ETERNA FINANCIAL GROUP

QUARTERLY REVIEW – DECEMBER 2022

ASSET SUMMARY AND ALLOCATION

The financial markets were put to the test in 2022. During periods of high inflation, the principle of balance between bonds and equities no longer favours balanced portfolios, as both asset classes depreciate. In this context, access to alternative investment products is even more important, as returns are not correlated to the traditional financial markets.

Thus, 2022 concludes with a -5.8 % return for the Canadian stock market and -18.1 % for the S&P 500 Index of the U.S. stock market. Not surprisingly, the Canadian stock market's outperformance relative to the U.S. market is explained by it overweight in the energy sector. This sector delivered an annual return of 24.4 %. In addition, the FTSE Canada Universe Bond Index also posted a negative return of -11.7 %.

Conversely, our Eterna Private Lending Fund and our Eterna Infrastructure Fund delivered net returns of 9.25 % and 4.1 % respectively . This clearly demonstrates why institutional investors, among others, are more inclined to invest in alternative products.

The 2022 stock market correction removed some of the overvaluation of the stock markets after the strong gains of the past few years. In 2023, it will be necessary to monitor corporate earnings, which could be vulnerable during an economic slowdown. Analysts have downgraded their forecasts for the coming year, but still expect year-over-year earnings growth over 10 % for the S&P 500. In the event of a recession, current estimates are probably too optimistic and could be adjusted downward, potentially causing volatility in the equity markets.

On the bond market, fixed-income securities are once again a relevant asset class after the rate hikes. The anticipated end of monetary tightening has made the short end of the interest rate curve particularly attractive (maturing in less than 5 years).

For 2023, we believe that inflation has most likely peaked and that central banks will adopt more accommodative rhetoric, abandoning strong interest rate hikes. Thus, there shouldn't be much upward pressure on interest rates and the performance of this asset class should normalize.

Some short-term concerns remain on the equity side: recession, earnings revisions. Stock markets may come under pressure at the beginning of the year, waiting for clear signs of a possible recession. However, for investors with a medium- to long-term investment horizon, equities continue to be an undeniable source of portfolio growth.

- **The financial markets were put to the test in 2022. In periods of high inflation, the principle of balance between bonds and equities is no longer favourable to portfolios, as both asset classes depreciate.**
- **One of the key economic problems of the pandemic was the very high inflation caused by, among other things, accumulated supply chain challenges and supply/demand imbalances.**
- **In the last quarter, general inflation slowed down, primarily goods inflation. However, services inflation is still high and historically declines during recessions.**
- **To contain economic deterioration in 2023, central banks will need to pause their monetary tightening campaign. The Bank of Canada and the U.S. Federal Reserve are diverging slightly.**
- **International: In Europe, the war in Ukraine is fuelling high inflation as energy costs rise. The Chinese economy was weakened by the Zero-Covid Policy and is struggling with softer global demand. In Japan, inflation is not as problematic and the policy rate has remained at the floor.**
- **The 2022 stock market correction removed some of the overvaluation of the stock markets after the strong gains of the past few years. In 2023, it will be necessary to monitor corporate earnings, which could be vulnerable during an economic slowdown.**
- **Fixed-income securities are once again a relevant asset class after the rate hikes. The end of monetary tightening has made the short end of the interest rate curve particularly attractive (maturing in less than 5 years).**

ECONOMY AND FIXED-INCOME SECURITIES

To kick off this final year in review, let's revisit the economic story of 2022: INFLATION. Last June, it peaked in Canada at 8.1 %; inflation concerns are not limited to Canada, they have been global. The causes were many:

- Soaring energy and commodity prices
- Supply chain issues
- Overly generous government programs
- Real estate boom
- Shortage of workers

