PALISADE
CAPITAL

Our Market View in Summary

September 2024

Interest sensitive stocks continued to work well in the month of September. These stocks have taken over the leadership of the market from growth and large capitalization stocks. As we continue through this new phase of the investing cycle, we need to contemplate what the next round of catalysts will look like. A large amount of capital has been attracted to GICs and money market funds over the past four years. They were initially a hiding spot when COVID created a bear market, and then a second leg higher emerged as yields on money market funds and GICs went above 5%. There is almost US$6.5 trillion of cash in US money market funds that will likely start to move into other sectors as interest rates come down. This should act as a tailwind for stocks in the next stage of the investing cycle, which started with more certainty over the last three months.

Key Highlights:

- **Interest Rate Influence:** Substantial interest rate cuts have bolstered sectors that leverage debt heavily, improving their financial conditions and investment appeal. With lower rates, these sectors have improved profitability and their dividend yields look relatively more attractive.
- **Dividend Appeal:** As yields on traditionally low-risk investments like GICs and money market funds decline, the relative attractiveness of high-dividend stocks has increased. Previously, money market funds offered yields above 5% with minimal risk, which have now contracted to around 4%, and are likely on their way to 3% or less. Some quality dividend paying stocks are now yielding over 5%, and in some cases over 7%.
- **Sector Outperformance:** Utilities, financials and real estate have been notable outperformers in the last three months due to their high dividend yields and reduced operational costs associated with lower interest rates.

Near-Term Outlook:

- **Sector Rotation to Continue:** With further interest rate cuts anticipated, a market shift towards more interest-sensitive and economically sensitive sectors is expected to persist into 2025. Sectors like oil and gas should catch up as lower rates buffer the economy and demand remains firm.
- **Potential Capital Flows:** Based on past financial cycles, we could anticipate significant shifts of capital from money market funds back into the broader market, potentially mimicking the shifts seen after the financial crises in 2000 and 2009, with as much as US$1.5 trillion potentially mobilizing.

The rotation of capital from money market funds and GICs into more attractive dividend paying stocks, companies whose profitability improves with lower interest rates, and some economically sensitive sectors should continue well into 2025 as central banks continue to lower interest rates. There will be bumps along the way, as there always is with the stock market, but we think it makes sense to consider investing opportunities through a different lens for now. Growth stocks could still perform well, but we expect to see outperformance from sectors like financials, real estate and commodities, and thus Canada generally, in this stage of the cycle.

Contacts:

Investment Matters:

James Anderson
Managing Director
(403) 531-2677
james@palisade.ca

John McAleer
Managing Director
(403) 531-2678
john@palisade.ca

Dan Zhigatov
Research Associate
(403) 531-2674
dan@palisade.ca

Operations and Administration:

Denise MacINNES
Corporate Secretary & Director
(403) 531-2671
denise@palisade.ca

Marni Friesen
Administrator
(403) 531-2673
marni@palisade.ca

Edna Barcelina
Wealth Management Administrative Assistant
(403) 531-2675
edna@palisade.ca

Jamie Duguay
Wealth Management Associate
(403) 531-2670
jamie@palisade.ca

Business Development:

Blair McDermid
Director of Business Development
(403) 803-0107
blair@palisade.ca

September 2024

Fellow Palisade Investors and Friends,

Please find attached our September 2024 Monthly Update, as well as the Fund Fact Sheets for the Palisade Funds. **Per our schedule of holding two client conference calls per quarter, we are not planning a call for this month. That said, we are always happy to answer questions about the markets, so please feel free to reach out at any time.**

All Fund performance figures are shown net of fees and expenses and include changes in security values and distributions paid. Palisade Vantage Fund performance figures include the reinvestment of distributions. The Palisade Vantage Fund currently pays a regular quarterly distribution of $0.11 per unit, or $0.44 per unit per year. The Palisade Select Fund and Palisade Absolute Fund pay irregular annual distributions for years in which taxable net income is positive.

