

PORTFOLIO MANAGER COMMENTARY - SEPTEMBER 30, 2021

**Global Markets Review**

Following a stormy month in September, global equity markets narrowly extended positive gains during the quarter. For the three-month period ending September 30, 2021, the MSCI World Index edged up 0.1%, led by the Financials sector, which gained 2.2%; Energy was the second-best performing sector, rising 1.6% during the quarter and boosted by robust oil and gas prices. In North America, the S&P 500 was up 0.6%, also driven by Financials, while the S&P/TSX Composite was up 0.2%, with Consumer Staples and Industrials as the top performing sectors. In Europe, the STOXX 600 rose 1.0% during the quarter. Italy and the U.K. were the best-performing countries, where the FTSE MIB was up 3.0% and the FTSE 100 was up 1.9%. CAC 40 and IBEX 35 ticked up 0.4% and 0.3%, respectively. Switzerland and Germany finished the period in negative territory, down 2.4% and 1.7%, respectively.

Global economies continued the path to recovery through the third quarter, while sentiment on the growth deceleration has weighed on the market. U.S. manufacturing PMI came in at 61.1 for September, the strongest reading during the quarter, while the unemployment rate also saw sequential improvement. Nonetheless, inflationary pressures remained elevated, with August core CPI at 4%, despite dropping from the June high (4.5%). Global yields spiked after bottoming in August. The U.S. 10-year Treasury yield peaked above 1.5% after a mildly hawkish Federal Open Market Committee (FOMC) meeting. The U.K. 10-year Gilts also mirrored its U.S. peer, touching 1% for the first time since May 2019. These triggered market selloffs of high-growth names especially among Information Technology and Healthcare sectors in the back half of September, while value stocks in Financials and Energy sector were buoyed on the back of rising yields. Although growth still outperformed value during the quarter, the gap has narrowed since mid-September, which coincides with rising yields. At the same time, uncertainties around China's slowing economic momentum and contagion risks due to the property developer Evergrande's debt crisis also sent market volatility higher in September.

There were few major monetary policy changes among global central banks in developed economies during the quarter, with inflationary pressures becoming the key variable for the pace of policy shifts. The Federal Reserve left the policy rate unchanged at 0%-0.25% at the September FOMC meeting, while acknowledging that "a moderation in the pace of asset purchases may soon be warranted". The latest median dot plot projects the fed funds rate at 1% by the end of 2023 and 1.75% by the end of 2024. Moreover, the 2021 inflation outlook was substantially lifted again to 4.2%, 80 bps above the June estimate, reflecting stickier inflation than had previously been expected. Real GDP forecast for the year was also revised down to 5.9% from 7%, implying headwinds in the near-term economic growth outlook.

In Canada, the Bank of Canada (BoC) kept all policy variables unchanged in the September statement, including the overnight policy rate at 0.25% and government bond purchases at C\$2 billion per week. On inflation, the central bank still saw the current spike as transitory, highlighting that wage increases have been moderate and medium-term inflation expectations are well anchored. BoC Governor Tiff Macklem also released a roadmap to exit monetary stimulus, outlining that once the new stimulus is removed the first step would be to move to the reinvestment phase of the QE program (most likely cutting bond purchases from C\$2 billion per week to C\$1 billion). He also reiterated that the reinvestment would be maintained well past the initial rate hikes.

The European Central Bank (ECB) kept the benchmark interest rate unchanged at -0.50%. President Christine Lagarde repeated in September that the upswing in inflation was temporary, and that base effect and rising energy prices would not result in lasting inflation. The Governing Council decided to moderately lower the pace of purchases under the pandemic emergency purchase program (PEPP) from that of the past two quarters, with an unchanged envelope of EUR1.85 trillion through the end of March 2022 at the least. Purchases under the asset purchase program (APP) will progress at a monthly pace of EUR20 billion. The ECB raised their projections on 2021 annual real GDP growth for the euro area to 5% from 4.6% in the June assessment and annual inflation rate to 2.2% from 1.9% in June. Despite the bullish tone on the economic rebound, it is still too early to call for an end of the PPEP, as the decision will still depend on upcoming economic data before the December meeting. The Bank of England (BoE) voted in September to keep the policy rate unchanged at 0.1% and maintain the asset purchase target of £875 billion, while revising down the Q3 GDP forecast to 2.1% from 2.9%. BoE also reiterated that it expected CPI inflation to rise slightly above 4% this year, double its target, largely on the back of upside risks posed by hefty energy and goods prices. On the political front, Olaf Scholz of the Social Democrats narrowly led Chancellor Angela Merkel's Conservatives in the German election. This narrow victory suggests that long negotiations lie ahead before a coalition government can emerge, which could raise extended period of market and policy uncertainties.

