ETERNA FINANCIAL GROUP

QUARTERLY REVIEW - JUNE 2023

ASSET SUMMARY AND ALLOCATION

The second quarter of 2023 saw financial markets overall continue to generate positive returns for investors, despite pitfalls encountered since the start of the year: restrictive monetary policy, high inflation, declining corporate profits, bank crisis/bankruptcies, the U.S. debt ceiling issue and a global economic slowdown.

This quarter's most impressive performance came from the U.S. technology sector. The NASDAQ Index returned 12.8% over the period and 31.7% year-to-date. Meanwhile, the S&P 500 Index returned 8.7% in the second quarter and 16.9% in the first half of 2023. As mentioned earlier in our monthly letters, U.S. growth is heavily concentrated in technology; stabilized long-term interest rates and investors' attraction to artificial intelligence are fuelling this stock market rebound. The rise is almost entirely attributable to Apple, Microsoft, Alphabet, Amazon, Meta and Nvidia.

In Canada, the S&P/TSX Index, less concentrated in the technology sector, failed to capitalize on the prevailing momentum in the U.S.; instead, declining energy and commodity prices and weaker results from Canadian banks drew the opposite attention. In the second quarter, the S&P/TSX returned 1.1%, but the index is still positive for the year to date, with a return of 5.7%.

Internationally, European stock markets experienced a strong rebound at the end of 2022 and in the first three months of 2023. This rally subsided in the second quarter. Although economic data was encouraging because of a milder winter, the Eurozone still slipped into a technical recession in the second quarter. As a result, Germany's DAX 30 Index gained 3.3%, France's CAC 40 Index 1.1% and the UK's FTSE 100 Index -1.3% over the period.

Interest rates on the bond market are up in recent months, with central banks returning to a tougher tone. Inflationary pressures are still strong and the labour market robust, prompting the Bank of Canada to end its pause, while the U.S. Federal Reserve is considering a higher final rate. As a result, the FTSE Canada Universe Bond Index posted second-quarter returns of -0.7%, but year-to-date performance remains positive at 2.5%. Only the long end of the curve in the Canadian bond market generated a positive return, with credit spreads narrowing. In fact, we are seeing increased risk in credit spreads, which continue to narrow despite the economic slowdown and declining earnings growth.

In this highly volatile environment, short-term bonds and money markets are still extremely attractive, considering the rates on offer. We retain a defensive strategy, gradually adding new money when promising opportunities arise on the stock markets. We are confident that this short-term economic uncertainty is, in a way, a necessary step towards returning inflation to target and strengthening the foundations for healthy medium-term growth.

- Financial markets continue to deliver positive returns despite pitfalls encountered since the start of the year: restrictive monetary policy, high inflation, declining corporate profits, bank crisis/bankruptcies, the U.S. debt ceiling issue and a global economic slowdown.
- Key factors behind the economic resilience are a still-strong labour market and surprisingly robust consumer spending, boosted by surplus savings accumulated during the pandemic. In Canada, immigration also remains strong.
- U.S. growth is heavily concentrated in technology; stabilized long-term interest rates and investors' attraction to artificial intelligence are behind this stock market rebound.
- Central banks returned to a tougher tone, with inflationary pressures still strong and a robust labour market, prompting the Bank of Canada to end its pause, while the U.S. Federal Reserve is considering a higher final rate.
- This short-term economic uncertainty represents a necessary step in returning inflation to target and strengthening the foundations for healthy medium-term growth.

The global economy is still resilient, encouraging forecasters to revise growth forecasts upward for this year and postpone the prospect of a recession into 2024. Key factors are a persistently robust labour market and surprising consumer spending, driven by surplus savings accumulated during the pandemic. In Canada, we might also add strong demographic expansion due to immigration. Another positive development for the economy is the greater flexibility of supply chains, and it is becoming clear that the challenges created by the pandemic are behind us.

