iA Clarington Investments

2022 Market Outlook

iA Clarington™ Investments

Year Ahead 2022

It is a fascinating time for the global economy. We are coming off a pandemic, close to eight billion vaccine doses have been administered worldwide as of this writing,[1] the world has broadly reopened (but cases are still surging in some spots), and consumption of goods is back in full force. The global supply chain, being as tightly knit as it's ever been, is now under a lot of stress and the hottest data point is the number of ships waiting at anchor in global ports. And then there's inflation – the logical consequence of the sequence of events over the last two years – which is sitting at a 30-year high despite ample slack in the labour market.

If 2020 was the year of the virus (alternatively, the year of the stimulus) and 2021 was the year of the vaccine, it would be fair to label 2022 as the year of uncertainty. There are no comparable years in the history books to guide an economist in his forecasting exercise right now, and so much hangs on how the Federal Reserve (Fed) navigates through the fog.

So, let's fall back on the known facts. First, consumers are flush with cash in the developed world, and spending should remain healthy. Businesses are willing and able to invest more in their production capacities and inventories, meaning that absent another major shock – from the omicron variant, for example – global GDP should continue to chug along. Global equities are also well positioned for further gains, as earnings on the MSCI All Country World Index[2] are expected to grow about 20% in 2022. Global rates should continue to climb, as many central banks have already started tightening their policies.

Against this backdrop, the U.S. economy is somewhat of an outlier, with a red-hot consumer that has been fueled by probably one-too-many stimulus packages in early 2021. We feel that inflation worries are more warranted south of the border, as the U.S. is now dealing with a demand problem on top of the global supply chain issues, leading to empty shelves and skyrocketing used car prices. The Fed, with its dual mandate of price stability and maximum employment, is stuck between the proverbial rock and a hard place, and its course of action will weigh heavily on risk sentiment next year. Tapering of quantitative easing has finally started and should run through the summer, while rate hikes should follow in the back end of the year. How many hikes will we see? It's uncertain, but right now we're anticipating one or two.

In our view, the Canadian economy (and market) should continue to shine in 2022, with its healthy labour market creating the bedrock for solid, sustainable growth. This backdrop also puts the Bank of Canada in a much easier stance to move ahead with some normalization of its monetary policy, and it should be well positioned to hike earlier, and at a faster pace, than the Fed. This bodes well for the loonie, which we would not be surprised to see hit 88–90 cents by year-end.

While the easy picking is clearly behind us, we still see the coming year as favourable for equities over bonds. Canada and emerging markets are well positioned to outperform, while the U.S. market already seems a bit expensive, in our view. As global rates remain historically low, 2022 could be another challenging year for bonds, although years of negative returns (like 2021) are uncommon. The key to adding value in 2022 will be active management and asset allocation, as well as a good dose of discipline.

– Sébastien Mc Mahon
Interim Chief Economist & Senior Portfolio Manager, Diversified Funds
IA Investment Management Inc.

Table of Contents

Dan Bastasic MBA, CFA

IA Clarington Investments Inc.

IA Clarington Strategic Corporate Bond Fund
IA Clarington Strategic Equity Income Fund
IA Clarington Strategic Equity Income Class
IA Clarington Strategic Equity Income GIF
IA Clarington Strategic Income Fund
IA Clarington Strategic Income GIF
IA Clarington Tactical Income Class

Where are the opportunities?

The script for investing could not have played out better than it has over the past 12 months. The overwhelming liquidity from monetary and fiscal policies helped fuel broad-based returns across most asset classes. The question going forward is: what will the backdrop for investing look like as liquidity declines and economies continue to normalize?

We think everything that peaked in the past year will revert to a higher mean in the coming year. In our view, economic growth and earnings growth will decline from year-ago levels but remain higher than the average growth witnessed pre-pandemic. Inflation will decline from the past year but remain higher than it was in the past 10 years while interest rates will be biased higher from current levels.

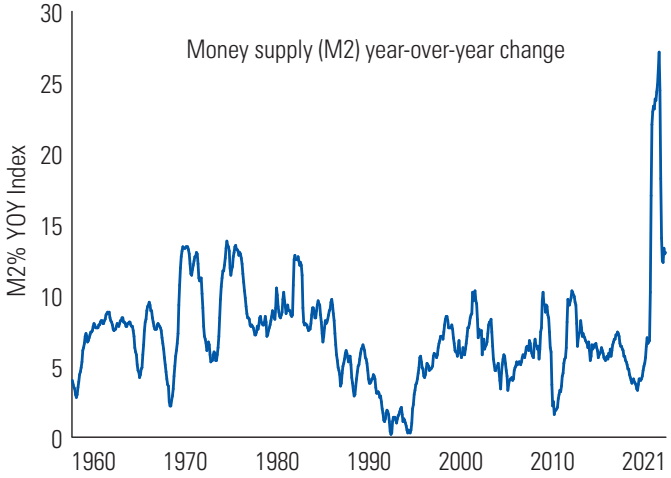
We are positioned for this scenario and believe we will find the best opportunities in sectors and companies correlated to economic growth. We will also have lower exposure to fixed-income securities at risk from higher interest rates.

Within equities, we expect to find many opportunities in the industrials and cyclical-related sectors as well as defensive dividend payers. Within fixed income, we still see relative value and superior yield potential in higher-yielding bonds versus investment grade bonds. If this scenario plays out as we expect it to, it should lead to an appreciating Canadian dollar as we approach year-end in 2022.

What are the challenges?

Despite unprecedented fiscal and monetary support, as the economy and earnings normalize, markets will be vulnerable to declines from peak levels of growth coupled with valuations that have not yet fully priced in higher interest rates or inflation.

Money supply growth has peaked



Source: Bloomberg, iA Clarington Investments. As at October 31, 2021.

Although timing this adjustment is a fool's game, we expect the first half of the year to be positive overall for returns while the second half will be ripe for this adjustment period to fuel short-term and periodic volatility. We fully expect at least a couple of periods of high volatility with ensuing market corrections as we normalize on many fronts over the next two years. Security selection and allocation will be key to managing risk-adjusted returns during the coming year.

How are you positioning the funds?

Our overall positioning – broad exposure to equities complemented by a higher allocation to high-yield bonds – has not changed materially during the past 12 months. We did adjust our specific positioning within those markets by reducing foreign exposure in favour of Canada, increasing specific security exposure in cyclical parts of the market and reducing exposure to investment grade bonds in favour of higher cash levels.

We enter the beginning of the year with the portfolios tilted towards dividend-paying defensive securities, financials and higher cash levels. Our currency exposure is currently mostly hedged.

Why is this the right approach for 2022?

We strive to produce the best possible risk-adjusted returns over time, and while conditions are favourable for continued positive economic and earnings growth, we believe the most effective approach is to emphasize companies with stable and growing cash flows and dividends while gaining exposure to securities with lower business sensitivity to rising interest rates and inflation. We believe it will be important to hedge foreign currency exposure as the year progresses while focusing on yield from high-yield bonds and undervalued dividend-paying equities.

Jean-Pierre Chevalier CFA

Senior Portfolio Manager, U.S. Equities

IA Investment Management Inc.

IA Clarington Canadian Leaders Class

IA Clarington Global Value Fund

IA Clarington Global Value GIF

IA Clarington Thematic Innovation Class

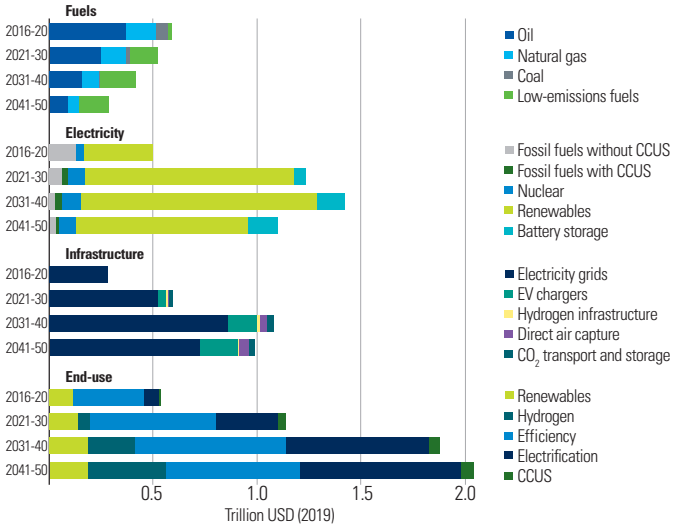
Where are the opportunities?

U.S. equity markets continued their strong performance in 2021 as earnings growth materially surprised to the upside. On the economic front, fiscal policies remained supportive, creating a surge in demand for goods that resulted in supply chain bottlenecks and rising inflation.

