CIBC PRIVATE WEALTH

INVESTMENT STRATEGY COMMITTEE

# QUARTERLY PORTFOLIO STRATEGY REPORT

## U.S. CORE EQUITY MODEL PORTFOLIO

May 2024

# Inside this issue

Market Review: Q1/2024 ..... 3
Portfolio Performance ..... 4
ISC U.S. Core Equity Model Portfolio ..... 4
Current Environment ..... 6
Outlook ..... 7
Appendix A: Investment Strategy Committee Members ..... 8
Disclosures and Disclaimers ..... 10
Important disclosure footnotes for companies mentioned in this report that are covered by CIBC World Markets Corp./Inc.: ..... 10
Key to important disclosure footnotes: ..... 10

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Unless otherwise noted, all prices quoted in this report are as of the close of markets on March 28, 2024.

# Market Review: Q1/2024

During the first quarter of 2024, the market maintained its momentum from the previous quarter. Investors entered the quarter with optimism, anticipating a soft landing and the avoidance of a recession. Macroeconomic data from around the world showed promising signs, further bolstering the likelihood of a soft landing. Expectations for interest rate cuts in the U.S. and Canada moved from March to June due to persistent inflation. Despite high interest rates, the market continued to perform strongly. In the U.S., the communications and technology sectors continued to benefit from the boom in artificial intelligence, while the bond market's performance was negatively impacted by the prospect of a delay in rate cuts.

In Canada, the S&P/TSX Composite Index achieved a total return of 6.6% during the first quarter of 2024, with widespread strength observed across the majority of sectors. The communication services and utilities sectors, however, lagged behind with negative total returns of 8.5% and 1.1%, respectively. These sectors are more sensitive to interest rates. The communications services sector is experiencing increased competition in Canada, which is reducing the valuation gap between the Canadian and U.S. communication sectors. Within the utilities sector, independent power and renewable electricity producers were the most negatively impacted, with a negative return of 8.3%, while gas utilities had a positive return of 8.2%. In contrast, the health care, energy, and industrial sectors were the top performers, with total returns of 18.4%, 13.1%, and 11.1%, respectively.

During the first quarter of 2024, the U.S. S&P 500 Index sustained its momentum, achieving a total return of 10.6%. All stocks within the 'magnificent seven' except for Tesla (TSLA) delivered strong positive returns. The gains in the S&P 500 were broad-based, with all sectors except real estate ending the quarter with an increase. The communication services, energy, and information technology sectors emerged as the top performers, with total returns of 15.8%, 13.7%, and 12.7%, respectively, while the real estate sector declined by 0.6%. The Nasdaq Composite Index, known for its significant exposure to technology stocks, posted a total return of 9.1%.

During the first quarter, global equities delivered gains on a price-return basis. Emerging market equities underperformed compared to their developed market counterparts. In Europe, Germany's DAX Index and France's CAC 40 Index achieved gains of 10.4% and 8.8%, respectively. Meanwhile, the UK's FTSE 100 Index recorded a modest increase of 2.8%. In Asia, Japan's Nikkei Index rose by 20.6%, while China's Shanghai Composite Index increased by 2.2%.

The Bank of Canada (BoC) maintained its benchmark overnight rate at 5.00% during its March meeting, in line with market expectations. The BoC continued to normalize its balance sheet, as policymakers remained concerned about the risks of inflation. The BoC stated that it will continue its quantitative tightening until it observes further and sustained easing in core inflation. Headline inflation in January eased to 2.9%, and policymakers project inflation to remain close to 3% during the first half of the year before gradually easing. The bank also noted that GDP growth remained weak and below potential, while employment growth continued to lag behind population growth, with signs that wage pressures may be easing. The unemployment rate in Canada rose to 6.1% in March 2024, up from 5.8% in the previous month, marking the highest reading since October 2021.

