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Canadian Equity Strategy

Key Takeaways

- ▶ A Canadian equity market battle hardened by U.S. tariff actions delivered gains in the first quarter, led by sparkling performance from the gold- and silver-dominated materials sectors as well as energy and traditionally defensive utilities and communication services.
- ▶ The Strategy outperformed as a result of strong stock selection in utilities, energy and financials and more defensive positioning versus the benchmark.
- ▶ While some damage from tariff and trade restrictions is already done, Canada's economy is, and will remain, heavily intertwined with the U.S., as will many of the businesses owned in the Strategy. Given a muddled outlook, owning businesses with resilience and predictability remains our preferred positioning.

Market Overview

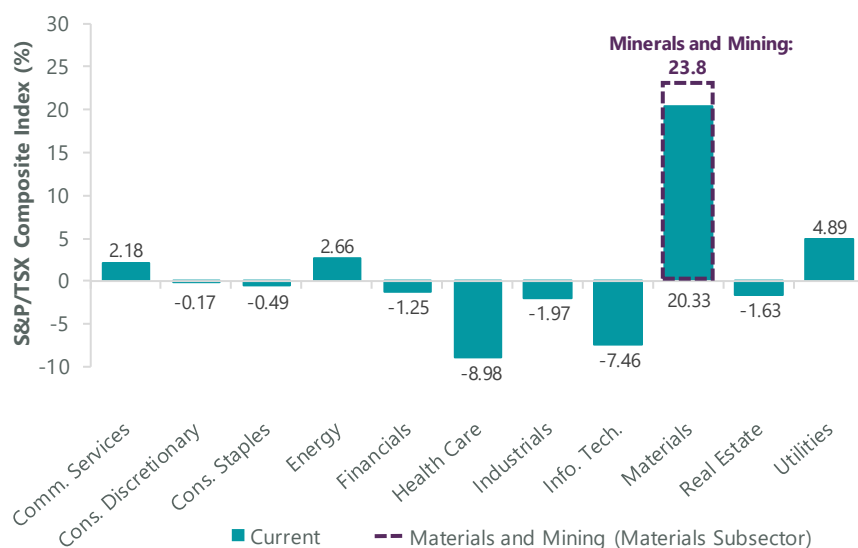
Despite the first quarter of 2025 being dominated by uncertainty surrounding U.S. tariffs, a battle-hardened Canadian equity market, highlighted by sparkling performance in the materials sector, finished the quarter in positive territory, with the S&P/TSX Composite Total Return Index (TRI) increasing 1.5%. This was quite the achievement for the primary bourse of a country that's been subject to a steady diet of threats by the current U.S. administration, including not only continuously changing tariffs (and vows to "crush" and "permanently shut down" the Canadian auto industry), but also Canada's sovereignty. But make no mistake, the prospects of a global trade war weighed heavily on sentiment and most sectors were worse off for it. After the Canadian equity market reached an all-time high on January 30, it subsequently declined in both February and March while credit spreads meaningfully increased for the first time since 2022.

Tariffs and related measures are expected to slow the pace of economic activity — consumer spending, business activity, hiring and investing — while concurrently stoking inflation from higher costs. The economic impact for Canada could potentially be severe depending on the scope and duration of the trade war. The frustration of market participants around the world, including in the U.S. itself, was arguably predictable and exacerbated by the "self-infliction" of such heavy-handed policy. Despite strong opposition from many corners, tariffs have gone ahead all the same.

With outsize performance in materials, investors were reminded of the unique significance of the gold and silver sub-industries in the overall Canadian benchmark, accounting for a combined weighting of approximately 10% as of quarter end. These securities' "safe haven" status and low correlation to outcomes for the broader market provided significant ballast in the first quarter in contrast to more cyclical and growth-oriented sectors. The benchmark heavy gold sub-industry advanced more than 34%, helped by a gold price increase of more than 18% to finish the quarter at an all-time high of US\$3,123 per ounce.

