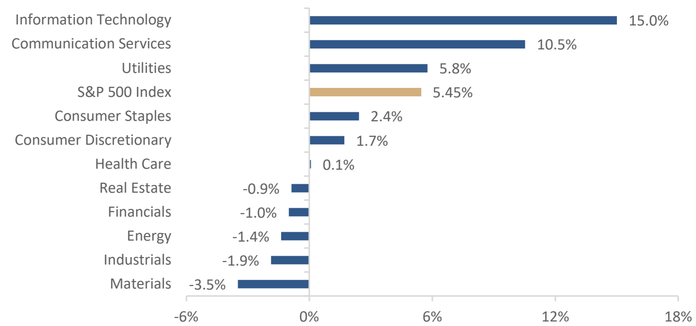
The FGP U.S. Equity Fund returned -0.20% in Canadian dollars in the quarter, compared with the S&P 500 Index (CAD) return of 5.45%. So far this year, the Fund has returned 10.85%, compared with the benchmark's return of 19.64%.

Performance of S&P 500 Sectors (CAD)
(Three months ending June 30, 2024)



Source: Bloomberg

The market's strong momentum in the first quarter moderated in the second quarter with the S&P 500 Index returning 5.45%. But the narrowness of the market worsened, with the S&P 500 Index, which is market weighted, outperforming its equal-weighted counterpart by 600 basis points in the second quarter compared with 300 basis points in the first quarter, thus continuing a challenging environment for stock picking.

Additionally, eight of 11 market sectors underperformed the index. Returns of the top three sectors were driven by the Generative Artificial Intelligence (GenAI) theme:

- The IT sector (up 15%), led by Nvidia Corp. (up 38%) and Apple Inc. (up 24%).
- The Communications Services sector (up 11%), led by Alphabet Inc. (owner of Google, up 22%).
- The Utilities sector (up 6%), which will benefit from GenAI as the energy consumption of AI server farms grows.

We reiterate our view from prior quarters that while we agree that GenAI is a revolutionary innovation, we believe that the economics of its impact are still unclear, and most companies are still only experimenting with its applications. As a result, the sustainability of demand for GenAI-related products and services remains uncertain.

We will maintain our approach of investing in more predictable, growing, high-quality businesses at reasonable valuations as we believe this is the best approach to increasing our clients' capital in the long term while keeping risk relatively low.

Leaders

Among the top contributors to relative performance in the quarter were Broadcom Inc. (Information Technology), up 23%; Motorola Solutions Inc. (Information Technology), up 10%; and Philip Morris International Inc. (PMI) (Consumer Staples), up 13%.

- Broadcom is a technology company selling semiconductor products that lead the market and which are set to benefit from growth in cloud adoption and AI. Its software products are sticky mission-critical tools geared towards the largest organizations with industry leading cashflow profiles. Broadcom has material exposure to the growth of GenAI through the sale of networking equipment and specialized semiconductor chips and its recent results benefitted from this exposure: AI revenue increased by 280% year-over-year.
- Motorola Solutions is the dominant provider of mission critical communication products such as Land Mobile Radios (LMR) to public safety officials in the U.S. The company is benefiting structurally from the increasing software content of its products and the associated upgrade cycle. The company reported strong results in its latest quarter driven by solid sales of its core LMR product.
- PMI is the leader in smokeless tobacco products and is expected to benefit from a market share shift away from cigarettes towards less harmful products like heated tobacco. The company reported good results in its latest quarter due to the continued growth in the sales of smokeless products.

Laggards

Among the top detractors from relative performance in the quarter were Henry Schein, Inc. (Health Care), down 14%; Ulta Beauty Inc. (Consumer Discretionary), down 15%; and Kenvue Inc. (Consumer Staples), down 14%.

- Henry Schein is the largest dental distributor in the U.S. The company operates in a steady, predictable industry while generating good returns. Furthermore, the company acquired its way into another good industry, the dental implant business, where it is now No. 3 in the world. As a result, its higher margin software and specialty dental businesses contribute one-third of its profit. The dental industry is going through a downturn as higher financing costs are reducing the volumes of certain procedures and equipment sales, leading to a lower stock price. We believe this is a cyclical slowdown, and the company is well positioned to do well when the recovery starts.