In March 2024, the U.S. Federal Reserve (Fed) maintained the Fed funds rate within the range of 5.25% to 5.50% for the fifth consecutive meeting, in line with market expectations. Policymakers continue to plan for three interest rate cuts this year, consistent with the quarterly forecasts made in December. The dot plot also indicated three cuts in 2025, one fewer than in the December forecast, and three additional reductions in 2026. Additionally, the annual headline inflation rate in the U.S. unexpectedly edged up to 3.2% in February 2024, compared to 3.1% in January 2024. The annual core inflation rate, which excludes food and energy, eased to 3.8%, down from 3.9% in the previous month, but still above the consensus of 3.7%. Furthermore, U.S. nonfarm payrolls surged by 303,000 jobs in March 2024, the highest in the past ten months, significantly surpassing the revised figure of 270,000 jobs reported for February 2024 and exceeding the market forecast of 200,000.

In the U.S. fixed-income markets, bonds delivered negative returns as government bond yields rose across the curve over the past three months. Specifically, the U.S. Treasury 2-year and 10-year yields increased by 37 and 32 basis points, respectively. The yield curve remained inverted, consistent with the level observed last year. The Canadian 10-year bond yield ended the quarter at 3.47%, while the U.S. 10-year yield finished the quarter at 4.20%.

# Portfolio Performance

## ISC U.S. Core Equity Model Portfolio

The CIBC Private Wealth U.S. Core Equity Portfolio delivered a positive return but underperformed the benchmark slightly during the first quarter of 2024. Selection detracted from performance while allocation contributed. Regarding allocation, the overweight positions in consumer discretionary and healthcare, and underweight positions in industrials, financials and information technology detracted from performance but this was more than offset by the contribution to performance from the portfolio's overweight positions in communications services and energy, and the underweight positions in utilities, materials, consumer staples and real estate. Regarding selection, the contribution to performance due to our selections in consumer discretionary, healthcare, energy, utilities, industrials, financials, and consumer staples was more than offset by the detraction from performance from selections in communications services, materials and information technology.

In communications services, the position in Meta Platforms (META) performed well after the company posted better-than-expected results and provided guidance that was higher than consensus estimates. In healthcare, the position in Eli Lilly (LLY) continued to do well on strength in sales of its blockbuster diabetes drug, Mounjaro. In industrials, the position in Caterpillar (CAT) performed well as the company benefitted from pricing power and the continued strong demand for heavy equipment in markets such as oil and gas, construction and infrastructure. In healthcare, the position in UnitedHealth (UNH) declined in value due to concerns that recent industry-wide increases in medical loss ratios (the percentage of premiums received that are used to pay for customer medical claims) will be permanent and not temporary. In information technology, the position in Apple (AAPL) declined due to increasing declines in sales of iPhones in China and due to investor concerns over the company's lack of a generative AI strategy. In consumer staples, the position in Nike (NKE) declined after the company reported slower-than-expected revenue growth, provided lower margin guidance and reported online sales in China that were below expectations.

During the quarter, certain factors detracted from outperformance including an underweight position in technology stocks. A considerable source of this was in semiconductors, where those companies involved in producing graphics processing units (GPUs) used in generative AI saw their share prices soar. We had held positions in semiconductor companies Texas Instruments (TXN) and Microchip Technology (MCHP), which did not have exposure to generative AI-related end markets but these companies underperformed as investors favoured those semiconductor companies with exposure to generative AI. To address this, we eliminated the positions in Texas Instruments and Microchip Technology and initiated a position in semiconductor company Broadcom (AVGO), which serves generative AI end markets by providing application-specific integrated circuits (ASICs) that are designed and built for their customers' particular generative AI needs. We also initiated a position in Synopsys (SNPS), which provides design software that is essential for the designers and producers of integrated circuits and semiconductors, including many of those that produce GPUs and other chips used for generative AI. We also own the shares of software companies such as International Business Machines (IBM), Microsoft (MSFT) and ServiceNow (NOW), which have a growing presence in the generative AI market and which have seen their share prices increase as a result. We will be seeking additional ways to participate in the upside potential in generative AI in 2024, either from investments in software companies, hardware companies or semiconductor companies.

