PALISADE CAPITAL

## Our Market View in Summary — October 2024

### Key Highlights:

- **Market Rotation:** As investors waited for US election results, the markets consolidated recent gains in October. Oil and gas bounced back but was exceptionally volatile day-to-day. Some interest sensitive stocks took a breather after their run-up since the middle of July, as bond yields moved meaningfully higher, reversing much of the aggressive decline of the previous two months.
- **Republican Sweep:** The US election results have created bullish market sentiment, anticipating less regulation, tax reductions and increased domestic manufacturing through onshoring.
- **Interest Rates:** Despite the US Federal Reserve cutting rates by 0.25% in October, following a 0.5% cut in September, US government bond yields have been increasing, suggesting expectations of higher growth and the need for higher interest rates to finance ongoing government budget deficits.

### Near-Term Outlook:

- **Shifting Sector Preference:** US two-year bond yields have risen from 3.6% to 4.25% post-election, indicating market anticipation of economic growth which might complicate further rate reductions but should allow for investment opportunities in sectors that are more economically sensitive and less interest rate sensitive. This should be positive for energy, industrials, growth and financials.
- **Economic Policy Impact:** The change in US government is likely to foster a more stimulative economic environment, potentially benefiting sectors poised for growth under less regulatory oversight and lower taxes.
- **Interest Rate Environment:** Although central bank interest rates are expected to continue declining, bond yields might remain elevated due to government budget deficits and growth expectations.
- **Canadian Market:** Canadian investors could see positive spillover effects from US economic policies, provided US/Canada trade relations remain stable. A potential change in the Canadian federal government would further align economic strategies, enhancing cross-border investment opportunities.

As we move forward our outlook remains cautiously optimistic, but the reasons are slightly different and our asset allocation between sectors will shift accordingly. We are incrementally more positive on oil and gas but will look to add more US producers to the portfolio to directly benefit from the improved outlook for US operators. We have been trimming, and will continue to trim, exposure in core interest sensitive sectors like utilities that have produced some substantial gains in the last four months and will rotate that capital towards more economically sensitive stocks that sport attractive yields and dividend growth rates. The growth sectors will also be slightly more in favor for us. Lastly, we have been looking to add to economically sensitive sectors like trucking and transportation that had previously been lagging the markets, which should benefit from more domestic economic activity. This is a good time to be invested in stocks – a business-friendly government has been elected in the US (and hopefully soon in Canada), central banks are cutting interest rates, and we have just entered the strongest seasonal period of the year for stock market returns.

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**October 2024**

Fellow Palisade Investors and Friends,

Please find attached our October 2024 Monthly Update, as well as the Fund Fact Sheets for the Palisade Funds. **This month's client conference call is scheduled for Thursday, November 14th at 11am MT.** The Teams Meeting details will be provided the morning of the call. In conjunction with this call, we will be emailing out a presentation that contains data and charts to further detail our thought process and outlook. We look forward to speaking with you then and answering any questions you may have. This call will include information on our investment funds, our broad market outlook, as well as an update on our wealth management model portfolios.

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

There have been clear changes in market dynamics in just the last few days that will determine positioning in the Palisade Funds through the balance of the year and into early 2025. These two elements are the election of a Republican sweep in the US and the recent decision by the US Federal Reserve to cut interest rates by 0.25% (on the heels of a 0.5% cut in September). Given the clear mandate by US voters to the Republicans we have to ask how that may affect the economy and the potential strategy that the US Federal Reserve will employ regarding future interest rate cuts. On the first point, it is noteworthy that since the election, investors have become very bullish on the US economy with an expectation of less regulation, lower taxes and more domestic manufacturing activity from various onshoring policies. Two-year bond yields have increased by approximately 0.65% since the first Fed rate cut on September 18th (from 3.6% to 4.25%), so it's fair to say that the market is going to make it a little harder to cut interest rates going forward. The bond market is saying that growth is going up and that financing government budget deficits will require higher interest rates to make those bonds attractive. So, how does this change the stock market outlook for the next six to twelve months?