A few big themes were top of mind this year. First, the broadening impact of the digital revolution, which transforms non-tech industries, was a big factor in helping companies better execute in this environment. Second, the energy transition and its long tail of capex-heavy decarbonization opportunities is becoming more and more a reality and also has the potential to introduce significant volatility in the commodity complex. We see opportunities spanning decades around the technologies enabling the energy transition (see chart). Lastly, the emergence of Web 3.0 (i.e., digital assets) and the eventual next computing platform (i.e., Metaverses) are still in the early stages, but have real potential to change the status quo and unleashing disruption along the way.

The path to net zero

Global average annual energy investment needs by sector and technology based on IEA's Net Zero pathway



Source: International Energy Agency (IEA), November, 2021.

As we move into 2022, we also see opportunities revolving around the upcoming enterprise spending boom. We already have good visibility on a record level of capex from the semiconductors industry, the public cloud buildout, and the telecom sector. We continue to favour cybersecurity as well, as the critical nature of digital infrastructure justifies massive investments on

that front. Automation should also be favoured in this environment, either from a software perspective or from the need to modernize outdated equipment.

We look to balance these opportunities with positions that reduce the overall risk of the portfolio while still offering attractive performance potential. For example, we like the traditionally defensive health care sector, which has underperformed significantly since mid-2020. We think an environment of declining fiscal and monetary support, reduced political pressures and an historical discount to the rest of the market bodes relatively well for the sector.

What are the challenges?

It appears that the pandemic is morphing into an endemic situation. How governments and societies deal with this in terms of its economic impact will remain a challenge going forward. Fiscal policy actions in response to the pandemic were mostly considered emergency measures, which means they should sunset and create a headwind to growth over the next two years. The same could be said about the monetary response, as central banks are trying to phase out quantitative easing and return to a path where they are able to raise rates. In that environment, and as long as supply chain bottlenecks get resolved gradually, we think inflationary pressures should remain under control. Over the medium term, if inflation settles at a slightly higher level, it will be mostly positive for the equity market, as many companies would be able to execute with higher pricing power. There is a risk of an overshoot in the near term, especially if the winter is colder than usual and commodity prices rise further. Productivity could be accelerating, while intellectual property investments, patent applications and new business formations have all been accelerating since last year.

Market valuation is elevated on a historical basis from a price-to-earnings perspective, but it's important to remember that the equity market's valuation is inversely correlated to the level of interest rates on a non-linear basis. That makes the multiple very sensitive to any significant move in interest rates.

So far, the great retirement in the labour force seems to be offsetting reflationary pressures. In this environment, positive earnings growth surprises will be a key driver of returns and we think U.S. companies will benefit greatly from the digital revolution, resulting in a greater ability to convert earnings into free cash flow, which enables a higher level of capital returns and the ability to invest for growth.

How are you positioning the fund?

IA Clarington Thematic Innovation Class is a U.S. equity mandate that invests in companies in all sectors that benefit from technological advances or prosper in a perpetually changing environment. This is a well-diversified strategy, making it possible to have a strong focus on risk management while benefitting from a deep understanding of long-term innovation themes.

We construct the portfolio with a barbell strategy. On one side, we like to have exposure to innovators and keep between 5–15% in small/mid-capitalization names. Each position needs to make sense from a risk and return point of view. We currently see pockets of overvaluation in some themes, such as electric vehicles and artificial intelligence hardware, and think our active approach of avoiding these deteriorating return propositions could result in alpha. On the other end, we go with dominant firms where we currently see more opportunities in some defensive sectors, such as health care, and in companies that have historically showed a higher level of pricing power.

Why is this the right approach for 2022?

Over the medium term, we are becoming more selective regarding our allocation to large technology companies. We think we are still early in the themes of the last decade – mobile internet, e-commerce, cloud computing and digital advertising – which means many years of strong earnings growth potential still lie ahead. At the same time, a growing number of headwinds from regulation and technology (e.g., Web 3.0) are becoming a reality.

As business models become proven and reach attractive levels of profitability, we seek to gradually increase our allocation to what we consider the themes of the next decades: the energy transition, robotics, automation, AI-Genomics fusion, next-generation computing platforms and Web 3.0. Doing this too soon would increase our risk in a disproportionate way, while investing in old-economy business models facing disruption is also not an option.

Our focus is on risk management and stock selection. Position sizing is very important for us and we apply strict guidelines to keep a strong discipline and prevent emotions from getting in the way. We think investing is about the future and will continue to work on our unique thematic style while incorporating our differentiated view of what lies ahead.

Sébastien Mc Mahon MA, CFA

Interim Chief Economist & Senior Portfolio Manager, Diversified Funds

Tej Rai

Senior Vice-President, Asset Allocation

IA Investment Management Inc.

IA Clarington Monthly Income Balanced Fund
IA Clarington Balanced Portfolio GIF
IA Clarington Moderate Portfolio GIF
IA Clarington Growth Portfolio GIF
IA Clarington Monthly Income Balanced GIF
IA Wealth Conservative Portfolio
IA Wealth Moderate Portfolio
IA Wealth Balanced Portfolio
IA Wealth Growth Portfolio
IA Wealth High Growth Portfolio
IA Wealth Enhanced Bond Pool

Where are the opportunities?

With equities sitting at all-time highs, and earnings expectations being rather aggressive, we strongly believe that our value-added in 2022 will come from being active and tactical. The economic recovery stemming from vaccinations and reopenings have long since been priced in, so country bets, sector bets, style bets and currency hedging should all play a central role. With interest rates on the rise and central banks normalizing their monetary policies, it's fertile ground for cyclicals and value, leading us to look quite favourably towards Canada and emerging markets as potential growth leaders. Within the emerging markets space, the strength of China's economy and, in particular, its credit cycle will be key indicators to watch as we assess the global economic cycle in 2022 (see chart).

Global manufacturing PMI vs. China credit impulse

Source: iAIM and Bloomberg, as at November 25, 2021.

What are the challenges?

It is hard to remember a time when there was so much uncertainty surrounding the global outlook for key macro variables. How important will the new omicron variant be, especially given China's COVID-zero policy? Is inflation transitory, and if so, how long does "transitory" imply? Most importantly, what will be the reaction of the central banks, especially the Federal Reserve, to inflation developments? Playing this story right will be key to picking the right themes in 2022.

We remain concerned about the diverging opinions that characterized financial markets in the fourth quarter of 2021, especially when it comes to the outlook for inflation and the impact of new COVID-19 variants. Picking the right themes and being disciplined will have to be, once again, front and centre.

How are you positioning the funds?

As we enter the new year, our strategy will be to overweight equities and underweight bonds. The backdrop remains favourable for equities to outperform fixed income in 2022, although by a much slimmer margin than in 2021. The outlook for commodities remains attractive, as global growth should be strong, leading us to favour Canada and emerging markets.

With the current level of inflation, both fixed income and cash offer mostly negative real returns, and the real yield curve could spend most of the year below zero. The prospects for tighter monetary policy could mean higher rates during the year, opening interesting investment opportunities, but more importantly pushing the Canadian dollar higher, leading us to partly hedge our exposure to foreign currencies.

Why is this the right approach for 2022?

It will be a year filled with new flavours of macroeconomic events, from the emergence of new strains of COVID-19 and the reaction of governments, to central banks removing stimulus, to strong inflation being a risk for the first time in decades, to equities sitting at all-time highs. We continue to believe that the best way to navigate these complex environments and add value through active asset allocation is to combine our deep fundamental expertise with robust data-driven insights. We believe the key to success in 2022 will be an integrated and risk-managed approach featuring sound long-term strategic asset allocation, tactical adjustments in response to the evolving macro landscape and consistent added value from a diversified suite of internal and external managers.

Alexandre Morin CFA

IA Investment Management Inc.

IA Clarington Bond GIF
IA Clarington Money Market Fund
IA Clarington Money Market GIF
IA Wealth Core Bond Pool

Where are the opportunities?

Demand boomed in 2021, supported by massive fiscal support and the fading of pandemic-related concerns. The supply side of the economy struggled to meet that demand, particularly for goods, which pushed inflation up to levels not seen in decades. Although supply bottlenecks in the goods sector appear to be easing – something that should continue in 2022 – the supply of available labour is getting scarcer heading into next year.

The U.S. and Canadian economies are expected to deliver above-trend growth in 2022, with broad support from consumers, businesses and government. With labour demand expected to remain strong, this should further lower the unemployment rate and boost wage growth. Thus, in the U.S., the preconditions for raising rates – a small inflation overshoot and maximum employment – should be met. If all goes according to the Federal Reserve's plan, asset purchases will be completed in the middle of next year.