Given the strong performance of equities during the quarter and the broad participation from most sectors of the market in the upside, significant near-term upside in equity indices may prove challenging. Uncertainty over when the U.S. Federal Reserve (Fed) will start to cut interest rates, and by how much, may weigh on equities over the next few months. Recent comments by Fed officials suggest that fewer rate cuts than expected might be in store for investors in 2024. An offset to this is that the U.S. consumer continues to spend at levels sufficient to sustain economic growth and this is underpinned by the continued strength of the U.S. job market. Being mindful of how well equities have performed to start the year, we are cautiously optimistic regarding equities in 2024.

The team here at CIBC will continue to deploy a multi-disciplined investment approach that uses fundamental, quantitative and technical research methods to construct a portfolio of mid-cap and large-cap U.S. equities that aims to achieve long-term growth of capital and income for our clients.

## Results as of the end of March 2024

| Portfolio Performance | 3 month | YTD | 1 year | 3 year | Since Inception[1] |
|---|---|---|---|---|---|
| U.S. Core Equity | 10.30% | 10.30% | 26.73% | 11.65% | 14.96% |
| Benchmark[2] | 10.56% | 10.56% | 29.88% | 11.49% | NA |
| **Relative** | **-0.26%** | **-0.26%** | **-3.15%** | **0.16%** | **NA** |

[1] February 16, 2016.

[2] Benchmark: 100% S&P 500 Index (USD).

## Current Environment

Canada has seen solid progress towards lower core inflation in recent months. The Bank of Canada has been given time to assess incoming data and economic growth appears to have picked up in the winter quarter. Although some factors are tied to one-time lifts from the end of strikes and improving supply, we expect to see more sluggish growth by spring, paving the way towards an easing in central bank policy rates towards mid-year. We expect somewhat more relief on that front than fixed-income markets are currently pricing in, although rate cuts will still be on a gradual path that will stretch out through 2025. Barring a surprising downturn, we still expect overnight rates to end up at higher levels than what prevailed in the pre-pandemic business cycle.

Still, rate cuts should be sufficient to allow Canadian economic growth to improve later in 2024 and into 2025, which should be supportive for earnings expectations over that period. Globally sensitive sectors should also benefit from policy easing overseas that will improve growth in major European economies. Our committee sees that of help to commodity prices, with our consensus on oil prices now higher than it was previously.

U.S. inflation readings were firmer in the first two months of 2024, but we see that as a bump on the road towards lower inflation ahead, with an easing in rent inflation likely to lead to improvement over the latter half of the year. With the U.S. economy having thus far seen solid growth, the US Federal Reserve (the Fed) is under less pressure than the Bank of Canada to ease up on rates, and will likely take a slower path as a result. While we still see a first cut in July if core inflation remains well-behaved, we’ve pushed one rate cut in our forecast from 2024 into 2025 with the Fed now likely to cut by 75 bps this year.

## Outlook

In the first quarter of 2024, North American equity markets continued their upward trajectory with nine of the eleven GICS sectors delivering positive total returns. Generative AI, especially Nvidia (NVDA), continued to be the story during Q1. Despite concerns over elevated valuations, money continued to flow into AI-related stocks, including many semiconductor stocks. This helped the NASDAQ deliver a total return of 9.3% for the quarter as technology stocks continued to drive U.S. equities. However, after an impressive run up during Q1, extended valuations and changes in sentiment could present a risk for certain technology stocks in the coming quarters.

