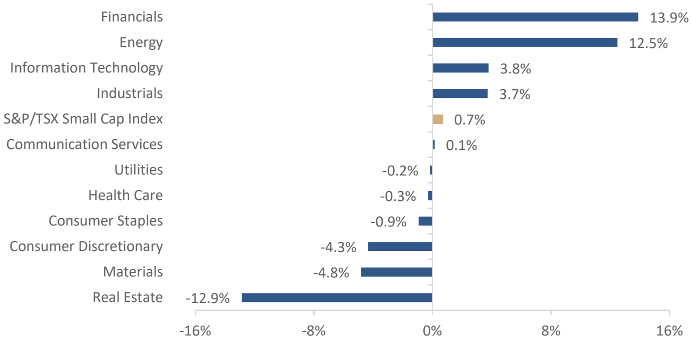
The FGP Small Cap Canadian Equity Fund returned 2.25% in the quarter, compared with the S&P/TSX Small Cap Index return of 0.69%. In 2024, the Fund returned 15.58%, compared with the benchmark's return of 18.83%.

Performance of S&P/TSX Small Cap Index Sectors
(Three months ending December 31, 2024)



Source: Bloomberg

What worked for us?

The leading driver of our portfolio's outperformance in the quarter was our underweight allocation to Real Estate, one of the lowest returning sectors in the benchmark.

The Industrials sector was the second-largest contributor to relative performance in the quarter. Strength was broad-based, with six out of the portfolio's seven investments in the Industrials sector exceeding the benchmark return, led by an 11% increase in shares of K-Bro Linen Inc., the largest operator of laundry and linen processing facilities in Canada. In November, the company reported record third-quarter earnings per share, driven by strong execution. K-Bro continues to fortify the competitive moat around its business via the acquisition and successful integration of smaller laundry operators.

The Materials sector also contributed to relative outperformance. Our absence from gold and silver producers and explorers was a positive factor this quarter as precious metals equities lagged. Among the Materials companies we did own, the shares of leading global methanol producer Methanex Corp. returned 29% amid an improved outlook for the commodity. On the other hand, within the Materials sector, the portfolio's lumber producers experienced weakness, with shares of Western Forest Products Inc. and Canfor Corp. declining 24% and 11%, respectively, reversing the strong gains recorded in the third quarter. Despite an increase in lumber prices in the fourth quarter following supply cuts, extremely negative investor sentiment won out, driven in part by disappointing U.S. housing starts in recent months.

What worked against us?

Security selection in the Consumer Discretionary sector was the only notable detractor from a sector perspective in the quarter, led by a 10% decline in shares of Linamar Corp., a leading global manufacturer of auto parts, scissor lifts, and agricultural equipment. Similar to other auto parts suppliers, Linamar's recent results and outlook were markedly impacted by a reduction in vehicle demand compounded by inventory destocking and deferred program launches. Meanwhile, the company's agricultural equipment segment was similarly impacted by higher financing costs compounded by weak farm incomes. Linamar management has done an outstanding job navigating these challenges, and this solid execution and focus on controllables significantly dampened the bottom-line impact. In November, the company launched a sizeable share repurchase program to exploit what we agree is a transitory, albeit well-advertised crisis. Underpinned by a compelling valuation of less than six times our estimate of normalized earnings per share, we added to our Linamar holdings in the quarter.

Elsewhere, we also took advantage of the recent weakness in shares of industrial equipment distributor Wajax Corp., which declined 16% in the quarter. We were able to add significantly to our modest stake in the company following the market's negative reaction to weak third quarter results and muted outlook. Despite continued near-term uncertainty, we believe patient Wajax shareholders will be rewarded. In November, we met with Wajax management to discuss the company's strategy to navigate the current environment and came away with increased conviction in our longer-term thesis. The company is attractively valued at less than seven times our estimate of normalized earnings per share.

Portfolio Activity

During the quarter, we initiated a position in Maple Leaf Foods Inc., a leading producer of fresh pork and poultry, prepared meats, ready-to-cook and ready-to-serve meals, snack kits, and plant-based protein. We used to own the company but exited our investment nearly a decade ago after shares exceeded our fair value target at the time.

We added Maple Leaf back to the portfolio primarily on account of the company's historically and relatively inexpensive valuation, with shares currently trading 45% below their 2017 high, driven predominantly by a multi-year compression in the company's valuation multiple, which gave us the opportunity to reinvest in this high-quality business.