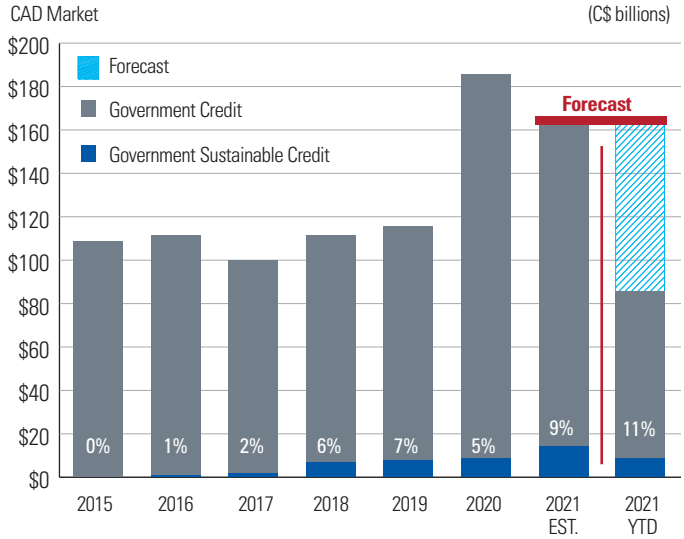
In Canada, the central bank is clearly indicating its discomfort with the high level of inflation witnessed since the beginning of the year. It already ended its bond buying program in October. We project that the Bank of Canada will raise rates in Q2, while the Fed will start in Q3.

In our view, bond yields will likely move upwards in 2022, and even if this does not happen in a straight line, we will favour a shorter duration in our portfolios relative to our benchmarks. We see 10-year bond yields breaking above 2.00% in the coming year, ending 2022 in the vicinity of 2.00–2.25% in both the U.S. and Canada.

The search for yield is alive and well, so we expect corporate bonds to post strong performance on a relative basis in 2022. Expectations for above-trend economic growth and higher yields will also be supportive of that segment of the bond market.

Finally, environmental, social and governance (ESG) investing is gaining more and more traction, with the volume of new issue activity increasing rapidly year after year (see chart). A recent JP Morgan survey showed that within fixed income, the ESG category will see the highest allocation increases in 2022. We continue to refine and apply our ESG methodology to our portfolios and believe it will yield superior alpha potential over time.

Sustainability as a percentage of government credit issuance



Source: BNS Dealstore, as at July 6, 2021.

What are the challenges?

One of the main challenges is the fact that most people expect bond yields to go up in 2022. Consensus views can bring strong market reactions in the case of an unforeseen event. The omicron variant reminds us that we are not out of the woods yet with this pandemic. If a vaccine-resistant variant emerges, governments could be forced to reintroduce general lockdowns. In that case, central banks could not afford to stop their quantitative easing programs, keeping long-term interest rates lower for longer.

If inflation keeps going up, it could make the Fed nervous about its view that the uptrend is transitory. In this case, there is a possibility that the Fed tapers its asset purchasing program more rapidly than expected. This would be a signal to the bond market to expect an earlier and faster overnight rate hiking cycle, bringing long-term interest rates way above target.

As always, politics and geopolitics can surprise the markets. The debt ceiling debate is still not resolved in the U.S. and the Biden administration's Build Back Better plan has not been signed into law. Also, tensions between the U.S. and China, while less severe than under the previous administration, are still a matter of concern. Finally, tensions are rising between Russia and Ukraine with reports of the Russian troop build-up at the border.

How are you positioning the funds?

As mentioned above, we expect bond yields to increase in the coming year. Consequently, we will have a shorter duration versus our benchmarks. As always, we will stay nimble in our management of duration, which will be done via Canadian, U.S. and other interest rate markets. Also, in the context of a flattening yield curve, we will express our short duration bias via intermediate-maturity bonds.

We will be overweight corporate bonds in 2022, as we think this asset class should do well on a relative basis in a rising yield environment. We will also have exposure to various U.S. credit products, such as corporate securities with a maturity of less than five years and high-yield corporate bonds. The aim is to benefit from their excess return potential and the depth and diversity of issuers in these markets compared to the Canadian corporate bond market.

We continue to like the ESG bond market and think it could provide us with good returns for our clients in 2022. We will continue to actively participate in the new issue market to show our commitment to ESG-minded issuers.

Finally, we expect to be overweight Province of Quebec non-rated municipal bonds throughout the coming year, as they provide a good carry and have low interest rate risk.

Why is this the right approach for 2022?

As usual, we will be particularly nimble in the changing environment of 2022. We will focus on liquidity and hold multiple active positions at the same time, giving us flexibility with the level of risk in the portfolio as well as the ability to quickly adjust our positioning if necessary.

We will maintain our core strategy of maximizing the risk/return profile of the funds while positioning them in accordance with our strategic views. In summary, our approach for 2022 will be to protect our portfolios from potential increases in long-term interest rates while taking advantage of relative value trades and the risk premium offered by credit securities.

Donny Moss CFA

IA Investment Management Inc.

IA Clarington Canadian Dividend Fund
IA Clarington Dividend Growth Class
IA Clarington Dividend Growth GIF
IA Clarington U.S. Dividend Growth Fund
IA Clarington U.S. Dividend Growth GIF

Where are the opportunities?

It has been a great year for the North American equity market, driven by very strong corporate earnings as we continue to emerge from the pandemic. As we predicted in this piece last year, sector returns were more evenly distributed, with energy leading the way after a tough year in 2020.

Looking out to 2022, we feel that financials and energy will remain relatively attractive, as both sectors are enjoying tailwinds that we believe should continue. Within financials, we believe the Canadian banks are set up nicely, as reserves are still being released from 2020 and loan growth is accelerating, while rising interest rates may be an additional benefit. Another tailwind for financials is the recent removal of restrictions against dividend increases and stock buybacks. We have already seen substantial dividend hikes from the insurers, with more expected from the banks when they release their earnings in December.

Within energy, the obvious focus is on commodity prices that have strengthened materially throughout 2021; however, that is only part of the story. What we have found most interesting is the change in capital allocation priorities from management teams, who have finally heeded calls from investors to slow growth, begin to repay debt and return cash to shareholders. We believe this approach will make the sector more interesting to investors, which could help improve the low valuation multiples and perceived risk.

What are the challenges?

The equity market is usually required to climb a "wall of worry" – as it reaches new highs, an increasing list of items usually appears for us to be concerned about. For example, in 2020 and early 2021 we obviously worried about COVID-19, then we worried about the timing and availability of vaccines, then we worried about equity valuations as the market recovered quickly. As we sit here in late 2021, several new challenges have appeared, including inflation, supply chain bottlenecks, a fifth wave of the pandemic this winter, the prospect of interest rate increases in 2022, and labour participation.

Of these, inflation is arguably the most important issue and, unfortunately, also the hardest to predict. We are already noticing a premium being placed on companies that are either marginally affected by inflation, or those that have strong pricing power. These companies will be able to pass on increased input costs and higher wages in order to keep their profitability intact, while companies that are unable to pass these costs along could be punished.

Another test for the market in 2022 may come when we start lapping the tremendous results seen in 2021. With the vast majority of companies beating earnings estimates for the past few quarters, valuations actually look reasonable, as earnings have grown faster than the

equity market. If we move to a more normalized level of earnings growth, the positive surprises will decrease, and this could make it challenging for equities to continue to push higher.

How are you positioning the funds?

Our investment strategy is bottom-up and focuses on finding well-managed companies with durable competitive advantages that can grow dividends over the long term without using excessive leverage. To achieve this, we use an in-house valuation model that focuses on cash flow and gives us the ability to forecast several scenarios over a longer time horizon. We run a concentrated portfolio and generally have low turnover.

In terms of positioning, we aim to keep our sector exposure close to neutral where possible and attempt to add value through stock selection. Our mandates in Canada and the U.S. have a large-cap dividend focus, which means our funds will usually be positioned as slightly defensive and conservative versus the index.

Within our Canadian and U.S. mandates, we continue to have a healthy weight in financials and believe this sector can continue to work well in 2022, with loan growth accelerating and rates becoming a tailwind instead of a headwind. Also, and as discussed, in the energy sector we are seeing a very positive change in capital allocation priorities from management teams. This is leading to substantial improvement in debt levels, dividends and even share buybacks from many companies. We think the set-up is interesting, as energy valuations in Canada are still at historical lows. It is also important to point out that Canadian energy firms collectively have the highest environmental, social and governance (ESG) scores in the world. As a result, we increased our energy exposure materially in early 2021, as we had been substantially underweighting the sector for years.

Outside of these sectors, and as a result of the focus of our process, our investment universe will consist of companies that should fare well in the current economic environment. Well-managed companies with durable competitive advantages will have an easier time retaining employees, raising prices for their goods or services where necessary, controlling costs, and ensuring that supply chain disruptions are kept to a minimum. We believe these issues will be important in 2022 and expect that the companies in our portfolio will be ahead of the curve in managing them.

Why is this the right approach for 2022?

