DESAUTELS CAPITAL MANAGEMENT

2022

Ukrainian Crisis Special Report

LETTER TO INVESTORS
THE UKRAINIAN CONFLICT

Dear Investors,

Two weeks ago, Vladimir Putin launched an all-out invasion of Ukraine under the guise of a “special operation”. Since then, hundreds of civilians have been killed and millions displaced. DCM stands in solidarity with the Ukrainian people during these troubling times. While the current conflict is foremost a humanitarian crisis, we also have a responsibility to analyze its financial impact on our investors’ funds.

YTD the Global Equity Fund returned -3.8%, slightly underperforming its benchmark by 0.8%, and the Fixed Income Fund returned -3.4%, outperforming its benchmark by 0.9%. Overall, our exposure to the conflict is similar to that of the benchmarks and we don’t plan to take any directional bets on the outcome of the war. We currently don’t own any Russian stocks/bonds and sold our last Russian position, Nornickel, earlier in 2021 due to concerns about the company’s ESG policies. We exited at a price of $33.52, representing an 18% gain, vs a current price of $3.02.

This report summarizes our outlook for the Russia-Ukraine conflict and its long-term implications on financial markets. As we write these lines, many unknowns remain, and the extent and consequences of the invasion are unclear. One thing that is certain, however, is the unique learning experience that managing investment funds during these times will provide for students in our program. On behalf of DCM, we thank you for your continued support and send our best wishes to you and your families during these difficult times.

Sincerely,

Julien Séguin, *Incoming Global Equity Strategist*
Rachel Tang, *Incoming Fixed Income Strategist*

DESAUTELS Capital Management
Gestion de capitaux

Risk, Strategy, & Economics

2022 Ukrainian Crisis Special Report

Dillon Graveline, *Senior Analyst*
Kyrie Tong, *Senior Analyst*
Jasmine Liu, *Economic Analyst*

Then, Now, and Beyond
THE UKRAINIAN CONFLICT

DEEP ECONOMIC TROUBLES

After months of growing tensions, Russia invaded Ukraine on February 24. Given Ukraine's significant resistance thus far, despite being significantly militarily outmatched, we would not be surprised to see the conflict extending several more weeks, if not months. At the same time, the West has imposed strict economic sanctions aimed at Russian space, defense, energy, and other key industries. The Risk team holds the view that more sanctions are awaiting should the conflict escalate, and that the global economic ramifications will be long-lasting regardless of the outcome of the war. Russia could use its oil and gas as a political weapons and cut off supply to the West. Even though the Russian economy is on the smaller side – it accounted for 1.75% of global GDP in 2020 – long periods of high energy prices are sufficient to cause a drag on global growth. This is not to mention that Russia is also a significant exporter of agricultural products, fuel oil (20% of world export), coal (18% of world export), aluminum (50% of European output), nickel (5% of world output), and a variety of precious metals, which cover input resources for many of the West's key industries such as aerospace and semiconductor. The conflict is also raising the risk of indirect warfare, including cyberattacks, and due diligence on cybersecurity will become even more important for investors going forward.

A RISK-AVERSE MARKET IN THE COMING WEEKS

The Risk team expects the war will escalate in the coming weeks as negotiations seem to be heading nowhere. In the following weeks, we will keep monitoring the development of Ukraine's NATO and EU membership application, which could serve as a major trigger for conflict escalation and Putin's point of zero-tolerance. Throughout history, the market has shown that it cannot accurately predict the development of armed conflicts, given that they are typically abrupt and unexpected. Therefore, the market invariably reduces its risk appetite in the short term. Risky assets such as equities could face pressure for an extended period if the conflict extends and market risk appetite decreases further.

This further accentuates the need to fully understand the unique risk profiles of each of our holdings. This report serves as an audit of all our positions and how this conflict impacts our investment theses. Overall, actively trying to be one step ahead of the market will allow us to sidestep potential losses.

Even if the conflict is brief, impacts on economic growth will be widespread. If Russia cuts off the energy supply to Europe and there is a massive risk-off scenario, the spike in energy prices and trade disruptions caused by a European recession will force the Fed to be markedly more dovish. In a backdrop of high inflation expectations, this can be a significant problem for the economy at large.

