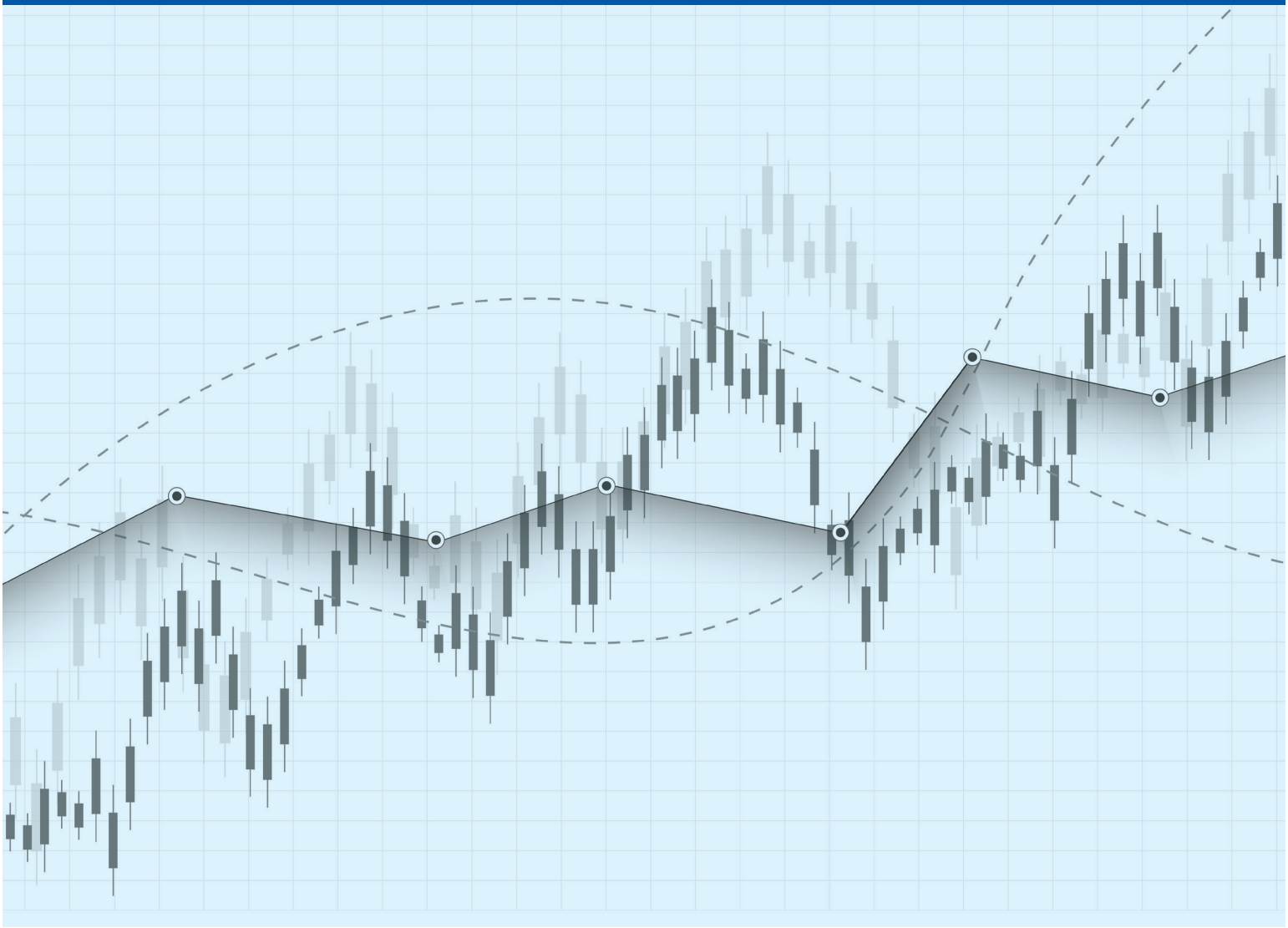
iA Clarington Investments

Perspectives on Market Volatility



iA Clarington™ Investments

Table of Contents

Dan Bastasic MBA, CFA
Senior Vice-President, Investments & Portfolio Manager

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

1. What is causing this volatility and how long do you think it will last?

- Towards the end of 2021, we believed that this year would likely have at least two periods of high volatility, with one likely occurring in the first part of 2022.
- The reasons were based on a reversion to the mean for a number of factors that supported excess valuations and the flow of funds, particularly into stock markets.
- We are of the opinion that this year will be trending lower from multi-year peaks in economic growth, earnings growth, low interest rates and excess liquidity. This expected normalization process seems to be right on schedule for the first part of the year.
- We expect there to be a consolidation and improvement in market sentiment and prices as we exit the first quarter and an adjustment occurs to account for "lower highs" in all things that support equity prices.

2. How is this volatility impacting your mandates?

- We have raised cash during the first part of January in most of our mandates to account for the expected volatility.
- Our fixed income is in the higher-quality part of the high-yield market, reducing business risk.
- Our equity exposure is defensive compared to passive investment strategies.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- We are not actively or broadly buying at the moment, as we believe our portfolios are well structured and in line with our expectations for higher volatility of returns during the coming 12 months.
- Our cash levels have increased since the end of 2021, and we plan on investing in individual names as those opportunities present themselves.

- As the markets move from trend and momentum investing to more of a fundamental approach, dividend growth stocks as well as financials stocks are attractive given earnings prospects and current valuations, which are not stretched relative to history.
- From a fixed-income perspective, higher-yielding bonds with low duration will get most of our attention until the risk and return dynamics shift from economy-sensitive credit to interest rate-sensitive fixed income. That could come at any time, but likely not until sometime next year.

4. Where do you see the opportunities and risks going forward?

- Geographically, we believe North America-centric security selection with some European exposure will provide the best opportunity for risk-adjusted returns for our clients over the next 12–24 months.
- Sectors with exposure to economic growth and interest rates will likely be better places to allocate capital during this year.