The nature of our mandate and stock selection process naturally tilts toward a conservative stance and one that is close to sector neutral. However, it is important to note that our investment time horizon is long, as most stocks in our Canadian fund have been held for over 15 years. Therefore, our overall positioning doesn't change much from year to year, as we aim to buy good companies and hold them for a very long time. We feel that the consumer remains in good financial shape, and this should help power GDP growth in the U.S. and Canada at above-average levels. We remain very positive on Canada, as valuations remain modest even after a 25% gain in 2021, as earnings have grown even faster (see chart). For this reason, we have lowered the U.S. weighting in our Canadian mandates, as we feel the set-up for Canada is more interesting.

Strong earnings growth has helped valuations: S&P 500 holding steady, while the S&P/TSX continues to get cheaper

Source: Bloomberg, as at November 26, 2021. Price-to-earnings ratios are blended estimates, based upon a weighted average of the most recent earnings per share and the closest forecasted values.

We believe the outlook is positive for dividends and dividend growth after a blip in growth due to COVID-19. The main reason for this outlook is the strength of earnings growth we have witnessed, as the trajectory of dividends usually follows earnings. It may be easy to overlook the importance of dividends when the market has performed so well; however, it is important to point out that dividends still comprise 30% of total returns over the long term. In addition, dividend growth for the S&P 500 and S&P/TSX has averaged over 5% per year for the past 30 years, and we feel this growth rate will be exceeded over the next few years. The growth in income within a portfolio will become very important as investors look to offset the higher levels of inflation we are currently experiencing.

Aziz V. Hamzaogullari MBA, CFA

Loomis, Sayles & Company, L.P.

IA Clarington Loomis U.S. All Cap Growth Fund

Where are the opportunities?

We believe the best opportunities are those few high-quality businesses with sustainable competitive advantages and profitable growth, which trade at a significant discount to our estimate of intrinsic value. We are an active manager with a long-term, private equity approach to investing. Our proprietary seven-step research framework is the cornerstone of our investment decision-making process and relies 100% on bottom-up, fundamental analysis. As a true fundamental manager, we build our portfolio stock by stock. Our outlook at any point in time, therefore, is tied directly to the businesses that we own and not on a generalized view of economic or market conditions.

Ultimately, our job as an investment manager is to allocate capital to what we believe are the most compelling reward-to-risk opportunities – those with attractive upside relative to our assessment of downside risk. Therefore, the more attractive we view the reward-to-risk opportunity, the larger our capital allocation and position weight. As a result, our top 10 positions represent what we believe to be the most compelling reward-to-risk opportunities. For alpha generation, the pursuit of greater upside potential and managing absolute levels of risk are inextricable goals. Each tenet of our investment philosophy and process is designed – individually and collectively – to promote this dual objective for our investors.

What are the challenges?

Over the last 18 months, we have witnessed a material shift in the market's appetite for risk that we believe is most analogous to the behavior we observed in the dot-com era of the late 1990s and early 2000s and the financial crisis and energy bubble in 2008. Due to what we believe to be short-term investor infatuation with companies seen as benefiting from the "work-from-home" environment, the market is placing an outsized and historically high premium on low-quality stocks that are considered to have the highest growth prospects.

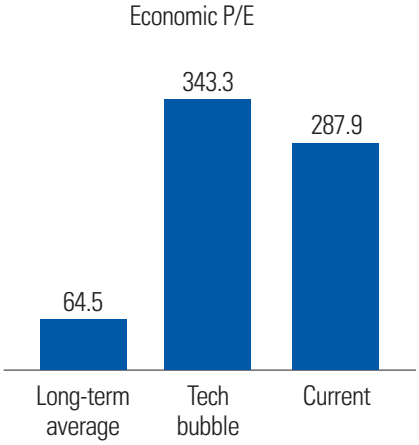
We do not contend, however, that just because these companies have experienced a significant run-up that they must therefore be in a bubble. Importantly, we arrive at this conclusion from a bottom-up perspective. That is, we take a long-term structural view that looks beyond simple valuation metrics and asks what cash flow growth expectations must be embedded in these companies to justify their current prices – let alone any further upside potential.

Our conclusion about today's high returners is similar to the answer we would have given back in 2000 and 2008: we believe the embedded expectations are unrealistic and unsustainable over the long term. In our experience, periods when market leadership has been similarly concentrated in a narrow group of companies expressing a popular theme are typically precursors to major inflection points and substantial corrections in those high-flying companies. In both 2000 and 2008, these

companies suffered significant corrections at a time when both the benchmark and our peer group had substantially elevated exposures.

Credit Suisse HOLT similarly identified inflated expectations in a cohort of stocks that it labeled as "hyper-growth," representing more than 10% of the 1,000 largest U.S. companies by market capitalization. On the basis of "economic price-to-earnings (P/E)," which measures the price paid by all capital providers per dollar of net operating cash flow, they estimated the cohort was trading at a multiple of 288x economic P/E – a level that approaches that of a comparable cohort at the height of the tech bubble, and is over 4.5x their assessment of the long-term market average for hyper-growth companies. In other words, investors are paying multiples per unit of growth that are extremely high relative to long-term history.

U.S. "hyper-growth" valuations hover near tech bubble levels



Data source: Materials provided by HOLT with permission as of August 2021. The hyper-growth group is designed to identify early lifecycle growth companies, committed to high rates of reinvestment but showing limited profitability due to the pursuit of growth. These firms often represent innovative products and technologies that are still scaling.

We believe efforts to precisely predict the timing, duration, and magnitude of any market correction, macro factor, or company-specific idiosyncratic event is futile. The good news is we believe one need not predict these events to be prepared for them. The best preparation requires, in our view, a consistent and disciplined ability to do the right thing every day, and that means allocating capital rationally based on informed views of reward-to-risk.

How are you positioning the fund?

Our disciplined quality-growth-valuation process leads us to avoid lower-quality names. Doing so requires the patience and temperament to be a contrarian who can buy into fear and sell into greed. It is not easy to stand alone, apart from the crowd. Because we approach investing as if we are buying into a private business, a long investment horizon is central to our philosophy. In our view, a long investment horizon affords us the opportunity to capture value from secular growth opportunities as well as capitalize on the stock market's shortsightedness.

Therefore, we attempt to identify intrinsic value and exploit the long-term differential between this value and the market's current perception. We measure and monitor our long-term investment thesis for each company through bottom-up analysis of a company's fundamentals, not by the fluctuation in daily stock prices. Our approach always looks beyond the current environment. What's happening today or on a daily basis does not dictate what we will do for the long term. What is happening in any given environment becomes relevant to the extent that it provides us with attractive investment opportunities.

The nature of our process leads to a low-turnover portfolio where sector positioning is the result of stock selection. We believe that diversification using traditional sector definitions can mask high underlying correlations between stocks in different sectors that are nonetheless being impacted by similar business drivers, such as companies levered to growth in China in 2007 or "work-from-home" beneficiaries today.

At the portfolio level, we seek to enhance risk management by diversifying the business drivers to which our holdings are exposed. Because business drivers are imperfectly correlated, the positive impact of one may offset the negative impact of another. We believe this fosters more efficient diversification of risk, limits our portfolio exposure to any single business driver, and reduces the impact of factor risks such as momentum. Adhering to our investment process not only helps us manage downside risk but helps increase upside potential.

Why is this the right approach for 2022?

We seek to create a margin of safety when investing in a company by requiring at least a 2:1 anticipated upside-to-downside, reward-to-risk opportunity. Holding all else

equal, the larger the discount between market price and our estimate of intrinsic value, the greater we view our margin of safety. Counter to the buy discipline of many growth equity managers, we believe the risk of investing in a great company is actually lower after its stock price has fallen, assuming our long-term investment thesis remains intact. Over time, as embedded expectations change and converge with our estimate of intrinsic value, positive returns are generated. Adhering to this discipline helps us manage downside risk.

Our investment philosophy represents our fundamental beliefs regarding the most effective way to generate alpha and leverages our understanding of persistent anomalies that create asset mispricing. These beliefs, or tenets, form the cornerstone of our investment decision-making process and can be linked to performance proof points, demonstrating continuity from belief to process to outcome. Collectively, this integrated system forms our alpha thesis. We believe that for any alpha thesis to potentially meet its objective, it should be founded on an enduring philosophy and persistent pricing anomalies. We think our alpha thesis is unlikely to be eroded through arbitrage because it is tied to perennial behavioral biases, not specific market conditions.