Inflation in Canada declined in January and in February fell by more than expected. This was welcome news and provided ample evidence that higher interest rates are working to tame inflation in Canada. It also reinforced expectations that the Bank of Canada (BoC) is on track to start cutting interest rates in June. However, at 2.9%, inflation is still above the 2% target of the BoC. After declining in January, U.S. inflation increased modestly in February to 3.2%, which gave investors reason to question if the U.S. Federal Reserve (Fed) will delay its decision to start reducing rates. With the continued strength of the U.S. labour market and consumer spending, it probably shouldn’t come as a surprise that Fed officials have downplayed the need for immediate rate cuts. In Canada, it may be possible that the BoC begins to cut rates before the Fed does, since Canada's economy and labour market are not performing as well as those in the U.S. However, with OPEC and Russia agreeing in March to extend voluntary oil output cuts into the second quarter, higher crude oil prices may persist, providing an inflationary catalyst. Whether this contributes enough to delay the BoC or the Fed from lowering rates remains to be seen.

The start of Q2 2024 could bring its own set of challenges for equity markets. These challenges include: i) uncertainty regarding when central banks will reduce interest rates; ii) the possibility of less rate cuts than expected; iii) sustainability of the current job market; iv) the likelihood of the consumer maintaining robust spending levels; and v) continuing problems in China's real estate sector and difficulties restarting China's economy. While CIBC's economics team believes the BoC is on track to start cutting rates in June, recent comments by Fed officials have helped to make investors wonder if the Fed may make less rate cuts than expected, which is a departure from the prior more optimistic view. If rate hikes are delayed either by the BoC or the Fed, the near-term upside for equities could be limited.

Equity valuations in Canada remain attractive. The TSX finished the quarter trading at 13.5x next year's consensus EPS, 3.0% below its 5-year average of 13.9x, suggesting modest potential upside from here. In the U.S., the S&P closed the quarter trading at 19.2x next year's consensus EPS, 3.2% above its 5-year average of 18.6x, suggesting U.S. equities are fully valued. However, with nine out of eleven sectors on the TSX and ten out of eleven sectors on the S&P participating in the increase in equity indices in the quarter, this increased breadth of participation compared to the previous quarter might indicate that equity indices may prove to be resilient, even if central banks start reducing interest rates later than expected this year. Should central banks start lowering rates this year, it might benefit the TSX more than the S&P since interest-rate-sensitive sectors such as financials, communications services, utilities and real estate were among the weakest sectors on the TSX this quarter and account for approximately 39% of the TSX versus approximately 26% for the S&P. Overall, we remain cautious in the near term given the current challenging macro backdrop and because equity markets have had such a strong start to the year. So, we remain defensively positioned within equities. However, we are maintaining our underweight position in fixed-income securities given the current volatility in fixed-income markets and the uncertain outlook regarding interest rates.

# Appendix A: Investment Strategy Committee Members

**Wincy Wong, CFA, FSA credential holder**
Executive Director, Investment Strategy Group, CIBC Private Wealth

Wincy Wong joined CIBC in 2021 and has over 20 years of investment experience. Previously, she held lead portfolio management responsibilities for a number of large cap dividend mandates at Mackenzie Investments. Wincy is the chair of the Investment Strategy Committee's (ISC) Stock Selection sub-committee. She is also a member of the CIBC Asset Allocation Committee. Wincy is a CFA charterholder and a holder of the Fundamentals of Sustainability Accounting (FSA) credential awarded by SASB.

**Ian de Verteuil, MBA**
Head of Portfolio Strategy, Quantitative and Technical Research, CIBC World Markets Inc.

Prior to joining CIBC in 2014, Ian was the Global Head of Research at another major financial institution and led that firm's 70+ fundamental analysts, its quantitative team and its Economics department. During his tenure in the investment industry, Ian was also a top-rated analyst in the consumer products and banking sectors. He has a B.Sc. in Chemistry from McGill University and an MBA from the University of Western Ontario.