Source: Bloomberg, Financial Times

Economic Ramifications

DEEP-DIVE INTO THREE ECONOMIC SCENARIOS

To assess the short- and medium-to-long-term implications of the Ukrainian conflict on North American markets, and thus DCM's holdings, we envisioned three economic scenarios examining the impact of the Russia-Ukraine war on growth and monetary policy in North America.

BULL CASE: LIMITED CONFLICT

Our first scenario consists of the following assumptions: politically, the conflict does not spread beyond Ukraine. Economically, sanctions from the West, especially from the EU, remain targeted at major financial institutions. Though the US announced its ban on Russian oil imports on March 8th, we believe the EU is unlikely to follow suit given its reliance on Russian energy supplies: nearly half of its gas imports are from Russia.

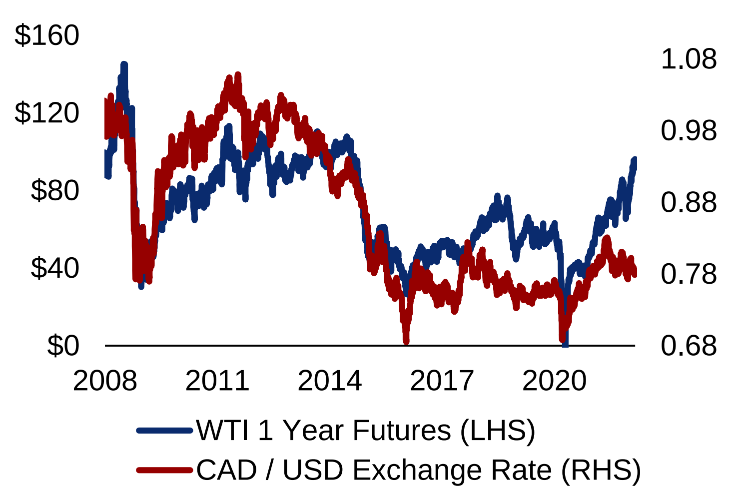
The impacts of such sanctions would be mainly felt in Russia through a falling ruble and rising inflation leading to aggressive rate hikes – as already seen through the Bank of Russia's decision to increase its interest rate from 9.5% to 20% in an attempt to shore up its currency. In North America, we argue that, should disruptions to oil and gas remain mild-to-moderate, the upside in US crude prices will be limited by (a) its ample domestic production capacity: specifically, the US is still producing ~10% less in crude oil compared to pre-pandemic levels, and (b) its limited dependence on Russian energy supply (only 3% of total US crude oil imports come from Russia).

We should keep in mind that fears of a prolonged conflict undermining growth may represent an excuse for central banks to avoid putting on the brakes through policy tightening, which could lead energy prices and long-term inflation expectations to increase. On the other hand, the possibility of the conflict ending at any moment could lead to a market rally.

BASE CASE: RESILIENCE AMIDST SUPPLY SHOCKS

In our second scenario, conflicts prolonging for over 3 weeks or even months along with stricter sanctions from the West would engender a greater shock to global energy supply and prices. In Russia, the impacts of a weak ruble and market turmoil could lead to a deeper recession. In North America, the main channel through which the development in Ukraine would affect the economy is persistent high commodity prices. We will explore their impacts on economic growth, inflation, and monetary policy in Canada and the US. Firstly, though crude price spikes benefit domestic producers, they may weaken consumers' real spending, thereby weighing on business and consumer confidence as well as growth. In Canada, a weaker currency that has not benefited from the rise in oil prices since the start of 2022 (*Figure 1*) increases the possibility that, as foreign imports become more expensive, inflation climbs higher, further hurting Canadian consumers' purchasing power.