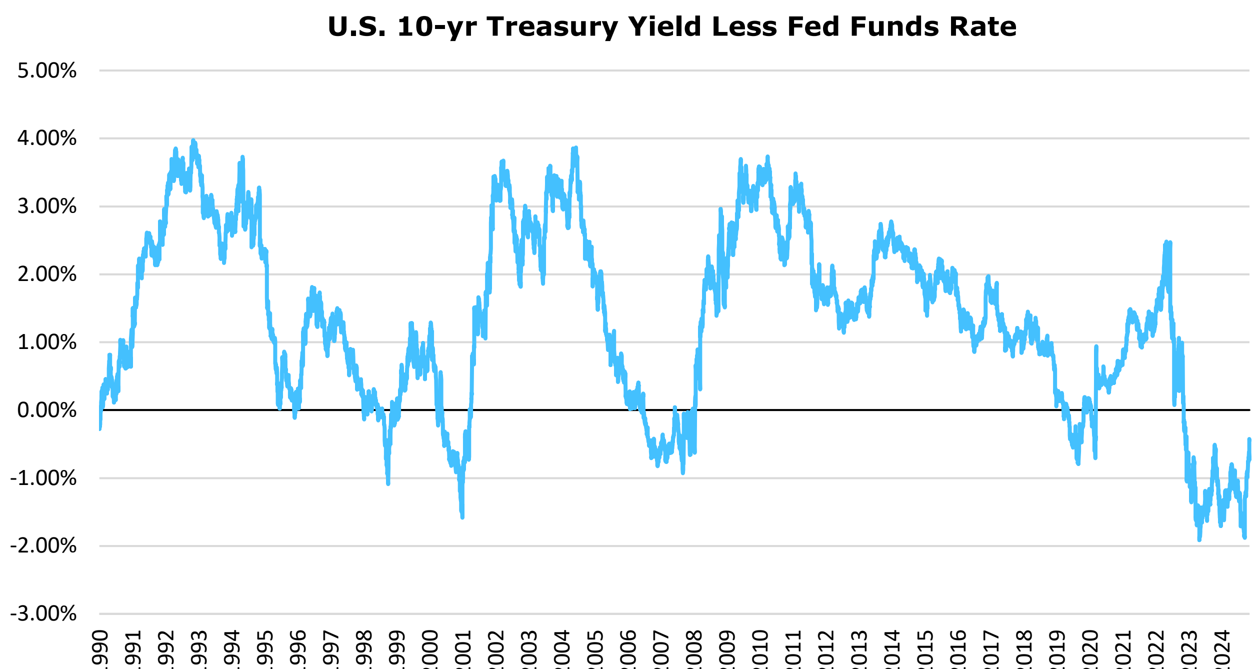
First, we maintain our glass half-full view of the US economic outlook, but the reasons for that will shift slightly. Previously we have communicated a view that relies on lower interest rates to cushion the downside risk in the economy and continue the soft landing that we currently find ourselves in. Now, the view switches slightly to more stimulative growth from government policy changes, while also being buffered by lower interest rates, even though those rates might not go down as much as we previously would have expected.

For Canadian investors, this should be incrementally positive as long as the talk about tariffs in the US doesn't dramatically impact current US/Canada trade relations. What would be a further positive for Canadian investors would be a change in the federal government in the next year that would align the two countries around similar economic policies. While we wait for a Canadian election there should be incremental upside for Canada as investors try to anticipate some change and find companies that benefit from a stronger US economy in the next few years.

The second key consideration is interest rates. Bond yields in both the US and Canada ran up in advance of the election and have since continued higher. It's important to clarify that there are two different types of interest rates that we are referring to in this discussion. The first is the overnight lending rate that is set by central banks like the Bank of Canada and the US Federal Reserve. These rates have been coming down in 2024 and will likely continue to come down in 2025. The second type of interest rates are bond yields. These rates generally correlate pretty tightly to central bank rates, but they move around daily in the bond market depending upon various macro-economic views and fund flows. Recently, bond yields have been going up (as mentioned above, 2-year US government bond yields have gone from 3.6% to 4.25% in the last six weeks) but over the same time the US Federal Reserve has lowered its overnight rate by 0.75%. There are two reasons for the rise in bond yields, despite central banks in both countries cutting interest rates. The first is that US investors are now expecting higher growth rates from the US economy, which means that interest rates don't have to be lower to stimulate growth. The second reason is concern about the size of US budget deficits and the amount of bond issuance that will be required to pay for those deficits. The more bonds that are issued, the higher the interest rate that is required to entice people to buy those bonds. There is an argument to be made that the Republicans won't let the current projected budget deficits continue, but that's a topic for a later write-up.

So, if interest rates don't go down as much as we had previously expected, does that change our outlook? Does that create more risk for the economy? The short answer is that like most things related to the stock market, as long as we don't go into a recession the markets will be fine. As long as US government policy changes allow for higher levels of growth, markets will be fine. It will require some changes in the types of sectors we have invested in the Funds, but overall markets will be fine. In the Fund specific sections below, we discuss some of the changes we have and will be making.

Related to this discussion, the chart below shows the spread between the US Fed Funds Rate and the yield on ten-year US government bonds. What this shows is that the Fed could cut rates by another 1.5% (or more) and if you keep the current yield on the 10-year bond constant, it moves this relationship just into a normalized level. In other words, bond yields don't have to go down much from current levels. The US Fed can keep cutting interest rates and bonds yields probably aren't going to change too much. If bond yields aren't going to move materially lower from here, we have to adjust our sector exposure in the Funds, as we outline below.