However, despite these positives, there are emerging pockets of weakness in the economy, and our message is the same; rapid, high levels of monetary tightening by central banks will continue to slow the economy, and the full impact of these rate hikes will be felt from this autumn, 18 months after the announcement of the first rate hike in March 2022.

On the Canadian economic front, investors were surprised on June 7 when the Bank of Canada ended its pause in interest rate hikes and raised its key rate to 4.75%, the highest rate since 2001. As mentioned earlier, the economy is proving to be more durable than the Bank of Canada had initially anticipated, but we believe it was impatient to raise its key rate back in June. To support its decision, the Bank of Canada listed a number of economic data which, in its view, presents a risk to restoring the balance between supply and demand and securing a sustainable return to the 2% inflation target.

Firstly, according to the Bank, inflation is falling mainly because of energy prices, but core inflation is still too persistent. Indeed, core inflation is slowing less rapidly; we've repeatedly mentioned in our monthly letters that services inflation remains anchored, and that historically you need a recession to see this component decelerate sharply.

Secondly, in its June press release, the Bank reiterated its inflation forecast of 3% for this summer, which in January had justified a break in rate hikes. Also, in April, it mentioned that it did not see inflation dropping back to 2% before the end of 2024; this was logical, allowing time for monetary policy to kick in and for the economy to pursue its slowdown.

It is likely, therefore, that April's slight re-acceleration in inflation prompted fears of a new wave of rising inflation. However, the data published on June 27 was very encouraging, with annual inflation down by 1% year-on-year to 3.36%. June inflation should again show a deceleration and should be close to this summer's 3% target. An interesting feature of May inflation was that mortgage interest costs rose by 29.9%, the biggest contributor to the year-on-year increase. In a way, it is a vicious circle: the Bank of Canada raises rates to lower inflation, but each additional rate hike raises mortgage interest costs, which in turn boosts inflation.

Thirdly, the Bank of Canada reports that consumption growth is surprisingly solid and widespread. However, about 50% of first-quarter consumption growth came from services, one of the last sectors to decline during economic slowdown. It is also important to note that roughly one third of household consumption is generated by durable goods, which posted 14% growth in the first quarter. Consumer spending is unlikely to be a big surprise, although as early as January, we reported healthy car sales; supply chains had eased, allowing delivery of vehicles purchased during the pandemic. High immigration is another factor stimulating consumption. And if we analyze actual retail sales, we can also see them stagnating for several months, a trend that occurs before the onset of a recession. Moreover, the Bank of Canada stated in its April press release that "consumption is expected to moderate this year, as more households renew their mortgages at higher rates and restrictive monetary policy takes its toll on the economy as a whole." In 2022, variable-rate mortgages were hit by rising rates, but the remaining two thirds of fixed-rate mortgages will be affected by rising rates in 2024, 2025 and 2026. The greatest impact on mortgages will be felt as early as next year.

Finally, the Canadian central bank's press release also refers to a tight labour market. Job creation is substantial, supported by high immigration, among other factors. However, the key point to remember is that job creation is a lagging economic indicator; in other words, job losses do not precede a recession, they occur during and after one. But if we analyze the number of vacancies, jobs posted and job creation in May, we see a downward trend, which indicates a slowdown in the labour market.

To sum up, we believe that the Bank of Canada's argument is valid, but it is a case of "the forest for the trees." Besides the arguments listed above, which already point to economic slowdown, disposable household income declined in the first quarter, economic productivity is very weak, business investment is anemic, surplus savings accumulated during the pandemic are almost exhausted, and corporate profits in the national accounts have fallen for three quarters. It would have been wiser to wait until the September meeting for another hike, at which point we would have had more evidence that inflation had actually reached this summer's 3% target, giving the economy another three months to experience the full impact of the sharp rate hikes. Each additional rate hike exponentially impacts the economy and heightens the risk of a deeper recession.