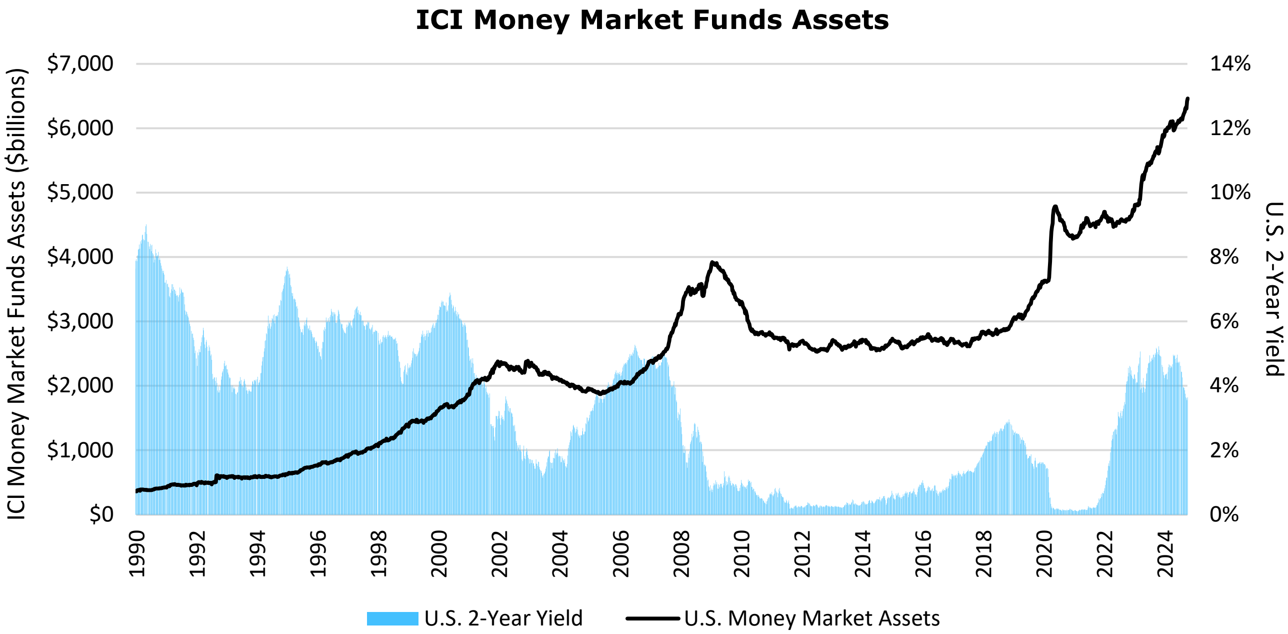
MARKET COMMENTARY

Over the last two months, we have seen interest sensitive stocks take a leadership role in the stock market. Sectors like utilities, financials and real estate have moved up quickly in conjunction with interest rate cuts from both the Bank of Canada and the US Federal Reserve. These sectors are highly sensitive to lower interest rates because they typically use a significant amount of debt in their business models, and they usually pay a higher dividend yield than most other sectors. Lower interest rates decrease their borrowing expenses and increase their profitability. Another benefit of lower interest rates is that it makes their dividend yields more attractive when compared to low-risk investments like guaranteed investment certificates (“GICs”) or money market funds. Earlier this year, a money market fund may have paid a yield over 5% with essentially no risk. Now that same money market fund yields a little over 4% with a near certainty that it will be paying even less as time moves forward and central banks continue to cut interest rates. The lower return profile of these money market funds makes the dividend yields of interest sensitive stocks relatively more attractive. Many stocks still yield over 5%, and there are some individual circumstances where stocks yield over 7% or more.

Over the last few months, we’ve noted that we think this outperformance will have legs beyond the last few months of 2024 and into 2025. As central banks cut interest rates, there will be more and more incentive for investors to rotate into interest sensitive, as well as economically sensitive, sectors like oil and gas. One of the tailwinds for these sectors will be cash coming out of money market funds and GICs due to their less attractive return profiles. When money market funds are yielding close to three percent, or potentially lower, investors will actively look for better returns in dividend paying stocks. For more risk tolerant individuals, the economically sensitive sectors like oil and gas will look attractive assuming that lower interest rates have spurred economic growth and the risk of a recession has been minimized.

Markets move in cycles between different sectors as the economy matures, declines and grows again. The next stage of the cycle should see investor confidence build as economic data improves in 2025, which will make a wider range of sectors more attractive to investors. Large capitalization and technology stocks are expensive and have been the beneficiaries of a scarcity premium as one of the few growth sectors when most other sectors were struggling to grow under higher interest rates. Investors wanted growth, and if they didn’t want to take on the risk to get that growth, they were very happy to hide out in GICs and money market funds making 5% while they waited for a more obvious entry point into other sectors and opportunities. Lower inflation and lower interest rates have provided the initial catalyst for that entry point.

A natural next question would be “How much money could move from money market funds into the stock market?” If we look at previous cycles over the last 25 years, it could give us a sense for what could be possible. Below is a chart that shows money market fund assets going back to the early 1990’s. Note that previous aggressive movements into money market funds were typically associated with stock market panics, like in 2000 and 2009. Similarly, we saw a 50%+ increase in money market fund assets in 2020 when COVID hit and stimulus cheques were sent out. This growth was further accelerated in the last two years due to much higher and more attractive yields on those funds. As mentioned above, getting over 5% return for a risk-free investment clearly attracted a lot of interested investors. Before COVID, money market fund assets were around US$3 trillion dollars. That has expanded to approximately US$6.4 trillion today.



Source: Bloomberg

How much of this capital could flow back into markets (public and private) once investors have comfort that they won't see a recession and are enticed by more attractive dividend yields and total returns in stocks? Coming out of 2000 and 2009, total money market assets shrunk by approximately 17% and 34%, respectively. If we applied a similar rotation to the current situation, we could see something in the order of US$1.5 trillion move into stocks, bonds and other investment opportunities. That is the equivalent of approximately 40% of the entire S&P/TSX Composite Index. Not all of that money would move into stocks, as bonds and other investment opportunities would certainly attract a fair share, but we believe that a meaningful amount of incremental capital would come into the stock market as a tailwind as we move into a new phase of the market cycle.