- We think the risks to cyclical stocks are elevated during a normalization process; however, we believe there will be an opportunity to increase exposure at some point in the next quarter or two. This thesis, if correct, bodes well for exposure to Canadian-based securities.
- From a fixed-income perspective, we expect defaults to remain low, rates to increase slowly and the economy to continue to grow at higher levels than generally experienced over the past eight years, leading us to favour high-yield bonds.

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

1. What is causing this volatility and how long do you think it will last?

- The catalyst was the Federal Reserve's hawkish pivot, signalling the start of quantitative tightening to start the year.
- Other factors include increasing real interest rates, slowing economic data, omicron adding to inflation fears, Russia-Ukraine tensions, and negative retail and hedge fund flows.
- On average, the market has historically experienced one correction per year; we didn't have one last year so it might be argued this was long overdue.
- It looks like the start of 2016 and we are expecting a volatile first half of the year, followed by a rally in the second half as the Fed's hawkish pivot gets priced in and markets get visibility on supply chain normalization.

2. How is this volatility impacting your mandates?

- In the U.S., it has been a significant drawdown for the indices, with small/mid-cap tech and health care being most impacted.
- Many stocks are down 40–60% from their highs, irrespective of whether they are free cash flow (FCF) positive.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- Currently, we are marginally moving from mega-cap to small/mid-cap technology names, which are very cheap on positive FCF estimates for 2023 and beyond.
- Themes we are currently looking at: e-content, software-as-a-service security, software-as-a-service cloud supply chain and innovative biotech.
- Themes of interest later in the year: e-commerce, digital advertising, digital platforms, fintech, population health, battery technology and renewables.

4. Where do you see the opportunities and risks going forward?

- We currently see opportunity in dislocated small/mid-cap technology names with positive earnings revisions and FCF yield in 2023 and beyond.
- We also like large-cap health care stocks with portfolio transformation potential via M&A.
- This summer, many structural winners from the pandemic that are now struggling should see their growth reaccelerate going into next year (e.g., internet and e-commerce space).
- A major risk is omicron outbreaks in China, which would negatively impact supply chains and demand.
- At the opposite and more structural end would be the risk of core inflation reversing back while wage inflation remains higher, impacting low-profit-per-employee business models.