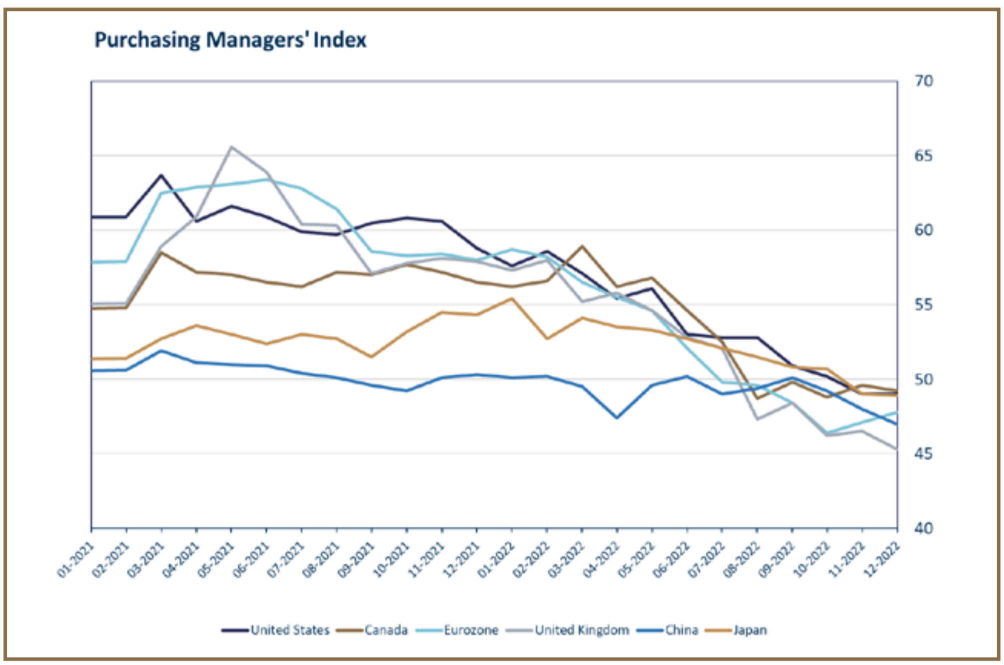
To bring inflation back to the 2 % target, the central banks had to significantly increase their interest rates. In Canada, households and businesses had to absorb a 4 % increase. As a result of these increases, assets and sectors of the economy that are sensitive to interest rates have declined in value.

A prime example is housing market correction; housing starts and prices are down. Many households are struggling with rising mortgage payments, which limits their consumer spending. Furthermore, even though wage growth is at its highest in almost a decade, inflation has been increasing at an even faster rate and has led to a decline in real wages; this is another blow to purchasing power.

Fortunately, total inflation has slowed in recent months, which means that annual growth is dropping each month. However, not all inflation components are decreasing. Inflation can be divided into three categories: goods inflation, housing inflation and services inflation (excluding housing). What we observe is that goods inflation has clearly slowed in the past few months. Housing inflation should normalize in 2023, as this component is slower to react to interest rate increases. That leaves services inflation, a source of concern for central banks. It typically takes a recession and job losses to reduce this component, which represents 55 % of total inflation. As mentioned in our last quarterly review, central banks should find the perfect balance point for interest rates, to reduce this inflation component without sending the economy into a recession.

Unfortunately, large rate hikes are increasingly difficult to absorb and a decline in leading economic indicators would suggest a slowdown in global economic growth.

Based on leading indicators, a recession remains highly likely for 2023, particularly in Europe, given the energy crisis stemming from the war in Ukraine.



To limit the economic deterioration in 2023, central banks will have to pause their monetary tightening campaign. The Bank of Canada, in its latest statement, seems ready to evaluate the impact of the rate hikes in 2022 before introducing further hikes in 2023. In Canada, we are confident that the policy rate may have peaked, and that economic data between now and the next meeting no longer supports increases of 0.50 % or more.

On the contrary, the FED Committee has remained on course and is expecting further rate hikes in 2023. At the press conference, Mr. Powell was pleased to see falling inflation, but stressed that the labour market must slow down if we want to return to a 2 % inflation target.