Figure 1: Relationship between CAD and crude oil



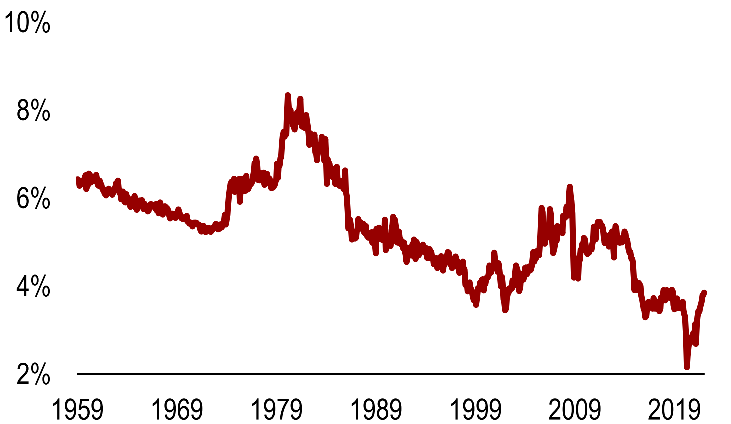
Source: FRED, Bloomberg, Bureau of Economic Analysis, BMO Economics

Yet, these inflationary pressures may be alleviated by strength in the current jobs market, particularly in the US. In fact, solid income growth combined with 50-year-low spending on energy goods and services as a percentage of overall income (*Figure 2*) would leave consumers less vulnerable to crude price swings.

Economic Ramifications

DEEP-DIVE INTO THREE ECONOMIC SCENARIOS

Figure 2: US Energy Consumption as a % of Disposable Income



BEAR CASE: STAGFLATION

While it is difficult to predict a worst-case scenario, we envisioned different possibilities of how the conflict may exacerbate, including the war expanding to other countries. As aforementioned, Russia could cut off its gas supply to the West; and Europe and the US could retaliate by applying intensifying sanctions, such as the EU joining the US in its ban on Russian oil imports. In this bear case, plausible outcomes include: (a) a deeper recession in Russia as its budget and energy sector take an additional hit; and (b) additional inflationary pressures and slowing growth in North America, solidifying stagflation fears akin to those in the 1970's following OPEC's oil embargo. Though the market shares such stagflation concerns, as reflected through the 10-Year Treasury yield's downward swing following Russia's invasion of Ukraine, we argue that these fears are overblown due to two main reasons. First, in the 1970s, the Fed did not target inflation, resulting in little monetary response in the face of soaring inflation. Today, long-term price expectations are better anchored as shown through the sharp increase in the 5-Year breakeven rate, a proxy for inflation expectations.

Second, the current period is not characterized by weak economic growth, high unemployment, nor stagnating workers' compensation, as was the case in the 70's. On the contrary, recovering labour markets – such as that in the US, which has maintained its high hiring momentum in February with nonfarm payrolls topping expectations by 220,000 jobs – hint at strong underlying economic conditions, which, in our view, helps shield the economy from shocks resulting from significant crude spikes.

Moreover, hourly wages have surprisingly flatlined, which indicates that workers are gradually returning to work. Such a slowdown in wage growth lessens the risk of a wage-price spiral, where higher wages implying stronger demand would lead firms to raise their prices, thereby reinforcing inflation. That said, DCM believes that the bear case is least plausible: higher inflationary pressures due to energy shortages, as outlined in the base case, should be short-lived considering the relatively strong underlying North-American economy fueled by the recovery from COVID-19.

CONCLUSION

As aligned with our base case, we do not expect the Ukrainian crisis to significantly alter the Bank of Canada and the Fed's broader views on monetary policy. In the US, although volatility in financial markets is likely to temper aggressive shifts, such as a 50-bps hike, record-high domestic inflation and a strong growth momentum lead markets to expect 25-bps rate hikes on March 16th followed by quantitative tightening. To summarize, the DCM exposure to the crisis is somewhat limited and aligned with its benchmark. As of now, we do not take a differentiated view on the conflict, and we remain confident in the resilience of our portfolio. The remainder of the report consists of a brief analysis of our funds' exposure by sector and key individual holdings.