Marc Gagnon MBA, CFA
Vice-President & Principal Portfolio Manager, North American Equities

iA Investment Management Inc.

IA Clarington Canadian Leaders Class

1. What is causing this volatility and how long do you think it will last?

- Inflation is running hot and is forcing central banks to be more aggressive with interest rates. For the Federal Reserve, a March liftoff now seems to be the base case, with the market pricing in 3–4 hikes in 2022. A gradual quantitative tightening is also likely to happen by mid-year.
- Based on global shipping costs, supply chain pressures are likely to moderate only gradually over the coming months, which should put pressure on economic growth. The early indication of Purchasing Manager Index figures for January showed a slowdown in growth at a time when bond yields are increasing.
- The situation in Ukraine could put more pressure on volatility. For the oil market, the situation in Yemen and specifically the recent rebel attacks on the UAE could also have an impact on prices.
- There is significant uncertainty around when inflation is likely to cool down. It could happen by the second half of this year if we start to see evidence that supply chain bottlenecks are receding. It will impact the pace and timing of rate hikes and the balance sheet normalization guidance – two risks that are not fully priced in.

2. How is this volatility impacting your mandates?

- So far, the impact is neutral and the mandates are mostly in line with the general market.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- We are increasing the weightings of high-conviction companies in industrials and consumer discretionary.
- Very recently we also decided to increase our exposure to the U.S. market.

4. Where do you see the opportunities and risks going forward?

- The direction of bond yields remains key for sector leadership and we expect cyclicals such as materials to continue outperforming.
- We believe that opportunities will also emerge in the technology sector.

Tej Rai

Senior Vice-President, Asset Allocation

Sébastien Mc Mahon MA, CFA

Senior Portfolio Manager, Diversified Funds & Interim Chief Economist

iA Investment Management Inc.

IA Clarington Global Risk-Managed Income Portfolio
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

1. What is causing this volatility and how long do you think it will last?

- The upcoming tightening of monetary policies in North America is front and centre.
- The outsized participation of retail investors was also a cause for concern.
- We recently saw the "hot themes" of 2020–2021, like "most shorted stocks" and IPOs, give up most of their outperformance, given how expensive they had become. It was natural to expect a kickback towards more value-oriented plays, and this is what is going on under the hood.
- No one can say how long this is going to last, as we've just emerged from a very low volatility year and the rotation from growth to value has just started.
- One thing is for sure, 2022 should be more volatile than 2021, with a few bumps along the way as central banks raise rates throughout the year.

2. How is this volatility impacting your mandates?

- Towards the end of 2021, we started to see fewer opportunities in the markets (relative to history) given stretched equity valuations and rising inflation.
- Consequently, we came into 2022 with a rather neutral positioning on equities, and a slight underweighting of bonds.
- We favour Canada and other value-oriented strategies, which have outperformed the U.S. and growth steadily so far in 2022.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- We have not started buying yet, but we do believe this will eventually be a buying opportunity.
- Global economic growth should remain strong over the next few years, and earnings growth should be robust.
- When our buying signals start flashing green, our focus is likely to be on Canadian and emerging market equities, as well as raising the hedge on our U.S. dollar exposure.

4. Where do you see the opportunities and risks going forward?

- Within equities, we believe the best opportunities lie within Canada, emerging markets and Europe, in this order.
- The next year should be tough on technology and growth, where valuations are historically expensive in a context of rising rates.
- In terms of sectors, energy, financials and materials should be favoured, and technology could be in for a tough year.

Alexandre Morin CFA

Principal Portfolio Manager, Fixed Income Investment Funds

iA Investment Management Inc.

