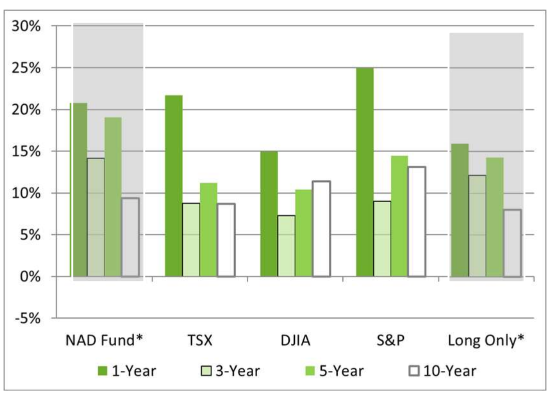
January 2025

"Markets are constantly in a state of uncertainty and flux and money is made by discounting the obvious and betting on the unexpected" – George Soros

Market Recap

Although markets gave back some of their gains in December, the fourth quarter of 2024 continued the upward trajectory of the first three quarters of the year. In Q4/24 the DJIA and S&P rose by 1.0% and 2.4% respectively, while the TSX was up by 3.8%. This brought full year returns for the DJIA and S&P500 to 15.0% and 25% respectively. The full year gain for the TSX was 21.7%, driven by a 40% rise in the gold index. The Agilith NAD Fund was up 8.5% in Q4/24, bringing the full year to 20.8%, while the Agilith Long Only Fund rose 4.8% in the quarter and 15.9% for the year (Figure 1).

Figure 1: Agilith Performance (12/31/2024)



Economic Backdrop

The US has remained in a leading position with respect to growth relative to other developed economies. The continued solid performance of GDP and labour markets combined with tempered inflation metrics has caused the Federal Reserve to put further rate cuts on hold for now. We think that from an investment perspective, the more important consideration will be the generally inflationary policies favored by President Trump and the likely impact on the US dollar as well as the deregulatory trend that may spur renewed profit growth. This is congruent with the inflationary thesis that we have held for the past few years.

With respect to the impact on Canada, the election of Donald Trump brings a level of chaos to Canadian/US trade relations with the threat of massive tariffs on our goods travelling into the US market. Our expectation, however, is that these disruptions will normalize as it is our firm belief that the issues raised by President Trump are not worth the damage that tariffs will have on the trade relationship. The trade deficit that he frequently cites is primarily driven by energy exports and not by subsidized manufacturing that is "stealing" US jobs. Illegal border crossings, while an important issue to address, is at least as big, if not bigger flowing north from the US into Canada. The same can be said for the illegal drug trade. The point is that imposing tariffs on Canadian goods does little to address these issues and even less to benefit the average US voter. Ultimately, we believe the long term dynamics of the US/Canada trade relations will be little changed in the long term. This follows the same pattern that we saw four years ago with the renegotiation of NAFTA and the ultimate creation of the USMCA.

The other political change is in Canadian federal leadership with the resignation of Justin Trudeau and the likelihood of a Spring 2025 election. We expect that any new administration will have to focus on reducing government spending and improving Canadian productivity, which has sunk to multi-year lows under Trudeau's leadership. A reduction in government spending may have an initial dampening impact on economic growth;

however, we believe the market is likely to focus on longer term gains in productivity. With all potential federal leaders indicating their intention to repeal the proposed higher capital gains inclusion rate (including Chrystia Freeland who introduced the change in her 2024 budget!), we believe this issue is now dead and investors will have increased confidence in Canadian markets. For the next six months, however, the main feature of North American politics is likely to be uncertainty. We believe that over the longer term, a focus on efficiency and productivity will ultimately drive renewed Canadian economic growth.

The US dollar has been strong against most global currencies, reflecting relatively stronger economic growth and the impact of potential trade tariffs on economic growth outside of the US. In our view, the USD is likely closer to a peak, and as measured by purchasing power parity appears to be roughly 15% overvalued. Interestingly, Trump has expressed a preference for a weak USD, which is a marked change in preference from every president since Nixon. We expect to see a reversal in the strength of the USD over the coming months, especially as some of the political uncertainty resolves itself.

Market Outlook

As has been well documented, the rise in the US markets has been largely driven by a few mega cap technology names. The question is whether this bifurcation in performance continues or is broken. It is our view that it will be difficult over the long term to justify the trillions being invested in artificial intelligence (AI) by the companies actually doing the investing. Instead, we expect that many of the benefits will accrue to businesses that are likely to enjoy above average growth in labour and capital productivity through the use of AI.