Benchmark 10-year interest rates in Canada and the U.S. declined 26 basis points and 36 bps to finish at 2.97% and 4.21%, respectively. While the Federal Reserve stood pat in the first quarter, the Bank of Canada cut rates for the sixth and seventh consecutive times in January and March, ultimately to 2.75%, intending to boost consumption and housing. The outlook for further cuts is complicated by inflation concerns tied to tariffs. The Canadian dollar was flat against the U.S. dollar, ending the quarter at \$1.44 CDN/USD.

Exhibit 1: Precious Metals, Commodities Lead Market Performance



As of March 31, 2025. Source: FactSet.

On an absolute return basis, the Canadian equity market's advance was narrow, with only four of 11 sectors producing gains: materials, utilities, energy and communication services. The energy sector was broadly solid, with crude oil prices relatively flat ending the quarter at US\$71.48/bbl (West Texas Intermediate) and NYMEX natural gas prices increasing 13% to US\$4.12/mmbtu (NYMEX). Resilience was shown by both the predictable utilities and washed-out communication services sectors. Health care and information technology (IT) were the worst-performing sectors.

Performance Overview

The ClearBridge Canadian Equity Strategy outperformed its benchmark in the first quarter with positive security selection more than offsetting weak sector allocation. An underweight to the exceptionally strong materials sector detracted, partially offset by an underweight to the underperforming financials and IT sectors, as well as our large overweight to the outperforming utilities sector. Security selection was positive and strongest in utilities, energy and financials.

In materials, underlying commodity price strength led to strong returns for Agnico Eagle Mines and Franco-Nevada, which the Strategy owns at an underweight to the benchmark.

In financials, Toronto-Dominion Bank (TD), the Strategy's largest holding, materially outperformed the sector and all other banks, as its share price recovered from relative weakness in 2024 on anti-money-laundering fines, regulatory monitoring and asset restrictions. In addition to accelerating its CEO transition in January, TD announced in February that it would sell its entire equity investment in Charles Schwab and use the proceeds to buy back up to 5.7% of its outstanding shares, add over 100 bps to its already strong CET1 capital ratio, and invest in the business to drive organic growth.

In utilities, a large overweight to the sector and relative strength within it contributed to performance with the strength and predictability of regulated utility returns increasingly attractive in an uncertain environment. Utilities have benefited from lower interest rates, but their predictability seems equally, or more, important in the current environment.

Portfolio Positioning

With increased volatility and pockets of strength, trading activity in the first quarter of 2025 was more surgical, trimming select holdings on strength including a few defensive and more interest-rate-sensitive holdings such as Enbridge, Waste Connections, Metro, ATCO, Hydro One and Fortis. We also trimmed a few of the market's deemed cyclical winners, such as Atkins-Realis, Manulife and TMX Group. Meanwhile, buying centered around out-of-favor cyclical names Alimentation Couche-Tard, Canadian Natural Resources, Canadian National Railway as well as BCE and Shopify. Additions also included two new holdings: Teck Resources and Intact Financial (IFC). While the Strategy is typically low turnover, we will continue to be decisive when warranted and as further opportunities arise.

Recent weakness in the shares offered an attractive opportunity to buy Teck Resources in materials. In recent years, Teck has completed a major transformation into a pure-play copper growth company, having disposed of its oil sands and coal businesses in 2023 and 2024, respectively. Following these dispositions, Teck has an exceptionally strong financial position with ample cash on the

balance sheet and is in the midst of returning meaningful capital to shareholders. Having completed the construction of its (60%-owned) giant Quebrada Blanca (QB) copper mine in 2024, Teck is focused on growing its copper production meaningfully in the coming years. Free cash flow is inflecting positively as QB kicks in. While demand is being impacted by geopolitical and trade tensions in the world, persistent supply challenges also characterize copper market fundamentals, to Teck's benefit.

