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## Canadian Small Cap Strategy

### Key Takeaways

- ▶ The S&P/TSX Small Cap Total Return Index delivered a strong first quarter, supported by elevated commodity volatility. Materials led performance in January and February, while energy drove benchmark returns in March.
- ▶ The dominant macro driver shifted meaningfully during the quarter — from a continuation of the precious metals rally to conflict-driven tightening in energy markets and rising inflation expectations.
- ▶ The Strategy delivered strong absolute performance but trailed the benchmark, with relative underperformance concentrated in the January-February mining rally.

### Market Overview

For the better part of the last year, volatility in commodity markets — generally to the upside — has been the key driver of returns in the Canadian small cap market. The small cap index has significant direct exposure to commodity-oriented businesses, while many industrial, financial and technology constituents also exhibit meaningful sensitivity to underlying commodity dynamics.

Unsurprisingly, volatility in commodity prices during the first quarter of 2026 continued to play a large role in determining the path of the overall index. For the first two months of 2026, the Canadian small cap market looked much like it did in 2025. Gold, silver and copper prices continued to move higher, and the index followed suit, rising 8.7% in January and another 12.6% in February, with the materials sector driving a large proportion of performance.

The escalation of the U.S.-Israeli conflict with Iran in late February introduced a new source of volatility centered on the energy market, with broader implications across commodities and interest rates. The physical crude market tightened materially. Brent crude ended the quarter at US\$127 per barrel, up 128% for the quarter. The historic move in crude prices resulted in a very strong quarter for Canadian small cap oil producers. The small cap energy sector was up 34.8% by the end of March after posting strong months in January and February.

One casualty of the conflict was the market's expectation for lower interest rates in 2026 and, by extension, the price of gold. As the conflict increased inflation concerns, the market reduced its expectations of rate cuts globally and longer-term interest rates moved

higher. With the opportunity cost of holding gold, a non-yielding monetary asset, increasing, the price of gold moved lower. Gold declined from a record above US\$5,500/oz in January to a conflict low of US\$4,099/oz, a 27% decline.

The S&P/TSX Small Cap declined 9.0% in March, led by a correction in the materials sector that was offset by a rally in energy.

Despite the month-to-month volatility, the net result was a strong quarter for the index (+11.4%), which underscores the value of the resource-heavy concentration inside a broader portfolio.

## Outlook

Our investment approach is bottom-up and research-driven, supported by a patient culture and a long-term horizon that allows us to act when expectations diverge from fundamentals. We continue to focus on businesses that pair prudent capital allocation with durable competitive advantages, strong balance sheets and the ability to compound value over time.

In our year-end 2025 commentary, we highlighted elevated event risk in 2026. We listed the renegotiation of the Canada-U.S.-Mexico free trade agreement (CUSMA), the durability of AI-related capital expenditure cycles and what, at the time, appeared to be an oversupplied energy market. The outcome of Canada-U.S. trade negotiations and the implications of AI investment and adoption remain key risks for Canadian small cap equities, but the market's focus has shifted to the implications of the conflict with Iran.

The energy market is clearly struggling to balance shut-in production in the Middle East, the implications for global inventory levels and the post-conflict supply-demand balance, which has increased volatility. Our approach to energy equities is unchanged; we favor producers with well-defined cost and resource advantages and energy service companies with demand drivers that are less sensitive to swings in energy prices. The Strategy's energy positions are, on average, less sensitive to swings in commodity prices. As a result, we would expect to trail the energy sector during surging bull markets, as we saw in the first quarter, but to deliver stronger performance full cycle.

Considering the broader market, it is our assessment that the quality of Canadian energy equities has improved considerably over the last decade. Capital allocation policies are more robust, balance sheets are more durable and cost structures are more resilient. This was apparent in 2025 when energy equities performed well despite a weak commodity market. While we expect energy equities to have lower sensitivity to crude prices, a product of wider margins and reduced financial leverage, it is more likely that windfall cash flows will accrue to shareholders rather than to capex growth.