According to the statistics compiled by the World Health Organization, the number of confirmed infections worldwide exceeded 233 million by the end of September, while the weekly cases have continued to drop after peaking in August. On the other hand, global vaccination efforts are well underway, with 70% of the population fully vaccinated in Canada and 56% in the U.S. However, due to fears of vaccine effectiveness against the Delta variant and delay of the vaccine rollout for ages 5-11 in the U.S., the pace of reopening was slower than previously anticipated during the third quarter. Fiscal support in Q3 was a mixed bag. The American Rescue Plan, along with other assistances such as Child Tax Credit, continued enhancing household savings, which were channeled into consumer spending amid reopening. Furthermore, the U.S. Senate passed a \$1.2 trillion infrastructure package in August, with the House vote delayed to the end of October. However, as many fiscal stimuli are fading, the fiscal impulse on growth could turn negative next year according to Goldman Sachs.

Looking ahead to the rest of 2021, sector rotations into value and cyclical could persist if the yield curve finds its support and ticks up. However, volatility would potentially linger into the fourth quarter given rising inflation expectations and contracting monetary gauges, as well as global supply chain issues and China's growth deceleration. Market leaderships would be rotating among value/growth and cyclical/defensive alternatively within short timeframes. In this regard, the barbell approach to our portfolios is still the preferred strategy, supplemented by opportunities in the covered call writing amid high volatility risk in the near term. We expect to have clearer visibility after upcoming waves of corporate earnings for Q3 and key economic releases. At the same time, widening vaccine coverage, resilient fiscal support, and abundant household savings should keep fueling economic growth.

### **Portfolio Review:**

Units (1 Class A share plus 1 Preferred share) of Dividend Growth Split Corp. (the "Fund") were up 2.2% during the third quarter of 2021, outperforming the S&P/TSX Composite High Dividend Index, which was up 0.8% over the same period.

Stock picking in Materials and Energy sectors was the top contributing factor to the Fund's outperformance. Supply chain disruptions translated into sustained high commodity prices this quarter, benefiting our agricultural chemical name Nutrien. Tourmaline Oil and Canadian Natural Resources delivered strong stock performance during the quarter. We expected the oil and natural gas supply-demand balance to remain tight for the rest of the year, which led us to increase the Fund's exposure to oil and natural gas exploration and production players including ARC Resources and Tourmaline Oil.

The portfolio's overweight position in Consumer Discretionary detracted from the Fund's gains in the aforementioned sectors. Auto-related names including Magna and Canadian Tire both weakened during the third quarter after delivering spectacular stock performance in the first half of the year, as wide-scale production disruptions pose a challenging environment for the sector, despite ongoing strong demand. We see spots of attractiveness within the Real Estate sector including retail, industrial and residential REITs. Reopening activities drove more foot traffic into shopping centers during summertime, boosting occupancy rates and rent growth for landlords. We have a more cautious view on office REITs as the delta variant take its toll on office space occupancy rates.

During the third quarter, we reduced the Fund's cyclical exposure by increasing the Fund's allocation to Communication Services, Consumer Staples as well as Real Estate and reducing weights in Consumer Discretionary, Industrials and Materials. Post adjustment, the Fund has greater exposure to growth-oriented names than value-oriented names, and the growth factor outperforming value during the quarter confirms our call. We'll continue to monitor our holdings closely for sentiment rotations.

Laura Lau, SVP & CIO

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Annual Compound Returns <sup>1</sup>	YTD	1-YR	3-Yr	5-YR	10-YR	Since Inception <sup>2</sup>
Dividend Growth Split Corp. - Class A	61.4%	86.4%	17.1%	12.8%	14.5%	8.9%
S&P/TSX Composite High Dividend Index	26.7%	43.9%	10.4%	8.5%	8.1%	5.5%
Dividend Growth Split Corp. - Preferred	4.2%	5.6%	5.5%	5.5%	5.4%	5.4%
S&P/TSX Preferred Share Index	17.4%	26.0%	5.1%	7.3%	3.3%	3.6%
Dividend Growth Split Corp. - Unit	20.5%	26.6%	9.6%	8.3%	9.0%	6.6%

<sup>(1)</sup> Returns are for the periods ended September 30, 2021 and are unaudited. The table shows the Fund's compound return on a Class A share, Preferred share and unit for each period indicated, compared with the S&P/TSX Composite High Dividend Index (the "Composite High Dividend Index") and the S&P/TSX Preferred Share Index ("Preferred Index") (together the "Indices"). The Composite High Dividend Index tracks the performance, on a market weight basis and a total return basis, of 50-75 highest dividend yielding securities within the S&P/TSX Composite Index. The Preferred Index tracks the performance, on a market weight basis, of preferred shares trading on the Toronto Stock Exchange that meet the criteria relating to size, liquidity and issuer rating. The Fund invests in an actively managed portfolio and is rebalanced at least annually. It is therefore not expected that the Fund's performance will mirror that of the Indices, which have more diversified portfolios. The Indices are calculated without the deduction of management fees, fund expenses and trading commissions, whereas the performance of the Fund's performance is calculated after deducting such fees and expenses. Further, the performance of the Fund's Class A shares is impacted by the leverage provided by the Fund's Preferred shares.

<sup>(2)</sup> Inception Date December 3, 2007.

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