IA Clarington Bond GIF

IA Clarington Money Market Fund

IA Clarington Money Market GIF

IA Wealth Core Bond Pool

1. What is causing this volatility and how long do you think it will last?

- The primary cause of the current volatility is increasing concern about when North American central banks will begin to tighten monetary conditions (both by raising policy rates and by reducing assets on their balance sheets through quantitative tightening).
- Underpinning monetary policy concerns are perceptions about whether the central banks will act too quickly or aggressively.
- The groundwork for recent volatility was laid in part by growing hawkishness – particularly with respect to inflation concerns – expressed by Federal Reserve officials starting in December.
- Another principal trigger over the past few days has been rising geopolitical tensions in Europe (Russia-Ukraine) and East Asia (Taiwan).
- We believe the recent equity sell-off and worsened market liquidity are consequences of these concerns, but are at the same time exacerbating an overall weak market tone.
- We expect central bank meetings in both Canada and the U.S. on January 26 to provide some market direction about future policy intentions, but that could trigger further volatility depending on the language they use in their comments.

2. How is this volatility impacting your mandates?

- Yield volatility is creating opportunity to tactically trade portfolio duration (extending or decreasing versus the benchmark as conditions warrant).
- Differences in policy rate expectations and economic conditions between Canada and the U.S. provide USD-CAD trading opportunities in the foreign exchange market.
- Dislocations in the credit markets are providing opportunities to selectively pick away newly created relative value among issuers (i.e., quality versus price).

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- We are slowly increasing exposure to high yield. We had previously been modestly biased towards higher-quality credit since spreads were towards the tight end of the range.
- More generally, we are looking for opportunities to add beta where we see market dislocations and good value.

4. Where do you see the opportunities and risks going forward?

- We should see opportunity if the central banks are perceived to be moving too aggressively, which will create mounting fears of spillover effects into the economy from tightening monetary conditions. In this scenario we would look to remain short duration over the near term.
- We are well positioned to add lower-quality credit during periods when the market is selling off.
- We are positioned to continue actively managing exposure to the USD-CAD exchange rate on the back of central bank policy differences between Canada and the U.S.
- We may also capitalize on market weakness in the face of escalating geopolitical tensions by increasing beta exposure.

Matthew J. Eagan MBA, CFA
Executive Vice-President & Portfolio Manager

Eileen N. Riley MBA, CFA
Vice-President & Portfolio Manager

David W. Rolley CFA
Vice-President & Portfolio Manager

Lee M. Rosenbaum MBA
Vice-President & Portfolio Manager

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

1. What is causing this volatility and how long do you think it will last?

- We believe much of the volatility is driven by a foggy inflation outlook and the Federal Reserve's recent hawkish pivot.
- Distortions in economic data may continue to cause some uncertainty over the next few months; as a result, volatility may remain somewhat elevated until the market has more conviction about the path of interest rates.

2. How is this volatility impacting your mandates?

- While there has been downward pressure on stock prices, the underlying fundamentals of the businesses we own have not changed.
- Accordingly, we have not made significant changes to our portfolio as a result of this month's volatility.
- We continue to focus on long-term alpha drivers: quality, intrinsic value and valuation.
- The companies in our portfolio have sustainable competitive advantages and strong balance sheets. This enables our holdings to weather challenging environments.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- Broadly speaking, we are opportunistic investors. Short-term volatility often provides us with entry points to build long-term positions in high-quality companies.
- The portfolio is built from the bottom-up; our decision to add to names is driven by each stock's scenario valuation framework.

4. Where do you see the opportunities and risks going forward?

- We see opportunities across technology with names spanning semiconductor manufacturing and equipment, digital payments, software, and consulting companies.
- We also have select exposure to consumer names that we believe are uniquely positioned, companies capturing e-commerce demand, physical retailers with a differentiated value offering and companies with valuable brands.
- Lastly, we have focused our health care exposure on higher-growth areas in the industry, and away from areas that are exposed to reimbursement risk.
- We continue to have no direct exposure to energy or utilities, as we typically do not find many opportunities in these sectors that exhibit our three alpha drivers.

Ian Cooke CFA
Portfolio Manager

Mathew Hermary CFA
Portfolio Manager

Joe Jugovic CFA
Portfolio Manager

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

1. What is causing this volatility and how long do you think it will last?

- The transition in monetary policy – from extremely accommodative to the start of a tightening cycle – historically leads to market volatility.
- Unlike other recent cycles, inflation is much more of a concern and the market is starting to get a sense that the Federal Reserve is behind the curve.
- We haven't really had much volatility since the pandemic lows. Pullbacks of 5–10% are completely normal and we're overdue.
- It is difficult to determine how long it may last.