Source: FRED, Bureau of Labour Statistics, NY Federal Reserve

Global Equity Fund

2022 Ukrainian Crisis Special Report

Julien Séguin, *Incoming Global Equity Strategist*
Frank Shen, *Outgoing Global Equity Strategist*

SECTOR OVERVIEW
A BOOSTER SHOT FOR OIL

ENERGY

Impact on the Sector

Short term: the European Union is looking to increase imports of liquid natural gas (LNG) by tanker ship from the United States or Qatar, as Europe relies on Russia – the third-largest exporter of Oil and Gas – for 40% of its natural gas supplies.

High gas prices and shortages of traditional energy sources are encouraging European countries to increase their usage of renewable energy sources. Nuclear energy has become a vital priority for countries such as Germany, the Czech Republic, France, Poland, and the U.K. American nuclear companies have the opportunity now to enter the European market as Russia continues to fall out of favour. With further action by Russia, we believe that additional and harsher sanctions will be imposed.

DCM Exposure

Oil & Gas

Given that Tourmaline, Parex, and Suncor are all O&G players, we expect them to perform very well if this crisis continues or worsens. As we have recently seen, their share prices have moved in line with increasing gas prices, so the energy squeeze from the further withdrawal of Russia from the global energy market will benefit those companies. Moving forward, the potential ban of Russian oil could act as an even greater catalyst for oil prices and therefore continue to push our holdings further up.

Note: Suncor's management has said that despite increased revenues from price spike, they will not be focusing any money on expansion of their asset base and instead will continue with their current plans to produce existing assets as efficiently as possible.

Methanol

If the supply of methanol from Russia is suspended, then the global methanol industry will be taking a great hit. The spike in natural gas prices has already severely affected European methanol production facilities and forced China to undertake the methanol demand, restricting its ability to provide for North American markets. This plays very favourably for Methanex as a global supplier of methanol to better corner the North American market and potentially increase its exposure to European markets.

Renewables

Much of Azure's recent gains can be explained by the recent release of the company's 2021 results, though the Russia-Ukraine conflict acts as an important catalyst for the clean energy transition, as already reflected in financial markets. In fact, the iShares clean energy ETP increased approximately 15% last week. Europe, the region most affected by Russia's energy squeeze, will act first (e.g. last Monday, the German Economic Ministry announced plans to accelerate wind and solar projects to reduce its dependence on Russia for energy). Other countries, such as India, where Azure is based, are expected to follow the renewed momentum. As such, our outlook for Azure is improved.

Sources: CNBC, IEA, Reuters, Wall Street Journal

SECTOR OVERVIEW

NEW WORLD ORDER IN COMMODITIES

MATERIALS

Impact on the Sector

Global commodity prices have seen double-digit gains across the board. The U.S. and Canada stand to benefit the most as they are least affected by the conflict and can continue energy and agriculture production at prices double the costs to produce.

Metals

Iron—China, the world's largest iron ore consumer, mostly determines iron prices through its import demands. However, Russia's invasion will likely only have a marginal impact as itself and Ukraine only account for 2.3% of Chinese iron ore imports meaning halting of those shipments will not change consumption. At the same time, China continues to reduce steel output in its green movement. Thus, altogether, iron may be up 15% since the invasion, but we don't see much continued upside from current levels.

Copper—Sanctions and SWIFT severance halted Russian copper exports, driving prices to $10,000/ton.

Coal—Disruptions to natural gas might temporarily shift Europe towards coal. However, Russia also accounts for 70% of Europe's coal imports; not surprisingly, European API2 coal prices jumped 14% on Feb. 25.

Aluminum—Given the cutting of Russia's exports and slow European exports due to high power costs, Aluminum is posed for price gains in the near term.

Nickel—A 90% surge marked a historic high. Russia is one of the world's largest suppliers and sanctions add to the already tight post-pandemic market.

Gold—Has crossed the $2,000/oz mark and at $2063, is at historic highs.

Building Materials

Even if they have limited sales, building material manufacturers in Russia and Ukraine (i.e. Buzzi Unicem and Holcim) are hurt from halting construction projects.

Agricultural Inputs

Russia is a top high-volume, low-cost fertilizer exporter; sanctions have driven up prices of potash and ammonia. However, the North American counterparts of Mosaic and Nutrien will see widening margins especially when the continent is now politically safe.