In the Eurozone economy, the most recently revised economic growth data reveals two consecutive quarterly declines in real GDP, signalling a technical recession. Germany has borne the brunt of the G20's weak growth since the start of the year. The German manufacturing sector is particularly dependent on Russian gas and Chinese demand. As a result, Germany was more severely affected by the Ukraine-Russia war, which continues to limit natural gas supplies, and by Chinese consumption, which failed to meet expectations following the lifting of health restrictions.

China's economic recovery has been disappointing, falling short of expectations after the lifting of sanitary measures. Chinese exports are declining, while the global economy and demand are shrinking. And while China is keen to steer its economic growth towards domestic consumption, the downturn in the property market since 2021 is worrying Chinese households, who are limiting their consumption and increasing their savings to protect property investments.

In view of these economic findings, the bond market is still volatile, as we predicted in March's quarterly review. After the first quarter's generalized rate cut, we indicated that short-term rate consolidation was possible, and that yields had probably peaked in this cycle. Despite these challenges, investors focused on the central banks' message of continued rate hikes, resulting in subsequent consolidation. Investors also ignored the current economic slowdown and falling corporate profits, which helped narrow credit spreads. At this juncture, we are increasingly uncomfortable with low credit spreads, and believe we are getting rewarded less and less for the additional risk. We are adopting a defensive stance by underweighting corporate bonds. We are also maintaining our longer duration positioning than the benchmark, favouring lower rates as the economy continues to slow.

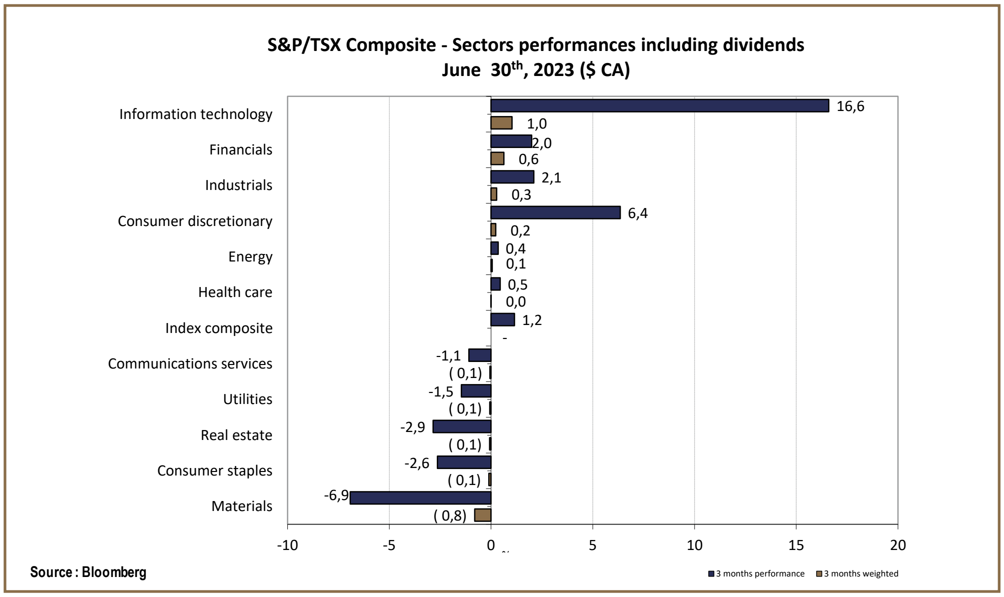
Bobby Bureau, MBA, CIM®
Senior Manager, Fixed Income
Portfolio Manager

