FAIRCOURT
Asset Management Inc.

3rd Quarter North American Market Commentary – 2024

Key Take-aways:

- The official unemployment rate in the U.S. has remain unchanged since the end of the 2nd quarter at 4.1%, compared to 3.7% at the start of the year and historical average of 5.7%, which while still low in absolute terms, is on an upward trajectory. The FED's focus is now shifting from battling inflation to managing employment levels and economic growth. FED officials have begun cutting interest rates even as inflation remains well above their 2% target. Once again, without fail, the FED's credibility has come under pressure, and they may regret not staying disciplined.

- The last quarter of the year for the U.S. remains poised for a deceleration in year-over-year growth and expect to see re-acceleration in inflation most likely beginning post election and quite evident by 1st quarter 2025. The 10/2 yield curve has been inverted for some time, now flirting with un-inverting. With yields once again rising, the bond market is anticipating inflation re-accelerating.

- Looking ahead, barring an exogenous event, the broader outlook remains unremarkable. All eyes focused on the U.S. election and with geopolitical risks rapidly escalating, the risk for higher volatility persists. Overall, we expect slower moves to the upside and faster moves to the downside. Up to now, markets are not behaving in any way as history has taught us. We remain in extraordinary times.

Positioning:

- The CBOE Volatility Index (VIX) began the year at 11 and is spending more trading days at the 20-level (historical average is 19.5) post Q2. The VIX registered 65 on August 5th, a fear level only matched in 2020 and 2008. Risk signals continue to suggest caution at minimum. For now, the situation remains quiet. Patience is advisable in this environment.

- In September, global central banks cut interest rates 21 times. Despite the absence of an obvious looming risk many central banks are expected to continue on this path into 2025. Unfortunately, the downside is weakening currencies and, eventually, accelerating inflation.

- The back half of the year for Canada remains poised for an acceleration in year-over-year growth and we expect to see re-acceleration in inflation. Canadian equities remain attractive destinations of capital in comparison to US equities.

- Markets remain, understandably, concerned with the pace of improvement in reported CPI, health of the labour market, and the implications for the FED's rate cutting cycle. Corporate earnings appear to be improving, and an accommodating FED support allocations to energy, industrials, rate sensitive utilities and REIT's, and high quality select growth opportunities focusing on investible volatility.

In the U.S., reported Headline CPI for September came in at +2.44% Y/Y, versus 2.59% Y/Y previously, and 0.1% lower month over month. Recall, Headline CPI measures the total change in the cost of all goods and services purchased by households. This includes all categories, such as food, energy, housing, apparel, transportation, medical care, recreation, education, and other goods and services. Food at home inflation increased by 1.3% in September, accelerating from 0.9% in August. Food away from home decelerated by 10bps sequentially to 3.9% Y/Y. In contrast, reported Core CPI excludes food and energy prices and includes all other categories, such as housing, apparel, transportation (excluding fuel), medical care, recreation, education, and other goods and services. Core CPI is often used by policymakers, like central banks, to gauge underlying inflation trends and to make decisions about monetary policy. It is considered, by them, an appropriate measure for setting interest rates because it is less affected by transitory price shocks, such as weather conditions and geopolitical events. Core CPI came in at +3.3% year over year, versus +3.2% year over year previously. Despite inflation being above their 2% target, the FED cut its benchmark interest rate by 50bps on September 18th, easing monetary policy for the first time in four years. This lowers the interest rate target to a range of 4.75% to 5.0%.

August (September not yet released) Canadian reported Headline CPI data came out at 2.0% Y/Y. Grocery inflation in Canada increased by +2.4% Y/Y in August, accelerating from +2.1% in July. Grocery inflation remains a real concern in Canada and continues to be a larger political issue than in the U.S. and has drawn more public scrutiny in Canada and a re-acceleration will bring the grocers more scrutiny. On September 4th the Bank of Canada cut its benchmark interest rate for the 3rd time this year by a further 25bps, with it's benchmark rate now settling in at 4.25%. It is being reported this decision reflects the central bank's observation that inflation is under control whereas we would point out that inflation is cumulative and the Bank of Canada should be held accountable for poor decisions made since 2020.

In the U.S., cumulative inflation since 2020 now sits at 21.83%. This means that today's prices are 1.2183 times as high as average prices since 2020. In Canada, cumulative inflation since 2020 is 15.95%. This means that today's prices are 1.1595 times as high as average prices since 2020. Inflation is a regressive tax, impacting households regardless of income, yet doing so with varying degrees of relative magnitude, is gradual and cumulative. As such, disinflation from record-high price levels offers little relief. Cost of things are not deflating; they are simply inflating less. Inflation for each person is individualized and cumulative. Real inflation simply means the destruction of the purchasing power of the currency. Inflation remains a huge concern in the real world. Consumers are not focused on what Wall Street is focused on which is the rate of change from M/M, Q/Q, Y/Y or the different categories. They are focused on the level of inflation on ‘needs’ and ‘wants’ and how things are drastically more expensive then they were pre-Covid. The level of arrogance out of the FED, Washinton, Ottawa and the Bank of Canada is at all time highs (rising money supply and ridiculous deficit spending leads to persistent inflation prints). Inflation only falls when there is a reduction in aggregate demand. And if that is taking place, the consumer is not in good shape. The point is underlying inflation has remained elevated and the cumulative decline in purchasing power of US dollars and CDN dollars remains a major concern for consumers and investors.