With these explanations, there can be no doubt that future central bank decisions will have dramatic effects on global economic growth and financial markets. In fact, when the monthly inflation figures are released and are below consensus, we see an appreciation in the stock and bond markets.

Interest rate levels improved in 2022 and now offer better coverage in case of high stock market volatility. This means that holding bonds is an increasingly attractive option for a balanced portfolio. The current rates have likely peaked in the current economic cycle and we anticipate a decline in rates as the year progresses.

However, we remain cautious about bond credit. During a recession, credit spreads tend to widen more than the rate decrease of a federal bond of the same maturity, thus underperforming the latter. Despite the possibility of widening credit spreads, we have no concerns about the financial strength of our municipal and corporate bonds.

Bobby Bureau, MBA, CIM®
Senior Manager, Fixed Income
Portfolio Manager

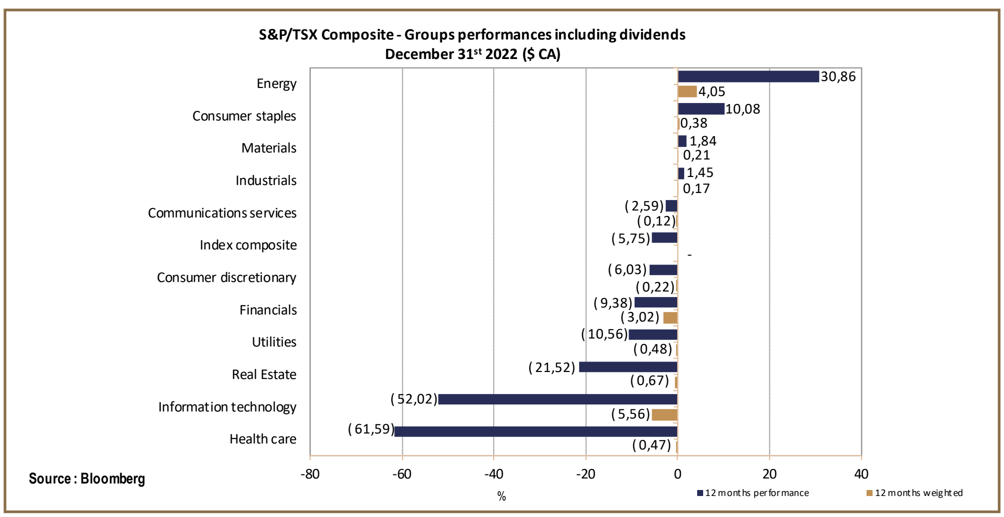
CANADIAN EQUITIES

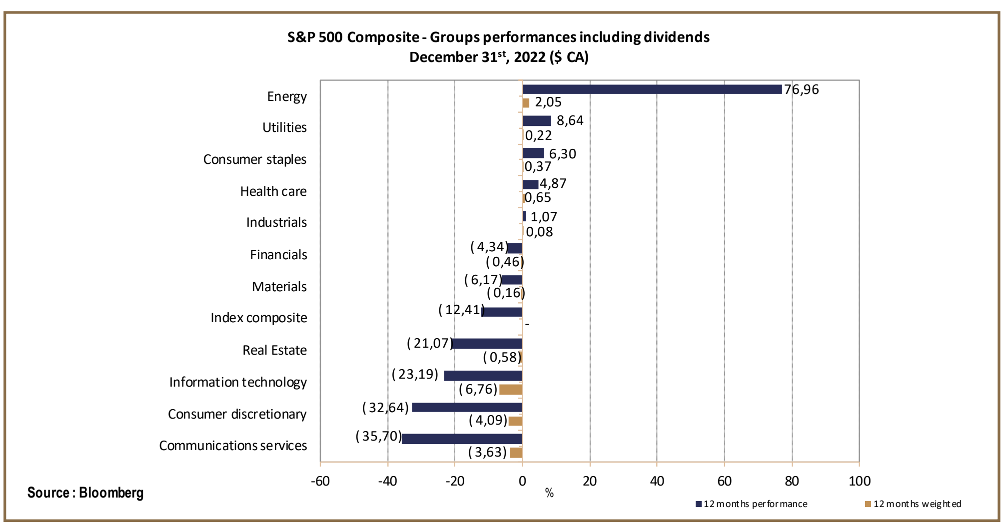
In a challenging year for stock markets, Canadian equities performed well against the major global indices. The energy sector, over-represented in Canada, is the main relative difference, rising +31 % in 2022. The Ukraine conflict and several years of underinvestment in the development of new production sites combined to push up the prices of oil and natural gas. The latter reached record levels in Europe, which prompted the authorities to impose a price ceiling to curb speculation. In early 2022, energy producer stocks traded at valuation lows. They subsequently capitalized on strong earnings growth, intricately linked to commodity prices, to drastically reduce their debt levels. Coupled with several shareholder-friendly actions (share buybacks, dividend increases), most producers experienced returns of 30 % or more, after several difficult years. Not surprisingly, consumer staples was another positive sector, returning +10 % in 2022. Driven by a defensive investor bias, as well as record low inflation, grocery stocks performed well, along with Alimentation Couche-Tard, which managed to benefit from high gasoline margin levels.