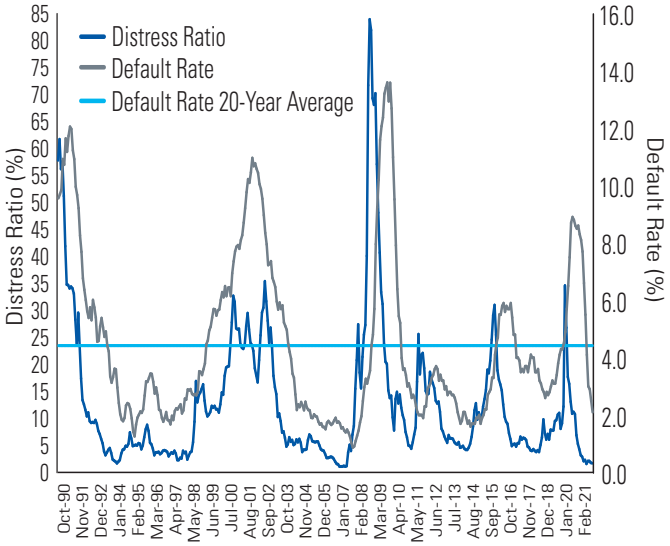
Matthew J. Eagan MBA, CFA
Brian P. Kennedy MBA
Elaine M. Stokes

Loomis, Sayles & Company, L.P.
IA Clarington Loomis Global Multisector Bond Fund

Where are the opportunities?

In our view, we are still in the expansion phase of the credit cycle, with credit fundamentals, technical factors and default expectations continuing to appear attractive (see chart). We remain positive on credit exposure for higher yields and believe that individual issuer selection will be key to delivering attractive performance in 2022.

"Distressed" securities and default rates have decreased since early 2010



Source: Bloomberg Merrill Lynch, as at October 31, 2021. Percent of bonds in Merrill Lynch High Yield Master Index with spreads 1,000 basis points over U.S. Treasurys.

Strong corporate profits, debt repayment, lower net issuance (including ratings migration) relative to 2020 and investors' strong appetite for yield should continue to provide a tailwind for credit markets, in our view. A positive macroeconomic backdrop in which financial conditions appear easy and both monetary and fiscal policies continue to be a tailwind for economic activity is also supportive of risk assets.

We believe that high-yield corporate bonds, because of their strong yield per unit of duration, and convertible bonds are well positioned for a rising-rate environment. Emerging market credit may present opportunities due largely to price weakness in Chinese property developers.

What are the challenges?

While our fundamental economic outlook remains positive, the world appears less synchronized than we expected at this point in the recovery. We are mindful of the risks inherent in our outlook, such as the lingering impact of the pandemic and the potential for a surge in reported cases, slowing Chinese growth (and deleveraging within its property sector) and ongoing global supply chain disruptions that could lead to a bumpier, if still solid, global growth environment.

Under our base case of a gradual economic expansion, we anticipate a slow rise in interest rates as the Federal Reserve (Fed) tapers quantitative easing (QE) purchases over the first half of 2022. Inflation continues to be

elevated, but in the Fed's view this is a consequence of transitory factors. We believe supply disruptions should work out over time and energy prices could ease in 2022, which would support the Fed's view. While we expect rate increases in 2023, the Fed may find it necessary to delay if growth is weaker or accelerate if inflation is persistently higher than expected.

How are you positioning the fund?

We are targeting sectors that have high yields, less interest rate sensitivity and positive convexity (a favorable risk/reward profile in a changing rate environment). As such, we currently favour high-yield corporates and convertible securities along with securitized debt, which can provide diversification away from pure corporate risk, relatively attractive yield potential and shorter duration profiles.

We are seeking out "rising star" candidates that possess strong balance sheets and catalysts to help drive ratings upgrades. We believe accommodative global monetary policies coupled with the tailwind of fiscal support could drive a wave of credit upgrades going forward. With regard to interest rate risk, we prefer to keep duration low at this point in the cycle, particularly our exposure to the long end of the yield curve, to minimize the negative performance impact should bond yields move higher in 2022.

Why is this the right approach for 2022?

In 2021, credit markets have generally been resilient to macroeconomic events, such as Fed tapering and concerns over Chinese growth and property sector challenges, suggesting that there is a strong demand for yield. We suspect this dynamic will likely hold going forward given our outlook for downgrades, defaults and losses to trend notably below long-term averages.

Given our macroeconomic expectations and credit cycle outlook, in our view embracing credit risk over interest rate risk is the right approach for 2022. We recognize, however, that valuations are elevated and credit spreads are through their long-term averages, and have built flexibility into our portfolios in seeking to take advantage of opportunities that may arise as a result of short-term disruptions.

Matthew J. Eagan MBA, CFA
Eileen N. Riley MBA, CFA
David W. Rolley CFA
Lee M. Rosenbaum MBA

Loomis, Sayles & Company, L.P.

IA Clarington Loomis Global Allocation Fund
IA Clarington Loomis Global Allocation Class
IA Clarington Loomis Global Equity Opportunities Fund
IA Clarington Loomis Global Equity Opportunities GIF

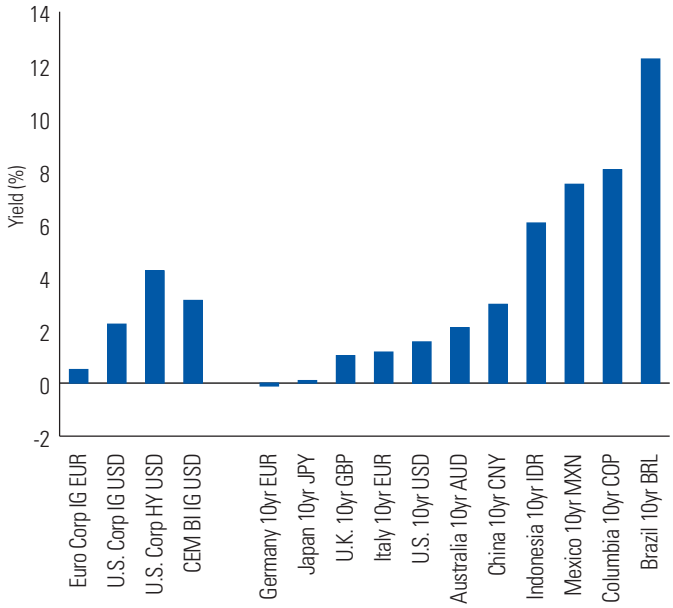
Where are the opportunities?

In equities, we are continuing to find opportunities in uniquely positioned technology companies, consumer companies capturing strong demand for e-commerce, and best-in-class physical retailers with a compelling value proposition. We have exposure to health care companies offering products and services geared toward higher growth areas, or greater revenue visibility and manageable reimbursement risk. We hold a diverse set of financial names with strong competitive positioning and companies across a range of industries with strong network effects.

In fixed income, we continue to favour name-specific high yield and crossover issuers with strong liquidity and solid balance sheets along with potential rising star candidates. We also remain selective on emerging market credit, where fundamentals are improving (in hard currency issues and specific opportunities in local currency issues). We remain overweight credit beta with preferred issuer overweight positions, continuing to rely on our fundamental credit analysis capabilities.

We continue to be tilted underweight duration, most notably in the developed markets space, given our view that most major developed market government bonds are expensive and that yields are likely to see some upside pressure as the cyclical upturn gradually progresses, output gaps compress and central banks look to move towards policy normalization.

Select global yields (as at October 31, 2021)



Source: Bloomberg, as at October 31, 2021. Euro Corp IG EUR = Bloomberg EuroAgg Corporate ISMA Yield to Worst, U.S. Corp IG USD = Bloomberg U.S. Agg Corporate Yield to Worst, U.S. Corp HY USD = Bloomberg U.S. Corporate High Yield to Worst, CEM BI IG USD – J.P. Morgan CEMBI Broad Diversified High Grade Blended Yield, Germany 10yr EUR = 10-year German government bond, Japan 10yr JPY = 10-year Japanese government bond, U.K. 10yr GBP = 10-year U.K. government bond, Italy 10yr EUR = 10-year Italian government bond, U.S. 10yr USD = 10-year U.S. government bond, Australia 10yr AUD = 10-year Australian government bond, China 10yr CNY = 10-year Chinese government bond, Indonesia 10yr IDR = 10-year Indonesian government bond, Mexico 10yr MXN = 10-year Mexican government bond, Colombia 10yr COP = 10-year Colombian government bond, Brazil 10yr BRL = 10-year Brazilian government bond.

What are the challenges?

The economic outlook in large part continues to depend on the successful management of the pandemic on a global scale. While the world has made demonstrable progress over the last year, uncertainty persists as infection rates increase in many countries. In addition, there remains a lack of consensus on the duration of antibodies and there is the potential for new variants. The outlook is also reliant on the duration of fiscal and monetary support, and other relief packages, in the U.S. and globally. Supply chain issues and inflation surprises continue to be risks. Thus, our focus remains on investing in companies that we believe have the ability to successfully navigate the current environment and generate value over the longer term.

How are you positioning the funds?

IA Clarington Loomis Global Allocation Fund continues to have a majority equity allocation, reflecting our view that valuations are more attractive in equities than fixed income. Within fixed income, we have a larger allocation to non-U.S. than U.S. securities.

In equities, we believe investing in companies that exhibit our three alpha drivers – quality, intrinsic value growth and attractive valuation – creates potential for long-term outperformance. Targeting these alpha drivers allows us to capture two market inefficiencies: mispricing, through our valuation alpha driver, and a 'duration effect' through our quality and intrinsic value growth alpha drivers. We define the 'duration effect' as a high-quality company's ability to add value over time through the compounding of its cash flows.