Looking ahead, central banks may regret not staying disciplined as we may have a more interesting re-acceleration inflation setup supported by rising commodity prices. The back half of the year for the U.S. remains poised for a deceleration in year-over-year growth and expect to see re-acceleration in inflation most likely beginning November, December and quite evident by 1st quarter 2025. The FED thinks we are headed to 2% when in fact we are more likely to head towards 3 plus%. The importance of the re-acceleration is the effect it will have on the FED’s rate cutting cycle decisions. Wall Street has the FED cutting rates aggressively since it sees 2% inflation whereas we have them slowly cutting rates (start/stop) since we believe inflation re-accelerates from here. Again, we focus on cumulative inflation and the rate of change along with GDP and monetary policy which dictates our core holdings and where we like to adjust our positioning. An escalation in the Middle East, global coordinated monetary policy easing, barrage of stimulus coming out of China, global shipping cost increases are all inflationary pressures. As a result, we may see more rate cuts removed from market expectations at future FOMC meetings.

The outlook for U.S. inflation to retreat and stick to 2% this year is not particularly encouraging all while the government's deficit is on track to balloon further. The official unemployment rate has risen from 3.4% to 4.1%, which while still low in absolute terms, is on an upward trajectory. The trade deficit is widening. And Washington and Central Banks can say publicly as they wish, inflation is caused by easy money policies and money printing, full stop. The quicker market participants accept this conclusion the less disappointed they become. As inflation moderates, for the moment, and as the labor market softens, the FED’s mandate is shifting from being entirely focused on fighting inflation, to a more balanced approach of managing employment and growth all the while monitoring inflation. Therefore, they have begun cutting interest rates even as inflation remains above their 2% target. The large fiscal deficits and a weaker consumption economy will likely lead the FED to go back to balance sheet expansion to keep U.S. Treasury markets liquid and stable, and to keep the banking system smooth and well-functioning with ample reserves. If the FED continues to cut rates aggressively it is because they have advance knowledge of deteriorating data and reduction in demand by the private sector. And finally, to add to the confusion, the FED had never taken aggressive action on cost of money and supply of money in an election year. We say, don't be fooled, as the FED cuts it will not be because they believe inflation is headed to their 2% target. We have been saying for a while now, the reason why interest rates get cut is more important than the when. If economic growth is positive, inflation stabilizes, and employment rates don't deteriorate materially then the FED will not have a reason to act aggressively in cutting as they did in raising. Instead, the FED should be patient.

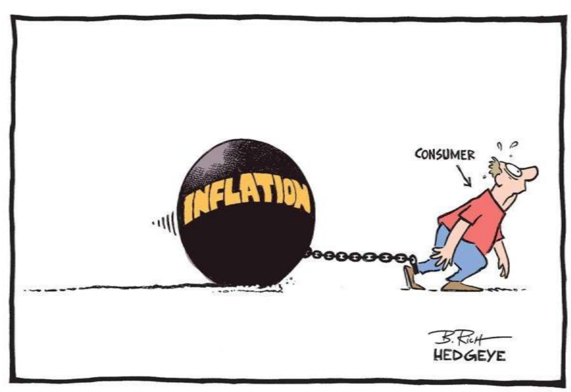
For period ending September 30th, the market cap-weighted S&P500 is up +21.9%, the TSX300 is up +17.0%, and the equal weight RSP500 has managed to climb +14.9%. The S&P500 is a clear example of market cap distortion, where a heavily concentrated index can be significantly skewed by the performance of just a few large companies. National Association of Active Investment Managers (NAAIM) member firms, consisting of active money managers, are asked to provide a number representing their overall equity exposure at the market close on Wednesdays each week. We like to use the index as a contrarian indicator when it reaches extreme levels, either above 100% or below 40% exposure to equities. Latest reading on October 9th came in at 90.26%, up from 85.44% when the quarter began. Of note, the lowest number in the year has been 53.54% (January 17th) and the highest number has been 104.75% (March 13th) with average for the year being 82.84%. These market participants are essentially near their peak exposure, they have nearly exhausted their buying capabilities, which means systematic funds will yet again be broadly inactive in the near term. Historically, this level of exposure has been a contrarian indicator, suggesting that high exposure often precedes slight market pullback as excessive optimism generally signals an overbought market ripe for a pullback. Volatility control funds and passive funds can have a significant impact on market behavior. With 3-month realized volatility still significantly higher than 1-month realized volatility and decreasing slowly, we're not observing substantial positive or negative flows from them. A meaningful reduction in 3-month realized volatility would likely reintroduce significant Vol Control buying pressure for equities. Once the uncertainty surrounding the election is resolved in early November, we should see these dynamics start to normalize. For now, the situation remains very quiet. However, now that a combination of longer-term risks is building in the market, including both the US elections and the rising geopolitical tensions in the Middle East, we're not surprised to see higher volatility come into play. One of the primary themes that has guided a lot of our investment decisions, is the concept that the capital markets are in the process of elevated volatility. For Q4, we expect slower moves to the upside and faster moves to the downside.