Source: Bloomberg

In summary, our view remains positive, but our exposure now needs to shift around the edges from interest sensitive sectors to economically sensitive sectors. That would include more growth sectors, more industrial sectors and more sectors that benefit from "America First" in both Canada and the US.

## PALISADE FUND COMMENTARY

The **Palisade Select Fund** ("PSF") was up 2.2% in October. The S&P/TSX Capped Energy Index ("Energy Index") was up 3.8% and the WilderHill Clean Energy Index ("ECO") was up 0.2% for the month. The rollercoaster in energy stocks continues as we think we are bouncing around the lows for stock prices, but the week-to-week volatility has been very high. From a big picture perspective, the US election results should be an incremental positive for the oil and gas sector and a negative for the green energy sector. The Fund continues to be over 90% weighted to oil and gas and energy services stocks and will likely stay this way in the near future. Our only green energy position is Quanta Services (NYSE: PWR), which is a more "green adjacent" company, and has not been impacted by the downturn in the energy technology and renewables sectors. Quanta provides infrastructure solutions for the electric power grid, as well as pipeline and communications networks. The stock has been a stellar holding for the PSF and continues to make new highs at the time of writing.

On the negative side, we had a poor quarter from Veren (aka Crescent Point) right at the end of the month which held back returns. This position has largely been liquidated in favor of additional holdings in our other oil weighted positions, as well as a new position in ExxonMobil. ExxonMobil has been executing very well, providing a combination of growth and shareholder returns, and should also benefit from the incremental improvement in sentiment towards US oil and gas producers following the US election. We are looking to add additional US names in the coming weeks to gain more exposure to this positive sentiment and to replace our position in Marathon Oil, which is being taken over by ConocoPhillips in a transaction that should close in Q4 2024.

US election results have provided an incremental positive spark to the sector, in our view. It is likely that there will be increased sanctions on Iranian and Venezuelan oil production, less regulatory burden for infrastructure projects and an increased focus on North American energy independence. We just need to make sure that the industry doesn't overdo it with "drill baby drill" and create an oversupply of domestic oil and gas. If the US economy now grows a little faster, that would add to demand and mitigate potential risk of oil oversupply. To the extent that the US election results are an incremental positive, we are thus incrementally positive on our outlook for oil and gas stocks for the next year. Having more US dollar exposure via USD priced stocks should be an additional positive.

The **Palisade Absolute Fund** ("PAF") was up 2.4% in October. This was a good month for the Fund, which was the beneficiary of positive moves in our sleeve of interest sensitive stocks, our focused growth stocks, and a bounce back in our oil and gas holdings. On the back of US election results we have already begun adding to the growth positions in the PAF with a slight tilt towards US growth names. We have also added to our holdings in Boardwalk REIT due to the 20%+ pullback it has seen in the last six weeks and the ongoing growth that we expect to see in its core markets in Western Canada. Cities like Calgary and Edmonton are poised to see continued rent growth and Boardwalk should be a primary beneficiary of those trends. Given our positive outlook, we expect the Fund's net exposure to remain between 50% and 60% net long, other than short-term periods when we lower exposure for defensive purposes.

The **Palisade Vantage Fund** ("PVF") was down 0.2% in October. For the month, the S&P/TSX Canadian Dividend Aristocrats Total Return Index ("Aristocrats Index") was up 1.2% while the S&P/TSX Composite Total Return Index ("TSX Composite") was up 1.1%. The PVF is now up 33.8% over the last year versus the TSX Composite up 32.6% and the Aristocrats Index up 37.6%. PVF will see the most change in holdings of our three funds due to new expectations around economic activity and the future direction of interest rates. The core of the Fund is still well-positioned. Financials have been a notable beneficiary in the days after the US election and should continue to benefit going forward. Our economically sensitive dividend-paying stocks (Russel Metals as a good example) should also continue to benefit if we see an uptick in US economic activity. Where we need to make some changes around the edges is in the core interest sensitive sectors, such as utilities. We had already been trimming these positions before the election due to their strong performance (our cash weighting at month-end was approximately 8%) with an expectation to be buying them back on weakness, but now we will continue to trim such names in favor of more economically sensitive dividend-paying stocks in the industrials and financials sectors.

Stock markets should continue to be a good place to be invested over the coming year. We have a business-friendly government in the US (and hopefully soon in Canada), we are entering a seasonally strong period for stocks, and central banks will continue to cut interest rates. Even if such rate cuts are less than we had previously expected, this mix of factors should provide an environment to create strong equity returns. 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.*