Portfolio positioning continues to be driven by where we are finding our best ideas. We currently have significant exposure to the information technology, consumer discretionary and health care sectors. Conversely, we do not have any direct exposure to the utilities, real estate and energy sectors.

In fixed income, although investment grade corporate credit spreads look fair-to-slightly-rich, we still like the yield advantage they offer. The fundamental backdrop, underpinned by solid corporate profit growth, and the technical backdrop remain supportive.

Our primary U.S. dollar view is for moderate softening as global growth starts to catch up to the U.S. Healthy investor risk appetites and cyclical improvement abroad are typically consistent with a weaker dollar. Rising twin deficits and higher commodity prices are additional headwinds for the dollar.

Why is this the right approach for 2022?

We believe asset allocation shaped by our best global alpha opportunities can generate attractive long-term risk-adjusted return potential. We allocate capital by leveraging our core competency in fundamental research, which we believe is a more effective method than trying to correctly predict macroeconomic variables, which may be backward looking and not correlated with returns.

We continue to be underweight duration given our expectation for government bond yields to rise alongside continued economic expansion as the Fed normalizes its policy rate. Inflation is anticipated to keep pace in both Europe and the U.S. Credit spreads are historically tight with little room to narrow. Nevertheless, we expect to maintain a modest credit beta overweight given limited high-quality carry alternatives. Lastly, we are cautious on non-dollar forex, as we do not see a catalyst for non-dollar performance until global growth expectations improve.

Ian Cooke CFA
Mathew Hermary CFA
Joe Jugovic CFA

QV Investors Inc.

IA Clarington Canadian Small Cap Class
IA Clarington Canadian Small Cap Fund
IA Clarington Canadian Small Cap GIF
IA Clarington Global Equity Fund
IA Clarington Global Equity GIF
IA Clarington U.S. Equity Class
IA Clarington U.S. Equity Currency Neutral Fund

Where are the opportunities?

While the global economy has continued to recover alongside ongoing vaccination efforts, inflationary pressures and supply chain issues are beginning to temper near-term expectations. These forces will have an impact on some of our businesses, but productivity gains and price increases should generally help to mitigate these risks. Stimulus efforts across the world are focused on reducing the likelihood of a below-trend recovery and avoiding what many developed markets saw after the global financial crisis.

The current environment is creating opportunities for many of our companies. Our energy holdings are benefitting from strong supply side discipline and recovering demand has driven pricing to a multi-year high. Excess cash flows from this sector are now being consistently used to reduce debt and enhance returns to shareholders. Our consumer discretionary holdings are also well positioned for strong consumer spending in the years ahead.

Our portfolios contain many world-class businesses that generate strong cash flows and attractive returns on capital. In many cases, we expect portfolio holdings to ramp up dividends or share buybacks in the next 24 months. We remain very selective about the businesses that enter our portfolios, including only those we believe to be enduring franchises at attractive valuations. With this discipline, we continue to see attractive risk-adjusted return potential going forward.

What are the challenges?

Fueled by animal spirits, risk-seeking behaviour is alive and well. Initial public offerings are coming to market at a blistering pace and earlier-stage growth stocks with no income generation but high hopes for a promising future are receiving hefty valuations.

As we move further past the depths of the pandemic, the costs associated with stabilizing the economy are coming to the forefront. Many individuals and businesses continue to struggle while labour shortages, inflation and supply chain challenges have become prevalent. As governments attempt to secure new revenue sources to manage higher debt loads, incrementally higher taxes and regulations may begin to weigh on corporate profits.

With record highs in stock markets and record lows in interest rates, risk management may not be in vogue but it is more important than ever. Now is not the time for disciplined investors to throw caution to the wind while chasing short-term returns outside of their core competencies.

As cost pressures mount, tailwinds for asset prices are dissipating. Investors need to be mindful of these dynamics; stimulus measures are fading at a time when economies and markets are more reliant than ever before on debt remaining cheap and accessible.

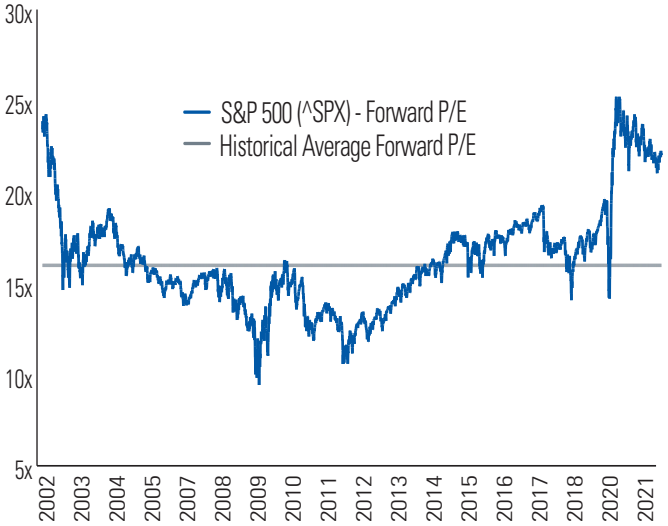
How are you positioning the funds?

We have constructed our portfolios with reasonably valued, everyday businesses exhibiting pricing power and productivity gains through innovation and growth. We expect these businesses to compound earnings at healthy rates while maintaining defendable business models in more difficult parts of the business cycle.

Why is this the right approach for 2022?

Although the fiscal and monetary backdrop is quite different today, in other respects the current investing climate reminds us of the tech bubble of the late 1990s. Growth at any price was in vogue, and less attention was paid to everyday businesses offering valuable services. Although history doesn't repeat, it does often rhyme. With many of the broader equity indices (such as the S&P 500) trading at lofty valuations (see chart), the margin of safety offered by our portfolios could be an important precursor to outperformance potential in a more challenging go-forward environment for equities, in our view.

S&P 500 forward price/earnings



Source: S&P Capital IQ, as at November 21, 2021.

Our equity holdings tend to exhibit high quality and lower duration (the present value of free cash flow is weighted towards the near term as opposed to far out into the future). Equity duration is likely to become more of a focus as markets continue to demonstrate a strong negative correlation to bond markets. With a number of market participants heavily invested in "growth at any price" (equities untethered from immediate cash flow), rising interest rates are a real and underappreciated risk.

Jeffrey Adams CFA, CIM, RIS
Wes Dearborn CFA
Kelly Hirsch CFA, Head of ESG
Jeffrey Lew CFA
Marc Sheard CFA

Vancity Investment Management Ltd.

IA Clarington Inhance Bond SRI Fund
IA Clarington Inhance Balanced SRI Portfolio
IA Clarington Inhance Canadian Equity SRI Class
IA Clarington Inhance Global Equity SRI Class
IA Clarington Inhance Growth SRI Portfolio
IA Clarington Inhance Moderate SRI Portfolio
IA Clarington Inhance Monthly Income SRI Fund
IA Clarington Inhance Monthly Income SRI GIF

Where are the opportunities?

It has been a year of extraordinary growth and unforeseen headwinds. The rollout of the vaccine during the first half of the year precipitated the release of pent-up demand that fueled the economic recovery and led the U.S. stock market to all-time highs. Simultaneously, the emergence of the delta variant slowed global reopening and exacerbated the extreme backlog in the supply chain, leading to higher rates of inflation with headline and core inflation hitting multi-decade highs in the U.S.

Global consumers, who were locked down at home for extended periods, collectively looked to splurge on capital goods (cars, home repairs, etc.) and services (restaurants, travel, etc.). Consequently, the global supply chain, which was already facing myriad issues, was unable to keep up. The average transit time for a product to get from Shanghai to Los Angeles more than doubled from what was typical pre-pandemic.

Companies that have strong audit programs for environmental, social and governance (ESG) factors throughout their supply chains tend to be more resilient to supply chain disruptions. This monitoring helps them understand where key components of their supply chain are sourced and can help them be proactive in managing shortages and delays. This will be especially important in the coming year as supply chain pressures, while likely to ease somewhat, do appear poised to persist with extreme weather events, pandemic-related disruptions and human rights-related import bans continuing to complicate the movement of goods worldwide.

As in most years, within the equity markets there are areas of over-valuation and under-valuation; however, we continue to identify opportunities that fit our process of investing in high-quality, ESG-leading companies with ample runway to reinvest at high incremental returns. Within our five-year view we are currently sourcing potential investments within sectors such as information technology, consumer discretionary and industrials, where temporary issues have pushed valuations down to more reasonable levels when considering potential growth rates.