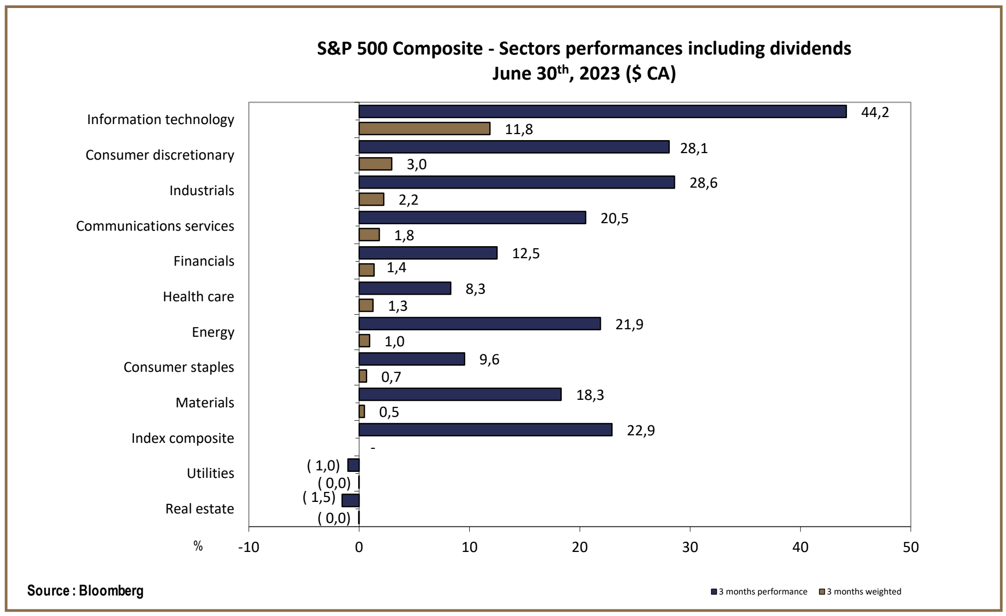
CANADIAN EQUITIES

Second-quarter 2023 performance for the Canadian equity portfolio was slightly ahead of the S&P/TSX Index. Sector-wise, Shopify's strong performance (+30% in the quarter, which we do not own) propelled the IT sector into the Canadian index. However, the Canadian market is heavily exposed to commodities, which were hit hard over the period with China's economic slowdown and the decline in manufacturing. An underweight position and better stock selection in energy and basic materials sectors helped us to offset Shopify's performance and achieve a positive relative performance for the quarter and year-to-date. In addition, our position in engineering consultancy Stantec, which is still making good operational progress, resulting in a 33% year-to-date rise in the stock, helped us outperform the Canadian industrial sector index. The financial sector saw a turbulent quarter, but finished up 2.0% for the period, driven by a 6.6% rise in the insurance sector, while banks reported a slightly positive quarterly performance (+0.5% in the index).

We intend to maintain our cautious approach to more cyclical sectors like Energy and Commodities until we see greater economic clarity, particularly in Manufacturing and China. We are, however, taking advantage of any excessive weakness to increase certain positions, as in the case with Nutrien. The fertilizer and agricultural products producer took a tumble following more challenging results and lower projections at the start of the year but still holds a unique global position in the agricultural sector. We followed suit with Brookfield Renewable Partner, where the stock dropped following a financing related to the acquisition of Duke Energy's renewable energy assets, and a sector under pressure from falling energy prices worldwide.

Quebec equities continued to perform well in Q2, boosted by favourable sector allocation and substantial performances from Stella Jones, Dollarama and CGI Group. The Quebec equity portfolio is up by over 10% in 2023, outperforming the Canadian index by more than 4%.





Among small- and mid-cap stocks, the Small Cap Fund is performing well, in spite of a more difficult North American performance for all the smaller companies. Annual returns of over 5% compare favourably with the TSX small-cap index, which posted negative returns and is slightly below that of the S&P/TSX, after outperforming the index in 2021 and 2022.

Philippe Côté
Vice-President and Portfolio Manager

Mickaël Carrier
Equity Analyst

GLOBAL, INTERNATIONAL AND U.S. EQUITIES

There was a notable shift in financial markets during the second quarter of 2023, with recession fears easing and investor confidence improving after banking turmoil in March. Stock markets continued to reward investors, although first-quarter results declined in earnings. The recovery was driven mainly by the technology and communications sectors and fuelled by the enthusiasm surrounding artificial intelligence.