2. How is this volatility impacting your mandates?

- Given the preponderance of ETFs and passive strategies, our holdings cannot escape the volatility in the markets.
- Month-to-date, QV's risk-managed approach is evident.
- Widespread selling is leading to more attractive valuations as the majority of our companies' earnings should remain durable.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- Our portfolios are not positioned in the most highly valued stocks (which are potentially impaired over the longer term). Therefore, we are not selling due to volatility.
- While some sectors have come off considerably, they were also very expensive. We have refocused on some areas where we hope the market will provide opportunity.
- If the sell-off continues, you should expect us to add to existing holdings as they go on sale; we will also consider adding new investments as they come into our valuation range.

4. Where do you see the opportunities and risks going forward?

- The opportunities will be in quality businesses with sustainable earnings and strong balance sheets.
- Even within what are generally highly valued markets there are a number of areas that offer reasonable opportunity.
- The greatest risks are in businesses with weak fundamentals and very stretched valuations.
- Broadly speaking, risks will remain in all assets (stocks, homes, hard assets) as monetary policy resets and asset values do the same.

Jeffrey Adams CFA, CIM, RIS
Director & Portfolio Manager

Wes Dearborn CFA
Portfolio Manager, Fixed Income

Kelly Hirsch CFA
Head of ESG

Jeffrey Lew CFA
Portfolio Manager

Marc Sheard CFA
Portfolio Manager, Equities

Vancity Investment Management Ltd.

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

1. What is causing this volatility and how long do you think it will last?

- For most companies, nothing fundamental has changed over the past month; the volatility and drawdown in the equity market is due instead to investor sentiment based on a few factors: fear of rising interest rates, persistent inflation, and pockets of excess valuation.
- Drawdowns are a natural part of equity investing. On average, we see a drawdown of 10% or more within a calendar year 63% of the time (going back to 1928). The equity markets, however, produce positive returns ~70% of the time, demonstrating their resilient nature.
- We see these market pullbacks as the price of admission for investors to gain access to the long-term compounding nature of equity markets.
- Unfortunately, nobody knows how long the current volatility will last or when the drawdown will end, but certain metrics such as the VIX (a measure of volatility and fear in the equity market) and U.S. Investor Sentiment are at stretched levels, indicating that we are probably closer to the end than the beginning.

2. How is this volatility impacting your mandates?

- Since we manage fossil fuel-free, responsible investing equity funds with a quality-growth mandate, the current market has been challenging as investors are crowding into energy, materials and banks while selling technology stocks.
- The performance of value stocks versus growth year-to-date is at extreme levels relative to history.
- Overall, bond markets have not experienced the elevated levels of volatility that equity markets have. With the recent risk-off tone, though, credit spread product has underperformed modestly as credit spreads have widened.

- Our bond mandate is overweight credit spread product as a yield enhancer, but has a bias towards higher-credit-quality issues, which has dampened some of the degree of credit spread widening.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- Volatility provides opportunities for long-term investors and the current market is no exception, as high-quality growth stocks are currently being sold indiscriminately, providing very attractive valuation levels.
- Within the equity markets the technology and consumer discretionary sectors in particular are offering compelling opportunities. We are currently finding companies that we think can grow revenue at 15%+ for the foreseeable future trading at depressed multiples versus their historical levels.
- After trimming preferred shares at the end of 2021 and the start of 2022, within the bond mandate we have been opportunistically adding back to preferred share holdings with the most recent sell-off. We continue to view preferred shares as an attractive yield enhancer with acceptable levels of risk.

