningful discount to our estimate of intrinsic value. We emphasize high-quality companies that demonstrate clear potential for future profitability, sustainable long-term growth, sound capital allocation and a balanced risk-reward profile.

We continue to emphasize defensive positioning, aiming to provide predictability and downside protection while maintaining reasonable valuations. This supports portfolio stability and outperformance during periods of equity market volatility and allows us to remain flexible in capturing developing opportunities.

Portfolio Highlights

During the second quarter, the ClearBridge Canadian Equity Strategy underperformed its S&P/TSX Composite TRI benchmark. On an absolute basis, the Strategy generated gains in nine of the 10 sectors in which it was invested (out of 11 total). The primary contributors were the financials, industrials and IT sectors while the main detractor was energy.

Relative to the benchmark, security selection and sector allocation detracted from performance. In particular, stock selection in IT, materials, energy and utilities sectors had negative impacts while selection in consumer discretionary was supportive. Regarding sector allocation, an underweight to the exceptionally strong financials

sector detracted, though this was partially offset by an underweight to the underperforming energy sector.

On an individual stock basis, leading relative contributors included AtkinsRéalis, Enbridge, Manulife Financial, ATS and Stantec. Top relative detractors included BCE, Alimentation Couche-Tard, Franco-Nevada, Fortis and Tourmaline Oil.

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