As of today, the five largest companies in the global index technology are linked to communications, and all are American. In fact, nearly 70% of the global index is currently held in the United States—a record since its creation. Furthermore, the five largest companies in the U.S. index are involved in technology and communications, accounting for nearly 25% of the S&P 500 index. In this regard, we have compiled the table below, illustrating the concentration of the S&P 500 in the five largest companies in the index since 1970.

Stock Index Concentration

The previous period of strong index concentration, in the early 1970s, heralded major changes in the financial markets, and we expect a similar situation in the coming years.

Our investment approach is founded on the long term through economic cycles, and we are confident that it will yield the expected results over the coming months. With index performance highly concentrated, a diversified investment process with a maximum weighting of less than 4% is not expected to follow the index.

Global and U.S. Funds

During the quarter, we underperformed the benchmark, largely because we do not hold the largest stocks in the index, like Apple, Microsoft, Amazon, Nvidia and Alphabet, reflecting excessive hype over the financial prospects of artificial intelligence. We expect artificial intelligence to have a profound impact on society, similar to the advent of the Internet. However, we believe that monetizing artificial intelligence will prove more difficult than anticipated, as it was in the early 2000s when we embraced the Internet, and Nortel still went bankrupt. As far as holdings are concerned, we were successful with Owens Corning and Cameco, thanks to Biden's Inflation Reduction Act clean energy plan. We also increased our overweight in Japanese equities during the quarter. Their economy is firing on all cylinders and their monetary policy is very flexible despite high inflation, as they will be patient before raising their key rate after 30 years of disinflation. Moreover, the valuation of Japanese companies is still interesting. Nutrien, Boliden and Holmen, all three representing the materials sector from different angles, had a tough quarter as the manufacturing economy slowed sharply, hurting commodity prices. We are vigilant about these positions but consider them attractive values at their current prices. All three companies are well positioned and have a sustainable approach to value creation.

International Fund

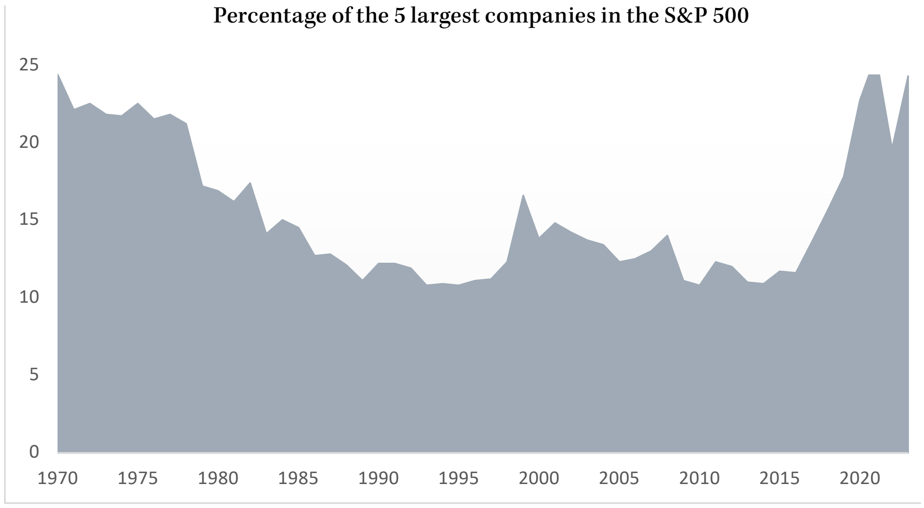
Technology sectors also boosted international markets. The Japanese market performed well, bolstered by solid economic performance and continued support from the Japanese central bank, unlike other central banks in developed countries. In contrast to the American market, the five largest companies in the international index are European: Nestlé, ASML, Novo Nordisk, LVMH and AstraZeneca, representing just 8% of the index.