4. Where do you see the opportunities and risks going forward?

- The pandemic has proven to be unpredictable – we have achieved key milestones and felt hopeful for the end, only to be hit with yet another wave. Although we are cautiously optimistic because of high vaccine uptake and effective protection against known variants, the evolution of the pandemic remains a considerable risk.
- Persistent inflation could result in a rapid rise in interest rates, potentially resulting in further selling of growth stocks, which could be detrimental to our short-term equity returns.
- With a longer time horizon, we are unwavering and confident in our process of investing in high-quality progressive companies with long runways for revenue growth, offering compelling compounding opportunities over time.
- With wider credit spreads, there will be opportunities in the bond mandate to add credit exposure and enhance expected returns over time.

Amar Dhanoya MBA, CFA
Portfolio Manager

Jeff Sujitno HBA, CPA, CIM
Portfolio Manager

Andrew Khazzam CFA
Portfolio Manager

Tracy Zhao CFA
Portfolio Manager

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

1. What is causing this volatility and how long do you think it will last?

- The recent bout of volatility has coincided with a rise in real rates after the Federal Reserve's hawkish pivot. The U.S. 10-year real yield has increased by close to 50 basis points (bps) as the market adjusts to an accelerated Fed tapering/hiking schedule and a pull-forward to the start of quantitative tightening. As the Fed – the buyer at any price – steps back from the Treasury market, borrowing costs increase as investors demand more yield for their investment.
- This has caused a revision in elevated valuations, particularly in equities of expensive growth companies and speculative stocks as their future earnings are discounted at a higher rate. The initial phase of the sell-off was localized in these areas but has since spread across the broader equity market, albeit to a lesser extent.
- The Fed faces a tricky balance as it contemplates a potential growth slowdown due to omicron globally and not falling behind the curve on inflation. Further complicating the matter are continued bottlenecks and rising input prices and wages, which are compressing profit margins. The market needs to see some clarity on either front so it can get comfortable with the Fed's options at hand. However, if this pace of asset decline continues it is possible the Fed may not have the luxury of choice after all.

2. How is this volatility impacting your mandates?

- **IA Clarington Core Plus Bond Fund:** Canadian investment grade credit spreads have remained fairly insulated from the equity volatility we've experienced in the new year. U.S. investment grade corporate spreads have widened slightly more, and at 102 bps, are 10 bps wider year-to-date. Rates will remain the driver of returns in 2022.
- **IA Clarington Floating Rate Income Fund:** The senior loan market has proven exceptionally resilient despite the volatility in certain assets. Demand has been strong year-to-date given the floating rate nature of the asset class, leading to record retail inflows and continued strength in institutional demand. Senior loan secondary prices are modestly above year-end levels.

3. Are you buying during this sell-off and, if so, in which sectors/asset classes?

- **IA Clarington Core Plus Bond Fund:** Investment grade credit is currently not presenting a broad opportunity given the lack of spread widening. However, the volatility is causing more two-way trading in certain sought-after credits that were tucked away and hard to source (primarily in pandemic-affected sectors). We have been using this volatility as an opportunity to add to those positions.
- **IA Clarington Floating Rate Income Fund:** We continue to evaluate opportunities in the new-issue loan and collateralized loan obligation (CLO) markets while also assessing relative value and duration between high-yield bonds and loans in the secondary market.

4. Where do you see the opportunities and risks going forward?

- Near-term opportunities would be more defensive in nature as the risk of central bank policy slowing growth and inflationary margin pressures must be taken into account; however, default risk is expected to remain below the historical average.
- The International Monetary Fund recently revised its global growth estimate to 4.4% from October's 4.9% on persistent inflation and weaker growth prospects for the U.S. (revised to 4% from 5.2%) and China.
- Should volatility present greater risks and if growth prospects diminish further, the Fed may slow implementation of its plan, potentially providing upside for risk assets, many of which have priced in an aggressive withdrawal of extraordinary stimulus measures implemented to support economic activity through the pandemic.

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

For definitions of technical terms, visit iaclarington.com/glossary or speak with your financial advisor.

As at January 25, 2022. 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. 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.

The iA Clarington Funds are managed by IA Clarington Investments Inc. iA Clarington and the iA Clarington logo, and iA Wealth and the iA Wealth logo, are trademarks of Industrial Alliance Insurance and Financial Services Inc. and are used under license.

(22-0204) 01/22

iA Clarington™ Investments

INVESTED IN YOU.