Aside from valuation, we're also excited by a couple of key catalysts which we believe could drive a significant re-rating of Maple Leaf's multiple back to higher levels. In July, the company announced its intention to spin out its pork processing business, Canada Packers, to shareholders as a separate company. We think this reorganization could be a game changer, lessening the impact of the volatile upstream commodity business, making it easier for the market to ascribe a higher valuation to the company's valuable consumer packaged goods (CPG) assets. Maple Leaf's CPG assets, such as Schneiders and Maple Leaf Prime, are some of the most recognized and trusted brands among Canadians.

Furthermore, after more than a decade of large-scale capital investments, which greatly strengthened the company's competitive position, Maple Leaf recently moved into cash harvesting mode. With management signaling relatively low maintenance-level capital requirements in coming years, strong free cash flow generation will facilitate rapid deleveraging and position the company to return additional capital to shareholders via share repurchases and increased dividends.

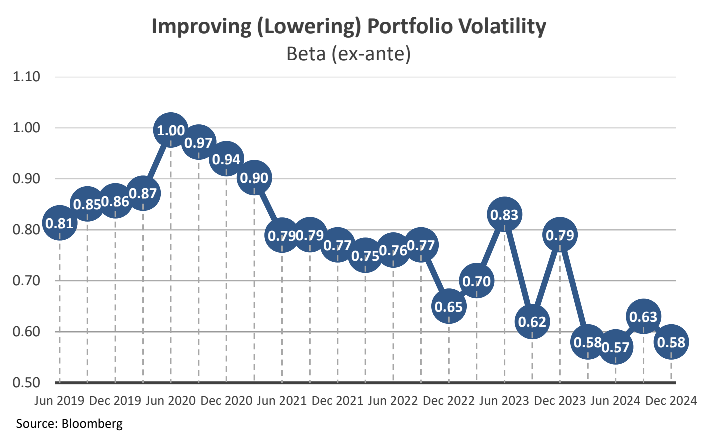
Outlook & Strategy

Continued optimism for the economic outlook has persisted, buoyed most recently by accelerated central bank rate cuts amid cooling measures of inflation. Optimism was also helped by an uncontested outcome of the U.S. presidential election. These factors helped most developed market indices hit all-time highs during the fourth quarter. Market returns continue to be led by mega-cap U.S. growth stocks, an increasing number of which appear to us as alarmingly overpriced at current valuation levels.

Among the companies we own and others we follow closely, we continue to observe a heightened focus on cost structure, a priority which should help these companies quickly adjust if demand falters. Amid easing labour conditions which increasingly favour the employer, and despite lower cost inflation and financing costs, companies generally remain reluctant to commit to new discretionary capital investments. We expect to see broadening year-over-year declines in investment activity upon completion of current projects and existing programs as 2025 progresses. Uncertainty surrounding potential policy actions of the incoming Trump administration in the U.S., particularly the potential for the imposition of significant tariffs, is now the leading driver of a freezing effect on many companies' investment and growth plans.

We continue to find attractive long-term value in the portfolio, which we believe is well positioned for an uncertain future. In addition to compelling valuations, which should offer superior compounding potential and better downside protection in a market selloff, we find that most of our portfolio companies are currently exhibiting some of their best financial health and resiliency in many years as measured by balance sheet strength and liquidity. The disparity in valuations between small caps and their comparatively expensive large-cap peers continues to exceed levels that have proven historically unsustainable.

While we seek to add value through our bottom-up analysis and portfolio construction, we are also mindful of striking an appropriate balance between return and risk. Beta is a commonly used measure of volatility. A beta of less than one means the portfolio is expected to be less volatile than its benchmark. At quarter-end, the beta of our portfolio on an ex-ante basis was (0.58), implying the portfolio is 42% less volatile than its benchmark, which is one of the lowest readings observed in recent memory.



Our decision to maintain portfolio risk at relatively low levels is driven by a combination of our cautious outlook and the relative attractiveness in the valuations of more defensively positioned companies, many of which we believe continue to offer some of the most compelling value in the Canadian small cap market on a risk-adjusted basis. Amid a sharpened focus on capital preservation, we remain less inclined to take risks, especially if such risks are not required for us to achieve our return objectives, as once again evidenced by our portfolio's risk-adjusted performance in the fourth quarter.

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 December 31, 2024.

Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not a guarantee of the performance of the stock market, or of any specific investment.

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