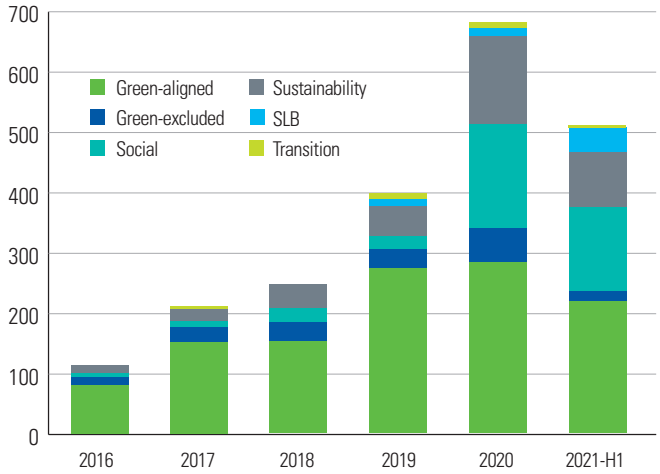
Fixed-income markets experienced significant volatility in 2021 as interest rates moved higher, reflecting a strong rebound in the economy, elevated inflation, and the reduction of asset purchases by the Bank of Canada. While these conditions create uncertainty heading into 2022, they also present opportunities. The normalization of interest rates across the yield curve increases the

potential for higher returns over the long run, while also improving the risk/return relationship between government and corporate bonds. We will look to take advantage of elevated interest rate volatility by continually assessing and reoptimizing positioning along the dynamic yield curve.

Corporate bonds continue to offer the potential for higher total returns compared to government bonds; however, the opportunity for outperformance has declined with relative yields and spreads trading near cyclically narrow levels.

ESG bond issuance has continued to grow rapidly as new government and corporate issuers enter the market (see chart). The evolution of this market provides additional opportunities for ensuring our fixed-income portfolios are invested responsibly and have a positive impact within Canada and around the world.

Labelled issuance: Five-year growth



Source: Climate Bonds Initiative, September 2021.

What are the challenges?

Heading into 2022, the stage is set for a difficult operating environment. Management teams will have to scramble to source inventory and see goods delivered within reasonable timeframes. A tight labour market will also act as a headwind as companies struggle to fill open roles. At the same time, companies will need to maintain a cap on costs as commodity prices, wages and global shipping rates have increased substantially.

We believe that our best guide, particularly in this type of environment, is our bottom-up investment process. The future always contains elements of uncertainty and unpredictable events happen – the last couple of years are a stark reminder of this. Ultimately, we look to own businesses that we believe can survive and even thrive under conditions of intense uncertainty.

The path of inflation in 2022 will be a key variable in determining both the direction of interest rates and the shape of the yield curve. Imbalances generated throughout the economic recovery have created uncertainty, with central banks forecasting that inflation will be transitory, while market-based inflation expectations suggest it may be more persistent. The divergence of opinions means interest rate volatility is likely to continue, with the ultimate outcome having potentially far-reaching implications for central bank policy and long-term growth.

We are confident that consumer demand will remain robust as economies continue to open and consumption normalizes. Although no one has a crystal ball, over time we also expect the supply chain issues to alleviate as elevated demand eases somewhat throughout the year. A key question will be whether the exacerbated inflation picture is transitory as proclaimed by central banks, or newly entrenched, leading to a more permanent situation.

Similar to the Taskforce for Climate Related Financial Disclosures (TCFD), the Taskforce for Nature Related Financial Disclosures (TNFD) is expected to launch by 2023. The benefits of well-functioning ecosystems are estimated to be double the world's GDP, while losses from the 'business as usual' scenario could cost the global economy $10 trillion by 2050. Measuring biodiversity impacts can be even more complicated than measuring carbon emissions and climate impacts. Companies need to be preparing for biodiversity-related disclosures and focused on identifying biodiversity impacts that are material to their operations. We expect to see increasing focus on biodiversity impacts both by regulators and investors in 2022 as TNFD prepares to launch.

How are you positioning the funds?

No matter the environment or macro outlook, we are constantly assessing our investments. We start each day as if operating with a clean slate, evaluating our portfolios without bias. Our goal is to ensure that we are invested in our highest-conviction ideas so that we are optimally positioned to outperform over full market cycles. We invest in companies with a sustainable lens, which includes assessing the sustainability of business models and competitive advantages, so that we are well positioned regardless of economic conditions.

Bond yields in Canada remain attractive relative to other markets and continue to be the primary focus of our fixed-income investments. With increasing uncertainties regarding the path of inflation, we continue to position defensively along the yield curve, with an underweight to the long end. We

remain cautiously optimistic that credit will continue to outperform government bonds; as a result, we are overweight high-quality short-term corporate bonds while maintaining a small exposure to defensive preferred shares. Positive impact bonds have always been a core position for us and we plan to increase our holdings as the market continues to evolve with new green and sustainable bond issuers on the horizon.

The highly anticipated COP26 UN Climate Change Conference held in November led to commitments in high-priority areas such as methane emissions and deforestation. Governments have increased net-zero ambitions, resulting in 80% of global emissions now being covered by net-zero targets. Investors responsible for almost 60% of the world's managed assets are also committing to net-zero targets. We believe that companies with well-developed climate risk management strategies are best positioned to navigate the evolving regulatory environment and investment landscape.

Why is this the right approach for 2022?

As quality growth investors, we seek out companies that operate in industries with high barriers to entry and provide products or services that are critical to their customers, a combination that leads to strong potential for above-average margins, high returns on capital and strong balance sheets. These characteristics act as a shield, protecting companies from unforeseen events such as the current inflationary environment, as they are likely able to pass on input cost increases. It enables them to weather market downturns, as their balance sheets and recurring revenue profiles will allow them to not only survive but improve their competitive standing against lower-quality peers.

With increasing uncertainty and volatility in fixed-income markets, we believe it is prudent to be defensively positioned along the yield curve and within credit. With our active approach, our current curve positioning and bias towards high-quality short-term corporate bonds will allow us to opportunistically take advantage of any material relative value changes should some of the aforementioned risks be realized in 2022.

ESG integration has always been fundamental to our low-carbon investment process. Our long-standing climate strategy and stakeholder-focused approach helps mitigate unpredictable events, such as increasingly frequent extreme weather events, and benefits from the growing investor focus on ESG issues resulting from the ongoing global pandemic. We believe this strategy will continue to mitigate risks and capture market opportunities over the long term.

Amar Dhanoya MBA, CFA
Jeff Sujitno HBA, CPA, CIM
Andrew Khazzam CFA
Tracy Zhao CFA

Wellington Square

IA Clarington Core Plus Bond Fund
IA Clarington Core Plus Bond GIF
IA Clarington Floating Rate Income Fund
IA Clarington U.S. Dollar Floating Rate Income Fund

Where are the opportunities?

We continue to be constructive on credit, in particular non-investment grade credit, such as loans and direct lending/private debt. Credit conditions remain extremely supportive, with economic activity and corporate earnings benefitting from a high level of pent-up consumer demand as economies continue to reopen. Loans were an outperformer within fixed income in 2021, benefiting from strong inflows as retail and institutional investors looked for yield in a low-yield environment as well as interest rate protection as the Federal Reserve (Fed) has begun tapering its bond purchase program and is widely expected to start raising rates in 2022.

Borrowers have taken advantage of the strong demand, resulting in a record level of new issuance for loans and high-yield bonds in 2021. The pace of new issues is expected to moderate in 2022 but remain at a healthy level. High-yield and loan default rates, which are currently near historical lows, should remain low with borrowers pushing out the maturity dates of their debt and economic growth driving stronger fundamentals.

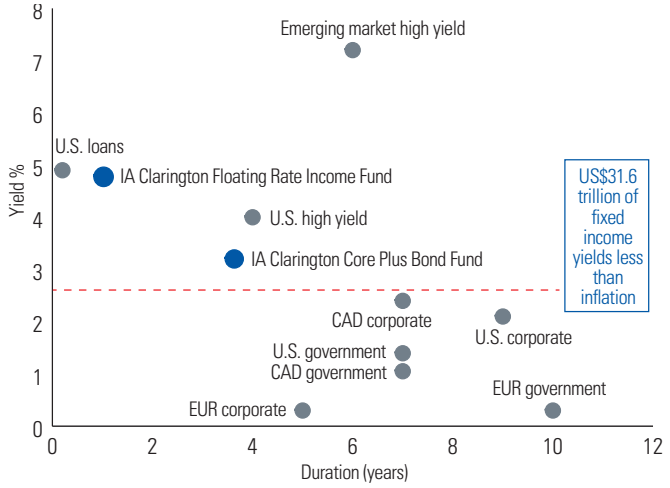
Against this backdrop, we also see opportunity in collateralized loan obligations (CLOs), given their yield pick-up over similarly rated corporate bonds. Another area we find compelling, which is often overlooked by Canadian investors, is direct lending/private debt. The additional yield premiums commanded for complexity, illiquidity and self-origination are very attractive in our view and provide tremendous compensation for the risk.

What are the challenges?