Wheat Worries—Ukraine and Russia account for 25% of the world wheat supply. War means a food shock at a time when countries' grain stockpiles have been in the fifth year of decline (pandemic exacerbating). Consequently, wheat futures have reached a record $13.535/bushel.

With farmers on the fighting front resulting in empty fields, and protectionism stirring as countries such as Hungary, Serbia, Argentina close off exports, famine becomes a real risk. Food insecurity usually spells societal unrest and, in that case, the effects spill over to all of the equity markets.

DCM Exposure

The run-up in global commodity prices is one of the most important economic developments from the Russia-Ukraine conflict, at least so far. Vale SA, the Materials sector's main holding, is once again expected to deliver another strong year of share repurchases and special dividend distributions, due to a rebound in steel demand from the Chinese housing market and base metal supply shortages caused by the potential boycott of Russian commodities.

Source: Bloomberg

SECTOR OVERVIEW
SUPPLY SHORTAGES, AGAIN

CONSUMERS

Impact on the Sector

One impact of the current situation we see on the Consumers sector is inflation stemming from supply shortages. In particular, wheat prices hit their highest since 2008, as Russia and Ukraine are major exporters of grain and oilseed supplies. Another subsector potentially impacted by the conflict is the auto industry, as Russia is the largest exporter of palladium. Finally, companies operating or sourcing from Russia and Ukraine, or that generate a significant portion of revenues from consumers in these regions, will be most affected. Overall, although we expect there to be significant volatility in some subsectors in the short term, we do not see major impacts on the overall sector in the long run.

DCM Exposure

Our only holding at the moment is Ocado, which could be exposed to rising oil prices for grocery delivery. However, our theses rely more on the shift towards a solution provider company, and we believe geopolitical risks are less of a concern for Ocado's solution division. We are also considering purchasing a Canadian stock, whose manufacturing and operations are largely based within the country, and we see minimal risk exposure for this company going forward.

Sources: Kiplinger, World Economic Forum

FINANCIALS

Impact on the Sector

The repercussion of the conflict on financial institutions could be great with over US$100 billion of Russian debt owned by foreign banks. European banks are the most exposed to this threat. Data show that French and Italian banks have tens of billions in outstanding claims on Russian debt. Relatively, American banks decreased their own exposure since the invasion of Crimea in 2014.

DCM Exposure

We believe that DCM's FIG sector will intrinsically remain unaffected by the downside, and our upside forecasts remain largely intact.

SSNC Technologies: SSNC has the vast majority of its revenues and earrings based in North America. As a result of America's largely vocal but not physical response, we believe that the US asset management industry will remain unaffected. While there may be a rush to safety, we believe the stickiness of their clients' offering will largely mitigate their exposure to outflows. On the European side, SSNC's growth may be hampered due to political uncertainty. In addition, this may affect acquisitions into Central Europe and those countries close to Ukraine. However, since SSNC is mostly providing software to clients we feel this relationship will mitigate any material downside to the holding.

Bank of America: Bank of America is a holding that has seen a large hit since the start of the Ukraine-Russia conflict dropping ~22%, despite EMEA in total only representing 10% of net income and ~7% of total assets held. We feel the drop as unwarranted and remain bullish on the short-term inflation outlook boosting bank interest revenues.

SECTOR OVERVIEW

INDUSTRIALS UNDER SPOTLIGHT

INDUSTRIALS

Impact on the Sector

The Russia-Ukraine conflict presents a moderate risk to our sector due to the industrial sector's exposure to gas prices. Many of our holdings' performances are affected by gas prices – for instance, Canadian Pacific Railway's margins have been compressed this past year due to higher gas prices (one of CP's most significant input costs), and this conflict could further decrease margins.

DCM Exposure

Continental AG has yet to respond to the crisis with a press release, but we expect the company's sales to Russia/Ukraine to be hit. Russia is not a key production or sales market for Continental AG, so we expect effects to be minimal.

