

NEI Canadian Small Cap Equity RS Fund

Q4 2024 Commentary



Performance

The Fund (Series I) outperformed the benchmark for the quarter.

Equity markets in the U.S. and Canada continued to rally this quarter, buoyed by the U.S. election results. The incoming Trump administration is expected to stimulate economic growth in the U.S. and, as a close neighbour, Canada may indirectly benefit. Returns continue to be skewed in favour of large cap companies with small cap indices generally underperforming. Commodity prices were mixed over the quarter with higher prices for energy but flat to lower prices for precious metals. Performance in the benchmark was mixed with double-digit declines in utilities and real estate balanced by double-digit gains in financials and energy. The Fund outperformed over the quarter in real estate, materials, and financials and underperformed in energy, industrials, and information technology. In a year dominated by gold equities, the Fund's performance differential has been partially offset by holdings executing well and security selection, as several holdings became more interesting to external acquirers (ex. Sleep Country recently acquired by Fairfax).

Returns

Fund	3 months	6 months	YTD	1 year	3 years	5 years	10 years	Since inception ¹
NEI Canadian Small Cap Equity RS Fund Series I	1.10	9.25	16.28	16.28	10.55	12.66	9.54	N/A
NEI Canadian Small Cap Equity RS Fund Series A	0.42	7.76	13.18	13.18	7.61	9.66	6.60	N/A
NEI Canadian Small Cap Equity RS Fund Series F	0.73	8.44	14.58	14.58	8.94	11.01	7.92	N/A
Benchmark 1: S&P TSX Small Cap Index	0.69	9.19	18.83	18.83	0.58	9.97	6.07	N/A

¹Source: Morningstar. As of December 31, 2024. Since inception is only provided for Funds with less than 10 years of performance.

Portfolio commentary

The Fund's top contributing investments in the quarter were Secure Energy Services, iA Financial, and Canadian Western Bank. The largest detractors were Stella Jones, Cargojet, and Information Services Corp.

The Fund initiated a position in A&W Food Services by retaining ownership in A&W Royalties Income Fund, which converted to this new trading entity during the period. The sub-advisor also actively added to the position after the company started trading. The new corporate structure provides shareholders with the opportunity to participate more fully in the growth prospects over time of the oldest and now the second-largest burger franchise in Canada. Growth is expected to come from a commitment to open at least 90 stores at Petro-Canada gas stations, and higher store penetration in eastern Canada where per store density is much lower than in western Canada. This is in addition to healthy same store sales growth that has previously been resilient through economic downturns.

The Fund also added to Parkland Corp as the valuation has gotten more attractive due to a cyclical slowdown in the refinery business, despite resilience in its core Canadian fuel and convenience operations. The company remains on track to pay down debt and leverage should improve as it continues to divest non-core assets alongside cyclical recovery in the refinery business.

Risk/reward of the Fund was further improved by adding to positions in Pet Valu and Mullen Group and trimming positions to manage weights. These additions enhance the Fund's recurring cashflow base and growth potential. Overall, the sub-advisor continues to see attractive opportunities for capital deployment due to the market's focus on larger companies.

Outlook

As each year passes, the futility of short-term market prognostications are reinforced. Looking back, few would have predicted a second consecutive year of 25% returns in the S&P 500, only to be bested by gold and digital assets. Scanning the road ahead, on one side, potential Canadian elections, tariffs and trade noise, and geopolitical conflicts

loom. On the other, there are benign employment levels, rosy corporate earnings expectations and easing financial conditions. Irrespective of the current economy or whether this bull market will extend, it is worth bearing in mind that intra-year market declines are normal. In the S&P 500's case, declines have been ~14% on average over the past 45 years.

The Fund continues to be prepared for a range of near-term scenarios and is positioned to continue generating resilient long-term returns. This view is informed by their internal risk controls and current margin of safety. The Fund's economic prospects are attractive with above average profitability, reflecting strong reinvestment and growth opportunities. The Fund's pricing indicates a discount to the market multiple and its own trading record. The Fund also maintains strong alignment, as many company insiders are significant owners or even founders who are incented to grow their businesses carefully. Finally, should unexpected inflation emerge, franchises within the Fund should be able to pass them on to customers over time.

While the strategy reflects sound risk characteristics, there is no guarantee against temporary market dislocations. Capital allocation decisions in the upcoming year will be directed at further improving the economic prospects and value offered by the mandate, while reducing risk through improved diversification.

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Series I have high minimum investment requirements and are typically aimed at institutional investors (such as pension plans) or investors making large investments in the fund. Funds in these series generally have lower management fees than the retail series of the same fund.

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