Inflation concerns remain at the forefront for investors as "transitory" price increases have persisted longer than many initially expected. A post-pandemic resurgence in demand coupled with supply chain bottlenecks and labour shortages are driving prices higher across broad segments of the economy. October's 6.2% year-over-year increase for the U.S. Consumer Price Index is the largest jump in the past 30 years. Increasing inflation expectations have raised the prospect of negative real yields for many fixed-income investors.

At the time of writing, there is over US$31 trillion of investment grade fixed income that is yielding less than expected inflation (see chart). While investment grade yields continue to hover near historic lows, duration (interest rate sensitivity) is near historic highs. This will present another headwind as central bank accommodation ends. In early November the Fed announced it would begin to taper its bond purchases at a pace that would have purchases ending completely by mid-2022. While the Fed messaged patience on rate hikes, noting that elevated inflation is largely reflecting factors that are expected to be transitory, the market is currently pricing in two interest rate hikes in 2022. If inflation continues to climb it may force the Fed to move more quickly with tapering and/or the pace of rate hikes, spurring market volatility. A resurgence of COVID-19 cases in parts of Europe, and with it the potential reintroduction of economic restrictions, threatens to add to market volatility as we enter 2022.

Loans provide higher yield and near-zero duration



Source: Bloomberg and Credit Suisse, as at November 5, 2021. Yield expressed as yield to worst for bonds and 3-year yield for loans. Bloomberg Barclays ("BB") Indices: EUR government = BB Pan-European Aggregate Treasury Index, U.S. government = BB US Treasury Index, CDN government = BB Canada Aggregate Treasury Index, EUR corporate = BB Euro-Aggregate Corporates Index, CAD corporate = BB Canada Aggregate Corporate Index, U.S. corporate = BB US Corporate Bond Index, U.S. high yield = BB US Corporate High Yield Bond Index, Emerging market high yield = BB Emerging Market USD Aggregate High Yield Index, CAD government = BB Canada Aggregate Treasury Index. U.S. loans = Credit Suisse Leveraged Loan Index. U.S. 5-yr. Break-Even used as a proxy for inflation.

How are you positioning the funds?

Our constructive outlook for the economy is supported by financially strong households, robust employment figures and the continued recovery from the pandemic. We expect to stay at the higher end of our allocation range for opportunistic private debt. We will also exit our very low-yielding names and reinvest into higher-yielding opportunities to improve portfolio yield potential while maintaining overall credit quality. Given the low default outlook and the prospect of higher rates, we will look to selectively increase our second-lien loan holdings, maintain a position in the CLO mezzanine securities we accumulated through 2021, and reduce higher-duration high-yield bond positions by rotating into loans issued by the same borrowers, subject to relative value considerations. These actions will enhance the yield potential of the portfolio without materially changing the weighted average rating of the fund.

Within our core plus bond mandate, the "plus" aspect of the fund will play a pivotal role in 2022 as investment grade indices face a tough battle given the rate environment. We plan on maximizing the use of this bucket by investing in assets such as high yield and private credit, which help boost the portfolio's overall yield potential. The fund is also exposed to floating rate securities such as CLOs, senior secured term loans, and floating investment grade corporates, which all help offset the fixed portion of the fund and lower duration. Within the "core" of the fund, we will take selective duration exposure to corporates that are still trading off their historically tight spread levels and offer potential for credit spread compression given that a steepening yield curve will remain a headwind.

Why is this the right approach for 2022?

Fixed-income investors should expect a challenging year in 2022. Spreads across the asset class are still near all-time lows, leaving little room for capital appreciation. The fundamental backdrop continues to be largely positive, but the end of central bank accommodation, inflation concerns and pockets of spiking COVID-19 cases are likely to result in higher volatility and potential periods of spread widening.

We believe the majority of fixed-income returns in 2022 will be generated through coupon clipping. In our view, credit exposure, particularly within non-investment grade, will be necessary for fixed-income investors to generate a meaningful real return. Loans' lack of interest rate sensitivity and higher yields set up the asset class for another year of relative outperformance. Within investment grade, astute security selection will be key to managing risk-adjusted returns.

Wellington Square refers to Wellington Square Capital Partners Inc. (sub-advisor) and Wellington Square Advisors Inc. (sub-sub advisor).

As at November 26, 2021, unless otherwise indicated. For definitions of technical terms, visit iaclarington.com/glossary or speak with your financial advisor.

[1]Source: https://ourworldindata.org/covid-vaccinations?country=OWID_WRL

[2]Source: MSCI Inc. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI.

Fund and benchmark performance, as at October 31, 2021	1 year	3 year	5 year	Since inception (Nov. 2013)
IA Clarington Floating Rate Income Fund – Series F	6.11%	2.83%	2.96%	3.42%
Credit Suisse Leveraged Loan Index USD	8.53%	4.17%	4.53%	4.20%

Source: Morningstar Direct.

The performance data comparison presented is intended to illustrate the Fund's historical performance as compared with historical performance of widely quoted market indices. There are various important differences that may exist between the Fund and the stated indices that may affect the performance of each. The benchmark is the Credit Suisse Leveraged Loan Index USD which is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. The Fund's geographic, sector and credit quality exposure may differ from that of the benchmark. The Fund can invest in high yield corporate bonds and government bonds, which are not included in the benchmark. The Fund aims to fully hedge the portfolio's foreign currency exposure at all times to remove any currency fluctuation risk. As a result, the U.S. indices referenced within are quoted in their native currencies of U.S. dollars to reflect the performance of the holdings as opposed to currency performance. The Fund may hold cash while the benchmark does not. It is not possible to invest directly in market indices. The performance comparison is for illustrative purposes only and does not imply future performance.

Fund and benchmark performance, as at October 31, 2021	1 year	3 year	5 year	Since inception (Jun. 2014)
IA Clarington Core Plus Bond Fund – Series F	4.63%	4.07%	3.03%	3.02%
FTSE Canada Short Term Bond Index	-1.06%	2.75%	1.64%	1.87%

Source: Morningstar Direct.

The performance data comparison presented is intended to illustrate the Fund's historical performance as compared with historical performance of widely quoted market indices. There are various important differences that may exist between the Fund and the stated index that may affect the performance of each. The benchmark is the FTSE Canada Short Term Bond Index and consists of a broadly diversified selection of investment-grade bonds, with maturities between 1 and 5 years, issued domestically in Canada. Returns are calculated daily, and are weighted by market capitalization, so that the return on a bond influences the return on the index in proportion to the bond's market value. The Fund's geographic, sector and credit quality exposure may differ from that of the benchmark. The Fund may hold cash while the benchmark does not. It is not possible to invest directly in market indices. The performance comparison is for illustrative purposes only and does not imply future performance.

Series F and its targeted payout options are sold with no sales charge and no redemption fee, but are only available to investors through a fee-based account with a full- service investment dealer. There may be a fee negotiated directly between the investor and his/her dealer for services provided. Please speak with your dealer about these fee-based series and whether they are available. Management fees and operating expenses are paid by the Funds. There is no trailing commission paid for these series of the Funds. There may be other fees such as short-term trading fees that may apply to certain transactions. Please refer to the prospectus for a more detailed discussion on the types of fees that exist.

The information provided herein does not constitute financial, tax or legal advice. Always consult with a qualified advisor prior to making any investment decision. Statements by the portfolio manager or sub-advisor responsible for the management of the fund's investment portfolio, as specified in the applicable fund's prospectus ("portfolio manager") represent their professional opinion, do not necessarily reflect the views of iA Clarington, and should not be relied upon for any other purpose.

Indicated mutual fund rates of return include changes in share or unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Returns for time periods of more than one year are historical annual compounded total returns while returns for time periods of one year or less are cumulative figures and are not annualized. Where applicable, compound growth charts are used only to illustrate the effects of a compound growth rate and are not intended to reflect future values or returns of a fund. A mutual fund's "yield" refers to income generated by securities held in the fund's portfolio and does not represent the return of or level of income paid out by the fund.

Information presented should not be considered a recommendation to buy or sell a particular security. Specific securities discussed are for illustrative purposes only. Mutual funds may purchase and sell securities at any time and securities held by a fund may increase or decrease in value. Past investment performance of a security may not be repeated. Unless otherwise stated, the source for information provided is the portfolio manager. Statements that pertain to the future represent the portfolio manager's current view regarding future events. Actual future events may differ. iA Clarington does not undertake any obligation to update the information provided herein. The information presented herein may not encompass all risks associated with mutual funds. Please read the prospectus for a more detailed discussion on specific risks of investing in mutual funds.

Commissions, trailing commissions, management fees, brokerage fees and expenses all may be associated with mutual fund investments, including investments in exchange-traded series of mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. Trademarks displayed herein that are not owned by Industrial Alliance Insurance and Financial Services Inc. are the property of and trademarked by the corresponding company and are used for illustrative purposes only.

(21-2533) 12/21-131564-08