On the opposite side of the spectrum, three sectors were hit particularly hard in 2022. Health care, the S&P/TSX's smallest sector, fell 62 % with the biggest negative contribution from Bausch Health, which carries a highly leveraged balance sheet. After 2021 saw technology stocks reach valuation highs, 2022 brought a strong majority of more speculative stocks, such as Shopify, back down to earth, pulling the information technology sector down 52 %. The real estate sector suffered from rising interest rates, finishing down 22 %.

For the Eterna Canadian Equity Fund, our focus on quality large-cap stocks and value-added sector selection produced a positive performance for 2022, with a gross return of 0.6 %, 6.5 % ahead of the S&P/TSX Index. This was achieved by ignoring speculative technology stocks (those showing no earnings or trading at extremely high valuation multiples), as well as real estate stocks and gold producers. Careful stock selection in financials and industrials also provided positive relative performance against the Canadian benchmark. The primary positives were in Canadian Natural Resources, Intact, Teck Resources and Canadian Pacific. The Canadian Small Cap Fund outperformed not only the comparable index by 5.2 %, but also the S&P/TSX by 1.7 %. Fundamental stock selection with less emphasis on resources and three stocks acquired during the year underpinned the positive relative performance.

We start 2023 with a cautious bias, which can hopefully shift to an opportunistic bias during the year, as we see sentiment measures showing higher investor pessimism and lower earnings estimates. We may eventually modify the portfolio to remain in quality stocks that might benefit from economic rebound and a potential decline in interest rates. When the market rebounds from an economic downturn, small-cap stocks have historically outperformed over the subsequent period. In terms of the Canadian banking sector, we continue to be confident that the credit quality of the banks is solid in the face of the economic downturn, although there are many pitfalls in the capital and mortgage markets.





Philippe Côté
Vice-President and Portfolio Manager

Mickaël Carrier
Equity Analyst

GLOBAL, INTERNATIONAL AND U.S. EQUITIES

Financial markets enjoyed their first positive quarter of 2022 during the fourth quarter, as central banks proceeded with rate hikes and the economy continued to grow despite recession fears. Following our takeover in mid-November 2022, we modified portfolios to favour defensive stocks that are leaders in responsible investing, such as Walmart, Unilever, Kroger and Waste Management. The revenues of these companies are minimally affected by the anticipated economic slowdown. We still have significant exposure to some of the more economically sensitive segments of the basic materials sector, such as Umicore and Boliden, which are excellent recyclers among mineral extractors. Over the past 10 to 15 years, ore mining was neglected by investors and very few new mines have come on stream, while demand for electrification has grown rapidly.

