NEI Canadian Small Cap Equity RS Fund

Q1 2025 Commentary

NEI

Performance

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

It has been a geopolitically charged environment this quarter with changes in the leadership of Canada and the breakout of a trade war with the U.S. There is still uncertainty in the near-and-mid-term with upcoming elections in Canada and a continuation of retaliatory tariffs and ongoing negotiations with the U.S. The significant increase in uncertainty has precipitated volatility and broader market declines. The commodity oriented Canadian market fared better over the quarter, with higher gold and copper prices helping it edge into positive territory.

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	-2.45	-1.37	-2.45	8.72	8.53	20.13	9.28	N/A
NEI Canadian Small Cap Equity RS Fund Series A	-3.10	-2.69	-3.10	5.81	5.65	16.94	6.35	N/A
NEI Canadian Small Cap Equity RS Fund Series F	-2.80	-2.09	-2.80	7.12	6.95	18.38	7.67	N/A
Benchmark 1: S&P TSX Small Cap Index	0.88	1.58	0.88	11.08	-0.67	21.29	6.10	N/A

[1]Source: Morningstar. As of March 31, 2025. Since inception is only provided for Funds with less than 10 years of performance.

Portfolio commentary

Within the Canadian Small Cap benchmark, materials was an especially strong performer underpinned by strong rallies in metals pricing. The Fund's underperformance this quarter was largely driven by the materials allocation as the exposure in this sector is much less correlated with commodity prices, due to its bias to more resilient businesses. While the benchmark's gold related equities have been the largest driver of relative underperformance in the past quarter and 12 months, over a cycle the sub-advisor believes being focused on better compounding businesses and biased away from riskier business models is beneficial to clients over the long term on a risk adjusted basis.

The Fund's top contributing investments in the quarter were AltaGas Ltd., Lassonde Industries Inc., and Parkland Corp. The largest detractors were Cargojet Inc., Mullen Group Ltd., and Winpak Ltd.

The Fund added to its position in Richelieu Hardware over the quarter. They are a distributor of specialty hardware that has been relatively resilient in previous economic downturns due to their focus on repair and replacement rather than new construction. While they are not immune to weaker economic prospects, a strong balance sheet and management team that has shown good ability to invest capital counter-cyclically through downturns contribute to an attractive risk/reward.

Additional capital was also allocated to Cargojet. As an operator of air transport, concerns around consumer weakness and less transport across borders due to trade wars have contributed to an attractive opportunity to add to this holding. A dominant market share in time-sensitive air transport, high quality of service relative to peers, and long-term customer contracts with contractual minimums should all help the company's resilience through potential economic pressures. The strength of their Canada-wide air transport fleet is showcased by a broadening relationship over time with e-commerce giants like Amazon that have fully outsourced air transport within Canada to Cargojet. This contrasts with a continued trend to be more self-reliant/insource air transport in other regions like the United States.

These and other additions broadened out the Fund's diversification to a range of areas including stabler consumer areas such as e-commerce and pet spending, along with areas such as defense and distribution-based business models. In conjunction, these changes were funded via reducing exposure within the financials sector. Future market visibility continues to be cloudy and limited. The sub-advisor continues to anticipate rising volatility as new rules of global economic engagement solidify.

Outlook

While the volatility may cause heartburn to some, it could be a healthy development as the market may have been too complacent on the building concentration and valuation risks of the past few years. Increased uncertainty has led to a heightened appreciation of risk, which has driven an expansion in risk premiums demanded along with a renewed focus on fundamentals, safety and predictability. Importantly, the volatility should increase opportunities for strategies such as this one that have been built for “all weather” scenarios rather than primarily sunny days only.

The Fund is better positioned today than when 2024 ended. The earnings power of the strategy has increased based on the rising profitability of holdings to an over 14.7% 4Y ROE. Crucially, this has been achieved while underlying risk has been diminished through broadening economic diversification and a stronger margin of safety, as the strategy’s P/E has declined to a market leading 12.6x. While the short-term outlook is dark and unclear, the Fund’s long-term prospects continue to be brighter. The Fund provides a well supported ~3% dividend yield, with potential for earnings per share to grow through countercyclical acquisitions, share buybacks or debt reduction due to the resilient cash generative positions of many holdings.