We remain biased toward copper producers and precious metals royalty/streaming companies in the materials sector. Copper supply

constraints, combined with growing demand linked to power generation and electrification, provide a constructive long-term setup for copper pricing. Our gold exposure is concentrated in royalty/streaming businesses, which offer diversified participation across multiple projects and jurisdictions while mitigating operational, geopolitical and geological risk. That said, we did start building a position in gold developer Skeena Resources during the first quarter. We remain extremely critical of capital allocation in precious metals, given the industry's spotty history. Even so, we believe select development assets can offer attractive risk/reward when management is aligned, financing risk is manageable and valuation compensates us for execution risk.

We continue to see a positive long-term opportunity domestically as federal and provincial governments push toward a more supportive policy mix. Steps aimed at easing internal trade frictions, accelerating approvals for major "nation building" projects and reinvesting in national capabilities can improve private-sector visibility and catalyze activity over a multiyear horizon. We see multiple companies inside the energy, utility, industrials and consumer staples sectors as beneficiaries of the renewed focus on business-friendly policies by Canadian governments.

### **Portfolio Positioning**

Volatility and ongoing M&A activity allowed us to remain active during the quarter. We initiated three new positions, exited four holdings and adjusted weights across a range of names as opportunities presented themselves.

We added North West Company and eliminated Empire in consumer staples. North West is a remote-community retailer operating in Canada's North, Alaska and the Caribbean. The company's history dates back centuries to fur trading posts, and stores in northern Canada have been in operation for more than 200 years. North West has developed a network of distribution and retail assets that allow it to provide cost-effective grocery and retail goods to hard-to-access communities. It also has a number of positive tailwinds, including settlement spending in northern communities and the federal government's commitment to Arctic sovereignty and resource development.

We were active trimming energy positions that had outperformed, including Parex Resources, Headwater Exploration and Enerflex, while adding a new position in Paramount Resources. Paramount has a long history of successfully developing plays and rotating capital through asset sales to larger producers and is currently developing a new natural gas asset in the Alberta Montney Formation that we believe will profitably accelerate the company's growth and complement its liquids-weighted Duvernay assets. In addition, the market is ascribing

very little value to its undeveloped properties in the BC Horn River/Liard Basin and its heavy oil assets.

In information technology (IT), we eliminated Sylogist, a small customer relationship management and enterprise resource planning software-as-a-service (SaaS) developer focused on non-profit and government end markets. Sylogist had struggled heading into 2026 with an inconsistent balance between margin and growth and is now contending with leadership changes and an activist campaign. While we do not subscribe to the broader view that SaaS companies will be broadly disintermediated, we believe Sylogist may struggle to compete given its size and leadership uncertainty in a market where AI adoption is becoming increasingly important. We rotated the Sylogist proceeds into Lumine and Kinaxis and added to Descartes, software businesses we believe are better positioned to compete in the evolving SaaS environment.

In materials, besides the new position in Skeena Resources, we added to Major Drilling and trimmed positions in Methanex and Winpak. Skeena's flagship Eskay Creek asset is now a fully permitted, fully financed, near-term gold development project in a top-tier jurisdiction, with manageable cost inflation, improving project economics and a clear path to first production in 2027. The recent refinancing and value-accretive stream buyback support a rerating from current discounted valuation as the asset transitions toward production and cash flow generation.

### **Portfolio Highlights**

During the first quarter, the Strategy underperformed the benchmark S&P/TSX Small Cap Index. Results were positive on an absolute basis, with the portfolio generating positive returns in six of the 10 sectors in which it was invested. The largest contributors to absolute performance were energy and materials, while IT detracted the most.

Relative to the benchmark, sector allocation was modestly positive, while stock selection detracted. In particular, selection in the industrials, materials, financials, consumer staples, IT, energy and consumer discretionary and an overweight to IT weighed on results. On the positive side, underweights to materials and health care, an overweight to utilities and stock selection in health care contributed to performance.

At the individual security level, the largest contributors were PHX Energy, Headwater Exploration, Enerflex, Calian and not holding Torex Gold Resources. These holdings benefited from strong execution and, in several cases, direct or indirect exposure to improving energy market conditions. The largest detractors were Capstone Copper, Propel Holdings, Boyd Group, Descartes Systems and Kinaxis.

In addition to the transactions mentioned above, we exited Brookfield Wealth in financials and GDI Integrated Facility Services in industrials.

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