New addition IFC has illustrated its past success with its 20% market share in Canada, an average return on equity outperformance of 500+ bps versus the industry and high-single-digit compounding of profitability over the long term. IFC's strengths are rooted in superior pricing and risk selection, claims expertise, a solid M&A track record and strong investment management contributions.

In IT, we continued to build our position in Shopify as recent results continue to illuminate the improved financial stability and capital allocation mindset guiding the business. The ever-expanding total addressable market, robust runway of embedded margin expansion and pricing power, improved capital allocation, and a best-in-class balance sheet continue to unlock the intrinsic value of the business at a rapid clip.

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-oriented/cyclical financials, materials and energy sectors.

Outlook

For Canada, concerns surrounding the likes of housing affordability and improvements in productivity have expanded to include the scope, magnitude and duration of tariffs and a host of related issues — for instance, diversifying export markets, including for Canadian energy. Developments of recent months are undoubtedly a net negative for the economy with "better-than-feared" tariff treatment by the U.S. administration so far the consolation prize. Canadian business and consumer confidence are weak. For business investment in Canada this could be setting up to be a dark period as commitments to long-term capital allocation decisions could be deemed too difficult to make.

For investors in Canadian equities, which in many cases have reach well beyond Canada's borders, the overall outlook has been muddled. Global economic uncertainty has materially increased, new downside risks have emerged, and the rationale for the U.S. administration plunging the world into a trade war is at best unclear at the outset. In managing the ClearBridge Canadian Equity Strategy, we are always working with different degrees of imperfect

information about the future; however, at present both transparency and visibility are lacking. This unsurprisingly leads to risk aversion in equities. Hopes that haphazard policies in the U.S. would ultimately wind up being more hyperbole and negotiating tactics have been dashed for the time being.

Through periods of turmoil, such as the one we are currently navigating, it is particularly important to maintain a long-term perspective, resisting myopia in the moment. For instance, Canada has a comparative advantage in the production of raw materials, including energy, and this has not changed. Canada is the number one export market for 34 U.S. states, often with deeply integrated ties.

Furthermore, the interconnectedness of the two countries is even more evident when considering that much of this trade is between parties with cross ownership. Global impacts and second-order effects will be critical. However, economically destructive policies at minimum provide strong incentives to find a resolution. And while cooperation is likely too valuable to ignore over time, tariffs and retaliatory measures will likely result in higher near-term inflation, inflicting a heavy "tax" as businesses make suboptimal decisions. Make no mistake; some damage is done. However, Canada's economy is, and will remain, heavily intertwined with the U.S., as will many of the businesses owned in the Strategy.

Without compromising on valuation, owning businesses with resilience and predictability remains our preferred positioning. We like these businesses along with those facing challenges and uncertainties where a lower share price is already discounting the increased risk in the environment. When risks are heightened, probabilistic thinking becomes even more valuable in evaluating the range and likelihood of various future scenarios, directly impacting risk/reward assessments. Typical concurrent volatility in these circumstances can present exceptional opportunities. Our positioning can provide ballast in more challenging equity market environments, allows the Strategy to power ahead with predictable growth, and serves as dry powder when better risk/reward opportunities arise.

Portfolio Highlights

During the first quarter, the ClearBridge Canadian Equity Strategy outperformed its S&P/TSX benchmark. On an absolute basis, the Strategy generated gains in five of the 10 sectors in which it was invested (out of 11 total). The primary contributors were the materials, energy and utilities sectors while the main detractor was the IT sector.

Relative to the benchmark, security selection was positive and strongest in utilities, energy and financials, more than offsetting negative sector allocation. An underweight to the exceptionally strong materials sector detracted, partially offset by an underweight

to the underperforming financials and IT sectors as well as our large overweight to the outperforming utilities sector.

On an individual stock basis, leading absolute contributors included Franco-Nevada, Toronto-Dominion Bank, Agnico Eagle Mines, Fortis and Waste Connections. Top absolute detractors included Alimentation Couche-Tard, Brookfield Corporation, Bank of Nova Scotia, Royal Bank of Canada and Shopify.

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