The only reason to be adding risk is when the interest-rate narrative is perceived to be improving, or if the markets reach an oversold/pessimistic extreme. The FED is obviously paranoid on CPI prints, and now beginning to worry about economic growth. The FED has spent a year or so relentlessly preparing market participants not to expect rate cuts until inflation printed 2pct. Now they have changed their tune and have begun cutting in advance. No policy maker seriously committed to fighting rising inflation would publicly announce an intention to start cutting rates before even achieving their very own price stability target of 2%. Once again, without fail, the FED's credibility has come under pressure, and they may regret not staying disciplined. FED monetary policy has disappointed us for a long time, especially since COVID. Theoretically, if politicians were not appeasing today's voters with tomorrow's spending, we would not be in this battle to fight historically above average inflation levels. Governments around the world are collectively engaged in devaluing fiat currencies, eroding their purchasing power. Given this dynamic is nearly assured, that nations collectively will continue to print money and devalue their fiat currencies, it should come as no surprise that individuals and corporations are increasingly turning to gold, bitcoin, and real estate.

Macro is the principal risk to our outlook for the equity markets, particularly around the Federal Reserve's delicate balancing act of controlling inflation and not harming the expected trajectory of real economic growth. Up to now, markets are not behaving in any way as history has taught us. Governments have been able to paper over weakness in economic data. We have a situation where a government's fiscal policy has ended up dictating the direction of monetary policy. The US National Debt has exploded higher in recent weeks and is fast approaching $36 trillion. Since the Debt Ceiling was suspended 16 months ago the National Debt has increased by over $4 trillion. The United States' unsustainable budget deficit is a problem, and interest expenses are rising because the government rejects any form of budget discipline. The Interest Expense on US Public Debt rose to a record $1.13 trillion over the last 12 months, more than doubling over the past two years. At the current pace it will soon be the largest line item in the Federal budget, surpassing Social Security. With employment levels still robust and inflation still above their target of 2pct, cutting rates by 50bps can only be explained away by saying their decision was directly correlated with the fact the Federal Debt levels are becoming so high and bond yields again soaring and global demand for

US Treasuries are declining. US Debt-to-GDP has climbed very rapidly to around 100% in 2024, an increase from around 35% in 2007. Fiscal deficits require the Treasury to find buyers for the debt. Federal debt held by Foreign and International investors has been in steady decline since its peak of 33% in 2007 and now stands at 22%. This printing of money to fund the government's irresponsible spending is inherently inflationary. This is the opposite of what Washington and the FED is telling us. They will have us believe that we should not be worried about debt levels as spending can always be absorbed by international investors. This is simply not true and the recent trend from the high of 33pct down to 22pct proves this. This all means there is a diminishing confidence level in the US government and its ability to navigate its financial obligations (existing and upcoming unfunded committed liabilities) and the upcoming administration should not ignore these warning signs and continue to push the imbalances and patience levels of global investors. If future administrations continue to pile on the debt levels this will lead to a period of economic lack of activity, growth, and continued elevated inflation. The FED would then be forced to continue to finance government spending by purchasing government bonds, which can lead to even higher inflation. This contrasts with monetary dominance, where the central bank can independently set interest rates and control the money supply without being influenced by the government's fiscal position. The main macro headwind as we head into the last quarter of 2024 and beginning of 2025 is the markets began repricing a scenario of higher for longer rates with slowing growth and elevated inflation, in contrast to the prior view that there would be a rapid cut in rates.

With the FED beginning it's next major policy pivot and no let up in fiscal spending that goes alongside, the outlook for rising debt/deficits and dollar devaluation remain firmly entrenched across the intermediate and longer durations. The November elections appear to offer little guidance in that forward path as neither party appears committed in any real way to taming the debt or reining in spending. Hard asset reflation through dollar debasement remains a principal means to hedge. Dollar devaluation will lead to commodity reflation. We are positioned for unremarkable growth with inflation re-accelerating by being overweight technology (growth), industrials, energy, commodities, select emerging markets, and rate sensitive utilities and REIT's. The message from the bond market has been clear, higher for longer on both inflation and yields. We are in extraordinary times. Patience remains our core allocation.



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Sincerely,

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The Portfolio Management Team