- Ulta Beauty is the leading cosmetics, fragrance, skin and haircare products retailer in the U.S. The company provides its customers salon services as well as a wide variety of products ranging from mass market to luxury. Key to its success is the company's ability to attract emerging brands early and bring them to beauty enthusiasts. Ulta Beauty performed strongly coming out of the COVID-19 pandemic as its suburban, standalone stores were more accessible than its mall-based competitors, leading to significant share gain and margin expansion. Recently, some of that share gain reversed. We anticipate the company will leverage its investment in logistics, technology infrastructure, and ecommerce to stem share losses and get back on track to growth.
- Kenvue is a leading global consumer health company that was spun off from Johnson & Johnson in May 2023 and which owns iconic brands such as Tylenol, Band-Aid, Neutrogena, and Listerine. We expect that being an independent company would give management greater flexibility to improve the business. Management is indeed investing in the business, thus putting pressure on profit growth near-term while the benefits will take time to appear. The market is focusing on the short-term results but ignoring the value of longer term gains.

Portfolio Activity

We added one company to our portfolio in the quarter: Genpact Ltd.

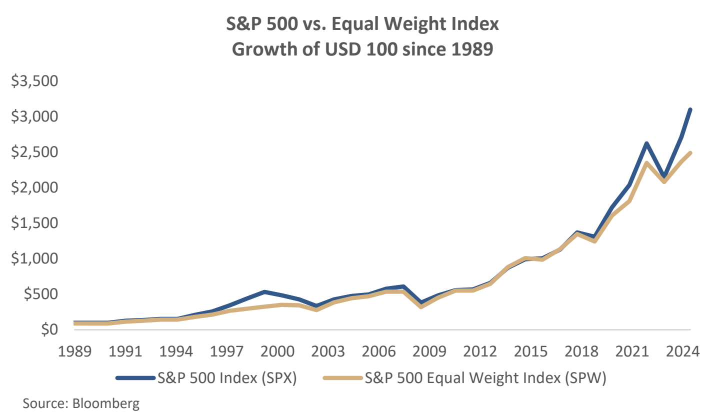
- Genpact is a leading business process outsourcing (BPO) company originally spun out of GE in 2007 and listed as a public company. The company derives 70% of its revenue from long-term contracts with renewal rates greater than 90%. Genpact benefits from institutional knowledge of business processes in its specialized areas and industries. The company also benefits from its long established reputation for excellence, which is key in generating new business. In our opinion, the market is overly pessimistic with regards to the impact of GenAI on this business as we believe Genpact will help its clients implement GenAI into their processes, thereby generating incremental revenue opportunities for itself. In our view, Genpact is attractively valued at current levels.

We sold our investments in Aon PLC and Pfizer Inc.

- Aon is a leading insurance broker with a good business but unreliable management. Most recently, the company significantly leveraged its balance sheet to make a mid-market acquisition after years of insisting that it was not interested in that portion of the industry. Aon's risk profile increased due to the higher leverage and integration execution risk.
- Pfizer benefitted massively from its success in developing a vaccine against COVID-19, but management invested that windfall in a large and expensive acquisition which significantly leveraged the company's balance sheet. We were disappointed with this capital allocation choice and were uncomfortable with the increased financial risk.

Outlook & Strategy

The U.S. market continues to be narrowly led as shown by material outperformance of the S&P 500 Index, which is market-cap weighted, compared with the equal weighted index. While we don't know how long this trend will last, the market has historically reverted back to the mean as larger-cap companies gave back their outperformance over time.



Meanwhile, we remain focused on executing our strategy of investing in more predictable, growing, higher quality businesses at reasonable prices.

Unless otherwise noted, all figures in this commentary are presented in Canadian dollars.

The Foyston, Gordon & Payne Inc. (FGP) performance figures and portfolio statistics shown in this report are for the FGP Pooled Funds. Client returns may vary due to cash flow timing and client-specific constraints.

Investment returns and assets under management are expressed in Canadian dollars unless otherwise noted. Investment returns are gross of investment management fees, net of fund expenses for FGP Pooled Funds, and include reinvestment of dividends and income. Returns are time weighted and annualized for periods greater than one year. Values change frequently and past investment performance may not be repeated.

These views are subject to change at any time based upon market or other conditions and are current as of June 30, 2024.

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