A Private Equity Approach to U.S. Equity Investing

with Loomis, Sayles & Company, L.P

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The following is a summary of a due diligence session with iA Clarington sub-advisor Loomis, Sayles & Company, L.P. (Loomis Sayles). The event was held on May 12, 2022.

Is the selloff we're seeing in the U.S. equity market – particularly in the growth segment – a result of fundamental, secular changes in the prospects of these companies or more short-term, sentiment-driven factors?

- A lot of investors have had a tremendous risk appetite – driven by recency bias – for low-quality companies such as Peloton and Zoom. What's now happening is reality is setting in and people are realizing these companies are not in fact the next best thing to sliced bread. As a result, we're seeing these names go through a severe price correction.
- These companies are not really differentiated in any meaningful way. For example, anyone with a computer and some programming skills can make a video conferencing platform. This lack of a wide competitive moat is typical of the overwhelming majority (almost 80%) of hyper-growth companies. In the IA Clarington Loomis U.S. All-Cap Growth Fund, more than 80% of the holdings have very wide competitive moats.

As the selloff intensifies, even some of the quality names that you and your team like are being smacked around pretty aggressively. How are you repositioning for this and where are you seeing the opportunities?

- During the tech bubble of 1999, most of the companies being bid up were junk, but there were a few high-quality names in the mix as well. They also got overbid and then pulled back severely when the bubble burst. Amazon is a good example – it reached $100 per share and came all the way down to $6 when the correction happened.
- The same is happening today, where the 'diamonds in the rough' got caught up in the irrational exuberance that drove the markets upward, only to get pulled back down alongside lower-quality names.
- We've taken the opportunity presented by the current volatility to add some high-quality names at attractive valuations (e.g., Netflix and Shopify).

Did Netflix's recent earnings release – which many see as catastrophic – in any way change your view of the company's long-term prospects?

- The release did not change our long-term view of the business.
- It was their first quarter of net-negative user growth, but keep in mind that exiting the Russian market cost them 700,000 users. If the war hadn't happened, the company would have actually posted a positive net user growth figure. In our analysis, the negative number is temporary and user growth will recover and further expand over time.
- The market, in our view, is overreacting to a single earnings release and we are happy to take advantage of the attractive entry point this has given us.

What are your thoughts on the view that we're on the verge of an environment where value outperforms?

- This is the kind of question that we would be inclined to leave to talking heads like Jim Cramer, because in our view it's futile to try to predict market factors like this.
- Importantly, risk factors like value, growth, momentum and beta have, in aggregate, very little impact on our strategy, which is driven predominantly by bottom-up security selection. Statistically speaking, whether value or growth is in favour doesn't make much of a difference for the fund.

Audience question: Tesla is facing an onslaught of competition, though it has a huge head start in the EV space. Can you speak to your investment thesis for this holding?

- Tesla is the market share leader and essentially the only major player at scale.
- 80% of first-time EV sales are Teslas.
- We understand the company will not maintain 80% market share over the next 5, 10, 15 years. Our expectation is that market share will normalize at around 50%.
- Their brand, scale, and the fact that they are bringing huge input costs down (batteries), will enable them to grow profitability faster than sales into the future.
- We think the company will start ramping up subscription revenue, which currently accounts for 0% of their operating income. We think it will reach about 25%.

How is inflation factoring into your security selection process?

- We look to invest in companies whose destinies are in their own hands, which means companies with sustainable competitive advantages, market share dominance, a position of leadership in their industry and pricing power.
- The natural tailwinds created by the quality characteristics of these companies tend to persist regardless of whether inflation is up or down.
- In an inflationary environment, these companies have the ability to pass on higher costs.

Are you seeing any opportunities in the hyper-growth segment of the market?

- We're following these companies closely and if any of them meet our strict criteria it is possible that we would add additional names to the portfolio. But we're avoiding the hangover that's followed a period of irrational exuberance, which we also avoided.
- Not participating in the bubble-forming stage has certainly impacted our short-term performance, but we see strong potential to add significant value over the full cycle by sticking to our patient, quality-centric approach.

Does the trend towards deglobalization create opportunities or challenges for your strategy?

- We do think we're looking at some short-term challenges, but ultimately we believe China wants to modernize and grow its economy – they need the global economy just as much as the global economy needs them. So we think China will eventually open up again and the status quo will prevail over the longer term.

Visit iaclarington.com/LS to learn more about the IA Clarington Loomis suite of funds.

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

Fund and benchmark performance, as at April 30, 2022	1 year	Since inception (Feb. 2021)
IA Clarington Loomis U.S. All Cap Growth Fund – Series F	-13.7%	-8.5%
S&P 500 Index (CAD)	4.1%	10.1%

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