



Canadian Equity Strategy



Garey Aitken CFA
Head of Canadian
Equities, Portfolio
Manager



Tim Caulfield CFA
Director of Canadian
Equities Research,
Portfolio Manager

Key Takeaways

- ▶ Canadian equities advanced for an eighth straight quarter, supported by strength in financials, industrials and other risk-oriented areas.
- ▶ The Strategy generated positive absolute returns but trailed the benchmark, as stock picking in industrials, IT and real estate more than offset strength in materials and select financials.
- ▶ Portfolio activity focused on adding to high-quality businesses pressured by AI, rate and cyclical concerns while exiting positions where valuation support or relative opportunity had moderated.

Market Overview

Canadian equities delivered a strong second-quarter performance, with the S&P/TSX Composite Total Return Index (TRI) rising 7.0%, its eighth consecutive quarterly increase. Geopolitical uncertainty around the Iran war and the Strait of Hormuz continued to influence energy markets, while AI-related capital spending, power infrastructure and broader “build Canada” initiatives supported strength in select cyclical, industrial, financial and infrastructure-exposed areas.

Tariff risk, renegotiation of the Canada–United States–Mexico Agreement, AI opportunity and disruption and geopolitical instability remained important themes. The quarter also reflected a widening divide between “hot” and “cold” parts of the North American economy: AI infrastructure, power, defense, robotics and related capex areas attracted strong investor appetite, while Canada’s economy was weak enough to temporarily enter a technical recession, with real GDP essentially flat in the first quarter after contracting in the fourth quarter of 2025. This mix complicated the policy backdrop as economic softness coexisted with energy price risk and concentrated capital spending strength.

The macro backdrop at quarter-end reflected these crosscurrents. WTI crude declined 3.1% to US\$69.50 per barrel as investors assessed U.S.–Iran diplomacy and Strait of Hormuz risk. Gold fell 13.1% to US\$4,038.50 per ounce as a stronger U.S. dollar and higher real-rate expectations weighed on the metal, while natural gas rose 13.6% to US\$3.28 per mmcf.

The Bank of Canada held its policy rate at 2.25%, while the Federal Reserve maintained the federal funds target rate at 3.75%. The Canadian 10-year yield declined nine bps to 3.38%, while the U.S. 10-year Treasury yield rose 15 bps to 4.47%, leaving equity markets to

balance capex visibility and nominal growth pockets against valuation risk, narrow leadership and persistent inflation uncertainty.

Eight of 11 GICS sectors in the S&P/TSX Composite posted positive returns, led by financials (+25.6%), health care (+14.0%), industrials (+10.6%), consumer discretionary (+8.9%) and real estate (+8.4%). Information Technology (IT, +6.4%), utilities (+5.9%) and consumer staples (+5.7%) also advanced, while materials (-11.5%), communication services (-10.0%) and energy (-5.0%) declined. Overall, the second quarter reflected a more constructive, risk-tolerant backdrop than the first, though headline strength continued to mask dispersion beneath the surface.

Performance Overview

The ClearBridge Canadian Equity Strategy underperformed the S&P/TSX Composite TRI in the second quarter, though returns remained positive in absolute terms. Relative underperformance was driven primarily by negative security selection, while sector allocation was neutral. The largest detractors were industrials, financials, IT, communication services and real estate, partially offset by a large positive contribution from materials.

Strength in Canadian financials defined the quarter. Held positions in Royal Bank, TD Bank, Bank of Montreal (BMO) and Bank of Nova Scotia contributed meaningfully in absolute terms, with BMO and the Bank of Nova Scotia being positive relative contributors. However, the Strategy's underweight exposure to the sector and lack of exposure to several outperforming benchmark constituents weighed on relative results.

In industrials, relative performance was hurt by negative security selection despite the Strategy's overweight position in a strong benchmark sector. Boyd Group was the largest detractor, while Stantec and Thomson Reuters also weighed on results. Canadian National Railway contributed positively but did not offset weakness elsewhere.

In IT, the Strategy benefited from being underweight Shopify, which underperformed, but this was more than offset by weakness in CGI and Descartes Systems and by not owning outperforming benchmark constituents such as Celestica and BlackBerry.

Overall, underweight positioning and security selection in materials helped relative results while consumer staples, utilities and energy provided modest positive contributions.

Portfolio Positioning

Trading activity remained elevated as strong market returns, sector dispersion and stock-specific volatility created opportunities to recycle capital. Additions were concentrated in industrials, IT and real estate, with selective new exposure to utilities and health care. Funding came primarily from the eliminations of ARC Resources, OpenText and Canadian Utilities, where conviction, valuation support or relative opportunity had moderated.

We are adding risk on our terms: where business quality remains intact, balance sheets resilient, free cash flow durable and valuation offering a margin of safety.

In energy, we eliminated ARC Resources after Shell's accepted offer crystallized value and would have shifted exposure from a Western Canadian producer to a global integrated company during an extended closing period. We redeployed the proceeds into Tourmaline Oil and Canadian Natural Resources, maintaining exposure to high-quality Canadian energy businesses with strong asset bases and long-term free cash flow potential. We also added to Keyera through its secondary offering, viewing the company's midstream infrastructure, contracted cash flows and expanded natural gas liquids value-chain position as attractive.

In industrials, we added to Stantec and Thomson Reuters as AI-related concerns pressured shares despite resilient fundamentals. We believe both businesses remain grounded in trusted expertise, proprietary content, workflow integration and accountability — areas where AI is more likely to enhance productivity and expand workflow spend than displace core systems.