PALISADE FUND COMMENTARY

The **Palisade Select Fund** ("PSF") was down 5.1% in September. The S&P/TSX Capped Energy Index ("Energy Index") was down 7.2% and the WilderHill Clean Energy Index ("ECO") was up 3.7% for the month. From the beginning of September into the first week of October, the Energy Index has made a full U-turn. Overall, September was challenging, but at the time of writing (Oct 4th) the PSF has made back all of September's losses and more. While it is an incremental negative that OPEC+ has essentially confirmed that it will start bringing some production back in December, overall we still have a high degree of confidence in our long oil thesis that we have been discussing in these monthly commentaries and on our conference calls for the past two months. This view is supported by low inventory levels, flat US production, ongoing demand growth as the US avoids a recession due to lower interest rates, incremental demand from US Strategic Petroleum Reserve refill, ongoing weekly inventory draws, and importantly, peak fear within the investment community with crude oil futures positioning at a record bearish level. This should all add up to an attractive return profile when we look into 2025, which has been accelerated by recent political events in the Middle East. We rotated 8% of the PSF's assets into more oil exposure on September 11th, buying more of existing holdings like MEG Energy, Veren Energy, Canadian Natural Resources and others. The timing of those purchases appears to be excellent and the current portfolio is approximately 95% in oil and gas (mostly oil stocks) with some energy service exposure and limited exposure to energy technologies and renewables.

The **Palisade Absolute Fund** ("PAF") was up 1.0% in September. The summary is quite simple this month. We benefited from the exposure that we added to interest sensitive stocks two months ago and saw some incremental gains from the more growth-oriented screen names, but overall returns were held back by our oil and gas exposure. As noted above, we have a high degree of confidence in the oil stocks at these levels and for continued gains in interest sensitive stocks. We still hold a collection of names from our growth screens, but we have lowered exposure slightly to that theme. At the moment, we have more relative exposure to oil and interest sensitive stocks, which may stay that way in the near term.

The **Palisade Vantage Fund** ("PVF") was up 4.6% in September. For the month, the S&P/TSX Canadian Dividend Aristocrats Total Return Index ("Aristocrats Index") was up 5.5% while the S&P/TSX Composite Total Return Index ("TSX Composite") was up 3.9%. The PVF continues to be the beneficiary of strong capital flows into interest sensitive stocks. The PVF is now up 28.7% over the last year versus the TSX Composite up 26.9% and the Aristocrats Index up 31.3%. As noted above, we continue to believe there will be running room for interest sensitive stocks into 2025. Fundamental rotations in the investment cycle typically don't end after only three months. While we have trimmed some of our utilities exposure in the last few weeks as the stocks became overbought, there are still opportunities to rotate into other stocks that have not participated to the same degree. One example is Allied Properties REIT (TSX: AP.UN), which is the premier owner of office buildings in Canada. Post-COVID, the company suffered because of the trend towards remote work and then took a further hit due to the rapid increase in interest rates. When we bought the stock, its distribution yield was over 9% and we have been seeing incremental improvement in office occupancy and more corporate announcements regarding "return to office" policies. Pre-COVID, the stock peaked around $60 per share and it currently trades at around $20 per share. We don't expect a return to $60 any time soon, but there would be an attractive return profile with even a modest recovery from here, and we are paid 9% while we wait.

We believe that this phase of the investing cycle should continue to benefit many sectors of the Canadian markets that have been out of favor for some time. We see this as a good time to be invested in Canadian stocks, which could be made even better if we were to see a change in the Canadian federal government in the coming months. If you have any questions, please feel free to reach out at any time.

All the best,

THE PALISADE CAPITAL MANAGEMENT TEAM

Please note that it is the responsibility of each investor to inform Palisade Capital of any changes to the information provided to us on the most recently completed Know Your Client ("KYC") information form or subscription agreement. Please contact Marni Friesen at (403) 531-2673 or marni@palisade.ca to provide any such updates. If you no longer wish to receive the Monthly Update, please send an email to info@palisade.ca.

All Palisade Fund performance figures are shown net of fees and expenses and include changes in security values and distributions paid. Palisade Vantage Fund performance figures include the reinvestment of distributions. Income taxes would have reduced returns. The Funds are not guaranteed. Performance of the Funds will fluctuate and past performance may not be repeated. To establish relative performance yardsticks for the Palisade Funds, we provide comparative references to the S&P/TSX Composite Total Return Index ("TSXTR"), the S&P/TSX Capped Energy Index ("Energy Index") and the WilderHill Clean Energy Index ("ECO Index"). Those indices are relevant to our portfolio content however the TSXTR, Energy Index and ECO Index data is provided for general reference purposes and their content should not be construed as directly comparable to the content of the Palisade Funds.