Over the quarter, we underperformed the benchmark. The underperformance was primarily due to our sector exposure, positioned in more cyclical sectors like basic materials and industrial companies. Unfortunately, in spite of more attractive valuations of our selected stocks in these sectors, they lagged behind the technology, healthcare and consumer discretionary sectors, where valuations are more generous. We believe, however, that this is a temporary situation that will be resolved over the coming months.

Our positions have performed well with Cameco, as well as Marubeni and Panasonic in Japan, which are gaining popularity through Japan's monetary policy, which is much more flexible than elsewhere in the world. For the same reasons, we increased our exposure to Japanese equities in the International Fund during the quarter.

Comments by:

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



Graph: Nordis Capital. Source: S&P Bloomberg. Created with Datawrapper.

STATISTICS ON JUNE 30TH, 2023

CANADA		
Unemploy. rate (April)	5.2 %	↑
C.P.I. (April)	3.4 %	↓
3 months treasury bills	4.91 %	↑
Bonds 5 years	3.69 %	↑
Bonds 10 years	3.27 %	↑
S&P/TSX	20 155	↑

UNITED STATES		
Unemploy. rate (April)	3.7 %	↑
C.P.I. (April)	4.0 %	↓
3 months treasury bills	5.28 %	↓
Bonds 5 years	4.16 %	↑
Bonds 10 years	3.84 %	↑
Dow Jones - Industrial	34 408	↑
S&P 500	4 450	↑

CURRENCIES		
$ USA / $ CAN	0.76	↓
$ USA / € Euro	1.09	↓
¥ Yen / $ USA	144.31	↓

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 JUNE 30TH. 2023

	3 months	6 months	1 year	3 years*	5 years*
FTSE Canada 91 Day TBill Index	1.01 %	2.14 %	3.70 %	1.40 %	1.48 %
BONDS					
FTSE Canada Universe Bond Index	-0.69 %	2.51 %	3.15 %	-3.75 %	0.65 %
FTSE Canada Short Term Overall Bond Index	-0.80 %	1.00 %	1.37 %	-0.95 %	1.11 %
Indice adapté gestion privée Eterna [1]	-1.25 %	1.36 %	2.08 %	-1.88 %	1.09 %
FTSE Canada Mid Term Overall Bond Index	-1.93 %	1.85 %	3.06 %	-3.31 %	1.02 %
FTSE Canada Long Term Overall Bond Index	0.64 %	5.39 %	5.90 %	-7.51 %	-0.26 %
NORTH AMERICA STOCK MARKETS $ CAN					
Canada - S&P/TSX	1.10 %	5.70 %	10.43 %	12.42 %	7.62 %
United States - Standard & Poor's 500	6.38 %	14.29 %	22.91 %	13.50 %	12.45 %
United States - Dow Jones	1.71 %	2.60 %	17.39 %	11.23 %	9.73 %
INTERNATIONAL STOCK MARKETS $ CAN					
United Kingdom - FTSE-100	0.43 %	6.10 %	17.14 %	10.78 %	2.95 %
France - CAC-40	-0.69 %	13.93 %	33.73 %	12.25 %	5.52 %
Germany - DAX	1.53 %	15.59 %	35.21 %	7.36 %	4.31 %
Japan - Nikkei-225	6.51 %	12.88 %	21.48 %	2.63 %	2.82 %
Hong Kong - Hang Seng	-9.13 %	-6.92 %	-10.94 %	-9.38 %	-8.02 %
Australia - S&P/ASX 200	-2.27 %	-2.14 %	8.75 %	4.73 %	1.09 %
CURRENCY					
USD versus CAD	-2.03 %	-2.30 %	2.87 %	-0.83 %	0.17 %

* Annual compounded total return.
1 The Eterna Adapted Private Wealth Index is made up of 60% of FTSE Canada Short Term Overall Bond Index and of 40% of FTSE Canada Mid Term Overall Bond Index.ada..

Source : Bloomberg

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