We also increased exposure to Boyd Group and Waste Connections. Boyd shares weakened on softer industry claims volumes and near-term communication issues, but we believe the selloff has become disproportionate given improving same-store sales, integration benefits and scale advantages in collision repair. Waste Connections de-rated as investors moved away from defensive industrials and focused on temporary cash flow noise, while we continue to view it as a high-quality, recurring-services business with durable pricing power and margin expansion potential.

In health care, we participated in the Apotex Health IPO, establishing a modest position in a newly public Canadian business with leading generics, specialty generics, biosimilars and branded specialty exposure. Shares quickly appreciated toward our estimate of intrinsic value, and we exited shortly after the IPO while continuing to view the company as worth monitoring.

In communication services, we added to TELUS on weakness as sentiment remained pressured by the CEO transition, dividend concerns, competition, macro headwinds and perceived satellite disruption. We believe the market is overly discounting the durability of TELUS's wireless and fiber assets, recurring revenue base and essential infrastructure characteristics, with potential upside as new leadership sharpens the focus on core operations, cost efficiency, balance sheet improvement and capital allocation.

In financials, we added to TMX Group after shares weakened on concerns around prediction markets and crypto perpetual futures. We view those risks as overstated and continue to see TMX as a high-quality, infrastructure-like exchange, clearing, derivatives and market data platform with recurring revenue, strong incremental margins and attractive long-term growth opportunities.

In IT, we added to Descartes Systems as AI-related concerns continued to weigh on shares despite improving organic growth and resilience in its mission-critical logistics and supply-chain software platform. Conversely, we eliminated OpenText as insufficient organic growth and

leverage created a less favorable risk/reward in a sector where technology risks remain meaningful.

In utilities, we eliminated Canadian Utilities on strength and initiated TransAlta on weakness. TransAlta's diversified generation portfolio, contracted capacity, hydro assets, dispatchable gas generation, energy marketing capabilities and strategically located legacy sites provide exposure to rising power demand. Weaker Alberta power prices and skepticism around data center demand created what we view as an attractive entry point.

In real estate, we added to FirstService and Colliers International amid continued share-price weakness. For FirstService, concerns centered on softer roofing and restoration activity; for Colliers, higher-for-longer rates, transaction delays and margin pressure weighed on sentiment. In both cases, we view the weakness as cyclical and valuation-driven rather than structural and used the dislocation to add to these service businesses with strong competitive positions and attractive recurring revenue characteristics.

At quarter end, the Strategy's largest relative overweight was to industrials, followed by the more defensive consumer staples sector, with a smaller overweight in communication services and real estate. The Strategy's largest underweights were financials and materials, followed by more modest underweights in consumer discretionary, IT, utilities and energy.

Strategy and Outlook

The second quarter was a constructive absolute-return period for the ClearBridge Canadian Equity Strategy, despite relative performance that trailed the benchmark. Results reflected an environment that continued to favor concentration, momentum and direct exposure to dominant themes. While this created a relative headwind, it was consistent with the Strategy's disciplined approach: owning high-quality businesses with durable growth potential, disciplined capital allocation and attractive long-term value creation, while remaining sensitive to valuation.

The quarter reinforced both the opportunity and risk created by elevated dispersion. Canadian banks rallied sharply as credit concerns remained selective and investors anticipated capital releases and higher returns on equity. At the same time, perceived AI "losers" in software, professional services, information services and engineering remained under pressure even as fundamentals generally held up better than sentiment implied. Heavy-asset, low-obsolescence (HALO) businesses tied to infrastructure and capital spending also continued to benefit from strong earnings growth and improved visibility.

Such a backdrop is difficult but increasingly constructive for the Strategy. We take AI-related risks seriously, particularly where business models rely on labor-intensive workflows, information advantages or software functionality that could become easier to replicate. However, we believe the current debate is too binary. AI may impair some profit pools, but it may also improve productivity, strengthen customer value

propositions, reduce cost intensity and enhance operating leverage across a broader set of companies.

This distinction has guided recent activity. We selectively increased exposure where prospective returns improved, while trimming or exiting positions where valuation was less compelling or risk/reward had become more balanced. We are adding risk on our terms: where business quality remains intact, balance sheets are resilient, free cash flow is durable and valuation provides a reasonable margin of safety.

We believe the forward setup is improving. Periods of narrow leadership can persist, but they often leave behind attractive opportunities in businesses that are temporarily out of favor. When investors cluster around dominant themes, the market can underappreciate companies with strong competitive positions, recurring cash flows and multiple paths to value creation.

Our objective remains unchanged, to own high-quality Canadian businesses at meaningful discounts to intrinsic value, pursue attractive absolute and relative returns over time, and do so with a better risk profile than the benchmark.

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 positive returns across seven of the 11 sectors in which it was invested, with financials the primary contributor while materials and energy were the main detractors.

On a relative basis, overall stock selection detracted from performance. In particular, stock selection in industrials and IT, an underweight to financials and overweight to communication services weighed on results. On the positive side, stock selection in materials and an underweight to the sector contributed to performance.

On an individual stock basis, the primary relative detractors included Franco-Nevada, Boyd Group, Tourmaline Oil, Headwater Exploration and not holding CIBC. Top relative contributors included Bank of Montreal and Canadian National Railway as well as not holding Suncor Energy, Kinross Gold and Barrick Mining.

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