The volatile market environment is expected to persist into 2023 and the sector strategy applied at the start of the year for the U.S. fund is broadly similar to the global and international funds. We have retained significant exposure to more economically sensitive market segments. For example, Archer Daniels and Nutrien, which are strong agri-food operators, as well as Cameco (nuclear) and Montauk Renewables (energy from waste), which will be key to the evolution of the energy sector. One of our big takeaways is the absence of mega-caps like Apple, Google, Amazon, Meta and Microsoft. These large companies profited from the special investment climate that favoured growth companies when the economy was stagnant and interest rates were at rock bottom. We believe that this period is now ending, that industrial transformation to a cleaner carbon economy will be the main theme over the next few years and that these companies will no longer be the primary beneficiaries.

Comments by:

Nordis Capital, new Global, International and U.S. Fund manager since November 2022

STATISTICS ON DECEMBER 31ST, 2022

CANADA		
Unemploy. rate (May)	5,1 %	↓
C.P.I. (May)	6,8 %	↓
3 months treasury bills	4,30 %	↑
Bonds 5 years	3,41 %	↑
Bonds 10 years	3,30 %	↑
S&P/TSX	19 385	↓

UNITED STATES		
Unemploy. rate (May)	3,7 %	-
C.P.I. (May)	7,1 %	↓
3 months treasury bills	4,34 %	↑
Bonds 5 years	4,00 %	↑
Bonds 10 years	3,87 %	↑
Dow Jones - Industrial	33 147	↓
S&P 500	3 840	↓

CURRENCIES		
$ USA / $ CAN	0,74	↑
$ USA / € Euro	1,07	↓
¥ Yen / $ USA	131,12	↑

The arrow indicates the trend since the publication of the last monthly data or end of the month.

MARKET INDICES IN CANADIAN DOLLARS AS OF DECEMBER 31ST, 2022	3 months	6 months	1 year	3 years*	5 years*
FTSE Canada 91 Day TBill Index	1,00 %	1,53 %	1,82 %	0,95 %	1,17 %
BONDS					
FTSE Canada Universe Bond Index	0,10 %	0,62 %	-11,69 %	-2,20 %	0,27 %
FTSE Canada Short Term Overall Bond Index	0,67 %	0,36 %	-4,04 %	0,03 %	1,01 %
Indice adapté gestion privée Eterna [1]	0,55 %	0,72 %	-6,56 %	-0,49 %	0,90 %
FTSE Canada Mid Term Overall Bond Index	0,34 %	1,19 %	-10,29 %	-1,32 %	0,70 %
FTSE Canada Long Term Overall Bond Index	-1,01 %	0,49 %	-21,76 %	-5,80 %	-1,12 %
NORTH AMERICA STOCK MARKETS $ CAN					
Canada - S&P/TSX	5,96 %	4,47 %	-5,84 %	7,54 %	6,85 %
États-Unis - Standard & Poor's 500	5,57 %	7,54 %	-12,41 %	9,17 %	11,12 %
États-Unis - Dow Jones	13,86 %	14,42 %	-0,38 %	8,82 %	10,06 %
INTERNATIONAL STOCK MARKETS $ CAN					
Royaume-Uni - FTSE-100	15,95 %	10,41 %	0,10 %	1,42 %	2,56 %
France - CAC-40	20,64 %	17,39 %	-8,93 %	2,50 %	3,24 %
Allemagne - DAX	23,42 %	16,97 %	-12,17 %	1,32 %	0,73 %
Japon - Nikkei-225	9,08 %	7,62 %	-15,66 %	-1,70 %	1,25 %
Hong Kong - Hang Seng	13,43 %	-4,33 %	-9,62 %	-9,94 %	-6,49 %
Australie - S&P/ASX 200	13,16 %	11,13 %	-5,23 %	2,15 %	1,82 %
CURRENCY					
USD versus CAD	-1,99 %	5,29 %	7,26 %	1,43 %	1,52 %

* Rendement total annuel composé
1. L'Indice Adapté Gestion privée Eterna est composé à 60 % de l'indice des obligations globales à court terme FTSE Canada et à 40 % de l'indice des obligations globales à moyen terme FTSE Canada.

Source : Bloomberg

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