The vulnerability of the Mega cap technology names to dramatic downside was exposed over the past week with news of the opensource AI out of China, DeepSeek. The prospect of comparable functionality at a fraction of the cost brought into question the AI dominance of the US Tech giants and resulted in hundreds of billions of market capitalization being erased in a day. Ultimately, the commoditization of Large Language Models (LLM) in AI poses a serious risk to the return potential on investments already made in AI. We also think that as AI evolves, there is a serious threat to barriers of entry previously enjoyed by many software providers.

In our view, the more important metric to watch for the balance of the market outside this narrow group is the trend in earnings growth. Over the short term, we see some policy uncertainty overhanging earnings growth. In addition, for US multinationals the relatively strong USD will depress international profits. Within Canada, although there is the threat of tariffs overhanging our exporters, we believe that any tariffs implemented will likely be short-lived. Moreover, the multiples in Canada are much lower in general, reducing the likelihood of a significant correction. Over the longer term, we believe corporations will benefit from the use of AI to increase the efficiency of their operations and we expect renewed growth once policy questions are clarified and companies have more confidence in deploying capital.

It is our view that while elements of the US market have lofty and potentially unsustainable multiples, there are plenty of attractively valued business that should support a reasonably healthy market in 2025, although returns may not match those of the past two years. Overall, we would expect the equal weighted index to outperform the cap-weighted index (the index that has higher weights assigned to larger companies).

Given the significant policy uncertainty in North America, we also expect a return to higher volatility after a period of relative quiet. We note that over the past year and a half, we have not seen any 10%+ corrections in the market. As such, some level of correction in the coming months seems well overdue. Market corrections are often accompanied by fears of an economic recession, driving a broad range of stocks down, rather than being limited to a small group. However, history tells us that unless there is a full financial breakdown, stock market corrections do not generally lead to economic recessions, and we would see a broad pullback as an opportunity, particularly among Value stocks.

Portfolio Positioning

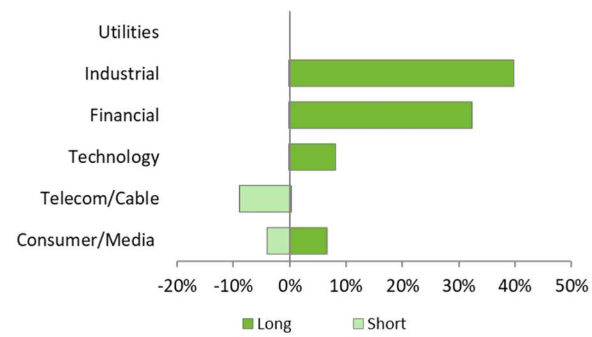
The biggest contributors from our long positions to fourth quarter performance were AtkinsRealis, AGF Management and Enerflex. AGF, due to its weighting in the portfolio had the biggest dollar contribution to performance in the quarter. It is also worth highlighting Enerflex's rise of 77% in the final three months of 2024 as the market began to reward the company for successful debt reduction efforts over the past year and renewed growth opportunities as the company now has available capital for new investments. AtkinsRealis, up 38% in the quarter, was a benefactor of renewed attention on nuclear energy and the company's commanding position in this market.

Within the short book in the North American Diversified Fund, our positions in the telecom sector (BCE and Rogers Communications, in particular), had a strong positive contribution in the quarter and drove the majority of the outperformance in the NAD Fund relative to the Long Only Fund. We closed out our short position in Enbridge in the quarter as we believe energy related names likely have some positive momentum in them over the coming year.

We made few other changes in the portfolio in the fourth quarter as we were hesitant to crystallize gains at the end of the year, given the uncertainty surrounding capital gains tax rates. Coming into the first quarter of 2025, with greater certainty around capital gains policy, we have shifted the portfolio somewhat, crystallizing gains in some of our stronger performers and adding a new name to the long book. Over the past month, we have added Nutrien Limited (NTR) to our investments. NTR (formerly Potash Corporation) distributes crop nutrients and other supplies to the agricultural sector. They are a market leader embedded in the sales and distribution of products geared towards global agricultural productivity. Despite improvements in productivity, a good earnings growth outlook and over a 4% dividend yield, their stock has really not moved over the past five years. Insider buying by senior executives was another catalyst to adding a position.

Over the coming months we will be watchful for further buying opportunities of companies with proprietary business models and solid cash flows that are not being appropriately rewarded in the markets.

Figure 2: Agilith NAD Fund Portfolio Positioning (12/31/2024)



AGILITH CAPITAL INC.

416-915-0284 www.agilith.com