**Sid Mokhtari, CMT**
Chartered Market Technician & Research Analyst, CIBC World Markets Inc.

Sid Mokhtari is a chartered market technician (CMT) and a research analyst with CIBC World Markets Inc., with a mandate in technical-model trading aspects of the Canadian stock universe. Sid assesses the internals of the broader indices for a top-down analysis, while his TrendSpotting Matrix provides bottom-up analysis from technical perspective. Sid plays an important role in educating CIBC's clients through technical disciplines and models. Sid has been selected as the first Canadian technician to hold a seat on the Market Technicians Association's Journal Review Board. He is a regular guest speaker on the Business News Network (BNN), at Canadian conferences, and is often quoted by the Canadian financial press.

**Michael O'Callaghan, MBA, CFA**

Director, Investment Strategy Group, CIBC Private Wealth

Michael O'Callaghan joined CIBC in 2011 and is responsible for providing market commentary, portfolio strategies and investment recommendations to CIBC Wood Gundy Investment Advisors and their clients. Prior to joining CIBC, Michael was in a similar position at another Canadian investment dealer. A graduate of the Richard Ivey School of Business's MBA program and a CFA charterholder, Michael has more than 15 years of experience in the financial industry.

**Andrew O'Brien, CFA**

Director, Investment Strategy Group, CIBC Private Wealth

Joined CIBC in 2023 and is a member of the Investment Strategy Committee's (ISC) stock selection sub-committee. Andrew brings over 10 years of experience in the investment industry, spanning equity research, investment strategy, and asset allocation. Prior to joining CIBC, he held the role of Director Investment Research at a large Canadian asset management firm, where he focused on Canadian equities. Andrew holds a Bachelor of Commerce degree and a Masters in Business Studies specializing in Finance from University College Dublin (UCD) in Ireland. He is also a CFA charterholder and holds a Certificate in ESG Investing from the CFA Institute.

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Bank of Montreal (2a, 2e, 2g, 3a, 3c, 7) (BMO-TSX, C$133.53)
Bank of Nova Scotia (2a, 2c, 2e, 2g, 3a, 3c, 7) (BNS-TSX, C$68.48)
Brookfield Asset Management (2g, 3a, 3c) (BAM-NYSE, US$41.97)
Brookfield Corporation (2g, 3a, 3c, 7, 14) (BN-NYSE, US$41.11)
Canadian Apartment Properties REIT (2g, 7) (CAR.UN-TSX, C$45.59)
Canadian National Railway Co. (2a, 2c, 2e, 2g, 7) (CNR-TSX, C$177.76)
Canadian Pacific Kansas City Ltd. (2g, 7) (CP-TSX, C$121.09)
Canadian Tire Corporation, Ltd. (2a, 2e, 2g, 13) (CTC.A-TSX, C$133.72)
Constellation Software Inc. (2g, 7) (CSU-TSX, C$3664.45)
First Capital Real Estate Investment Trust (1b, 2a, 2e, 2g) (FCR.UN-TSX, C$16)
Intact Financial Corp. (2a, 2c, 2e, 2g, 3a, 3c, 7) (IFC-TSX, C$221.5)
Loblaw Companies Limited (1b, 2a, 2e, 2g) (L-TSX, C$149.09)
Manulife Financial Corp. (2a, 2c, 2e, 2g, 7) (MFC-TSX, C$33.45)
Northland Power Inc. (2a, 2e, 2g) (NPI-TSX, C$22.5)
Nutrien Ltd. (2a, 2c, 2g, 7) (NTR-NYSE, US$56.24)
Restaurant Brands International Inc. (1b, 2g, 7) (QSR-NYSE, US$74.24)
Sun Life Financial Inc. (2a, 2c, 2e, 2g, 7) (SLF-TSX, C$72.18)
Toronto-Dominion Bank (2a, 2c, 2e, 2g, 3a, 3c, 7) (TD-TSX, C$80.18)
Waste Connections Inc. (2a, 2c, 2g, 4a, 4b) (WCN-NYSE, US$168.36)
Wheaton Precious Metals Corp. (2g) (WPM-NYSE, US$51)
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