Volkswagen has stopped production of vehicles in Russia, as well as export of vehicles to Russia, as of March 3, which will result in decreased sales. Furthermore, the supply chain for several German and European plants have been affected, as the company sources several parts (specifically, wiring harnesses for vehicles' electrical systems, as well as switches in the interior) from suppliers located in Ukraine. Volkswagen is working to establish and secure alternative production sources but, in the meantime, this will lead to decreased or delayed production. Carmakers depended on Ukraine for wiring systems due to cheap and well-educated labour, as well as proximity to European manufacturing plants, so finding a replacement for such strong demand will be challenging. Overall, Volkswagen cites Russia as a key sales market accounting for 2.4% of the company's passenger vehicle deliveries, and 4.5% of the company's commercial vehicle deliveries in 2020. Other major carmakers have joined Volkswagen is suspending production and sales to Russia. Although the company's sales will be hit, the whole industry will likely be similarly affected.

In addition to Volkswagen's operations in Ukraine, its operations in Europe will likely be hit as well. Almost a third of Germany's gas is imported from Russia, so if Russia follows through on its warning that it will shut off its main Nord Stream gas pipeline to Germany, production would be stalled across Germany and the rest of Europe which is also heavily dependent on Russian gas. Gas shortages worldwide, and higher gas prices in general, would also lead to reduced consumer demand for cars over the long term. Should the conflict continue in the long-term, it will likely result in Volkswagen and other carmakers' deglobalizing operations. With the supply chain already thrown off by chip shortages in the past year, the current stall on supply chains from this conflict will push this deglobalization trend forward.

TMT

Impact on the Sector

Increased news coverage and readership on the Russia-Ukraine conflict could positively affect TMT's media exposure (NYT), particularly as the NYT is a leading source for up-to-date news on the situation; the rising concerns and impact of hostile cyber warfare are a boon for cybersecurity and validate TMT's thesis to gain exposure to the cybersecurity industry (BUG).

DCM Exposure

T-Mobile has waived international customer charges in several countries impacted by the crisis and faces potential broadband outages in heavy combat zones, as well as the looming threat of internet shutdown in Ukraine, which could negatively impact performance in the short to mid-term but is overall of low incidence.

SECTOR OVERVIEW

HEALTHCARE SERVICES UNSCATHED

HEALTHCARE

Impact on the Sector

The DCM healthcare sector has a minimal risk exposure towards the ongoing Ukrainian war given our portfolio's concentrated weighting in the healthcare services subsector, which is moderately protected by its singular geographical exposure (~1% of total sector revenue at risks in Russia and Ukraine). Moving forward, we anticipate a temporary increase in volatility of healthcare equities in the short-to-medium term due to market noises, but without any structural impact on the sector's fundamental valuation as company earnings remain relatively unaffected by the war. Currently, we see attractive opportunities in health care supplies including medical consumables and instruments, as well as cybersecurity for health care systems.

DCM Exposure

Aveanna Healthcare: The Russo-Ukrainian war does not directly affect our investment theses focusing on the aging US population, but we see a potential change in resource allocation in the US labour market, which could compress the company's profitability margin in the short term. We remain positive about its long-term outlooks.

Orchard Therapeutics: By nature, ORTX is more affected by idiosyncratic events rather than systematic events, namely the ongoing Russo-Ukrainian war. We anticipate potential change in ORTX's valuation as investors revaluate the risk profile of their portfolio and reallocate assets towards low-risk equities. This consequently increases the discount rate of high-risk, small-cap companies such as ORTX. Although decreasing relative valuation could be unfavorable towards short-term return performance, we do not see any fundamental changes in ORTX.

Fixed Income Fund

2022 Ukrainian Crisis Special Report

Mirella Deng, *Senior Analyst*
Rachel Tang, *Junior Analyst*

Fixed Income Market
UNDER MILITARY CONFLICT

CREDIT MARKET TUMBLES

Following the onset of Russia's invasion of Ukraine, the global credit markets have been thrown into turmoil. As of March 3rd, 2022, major crediting rating agencies (S&P, Fitch, and Moody) cut Russia's sovereign credit ratings deep into the Junk grade territory, reflecting Russia's weakened debt servicing ability in the face of Western sanctions.

Figure 1: Russian Sovereign and S&P IG YTM (YTD)

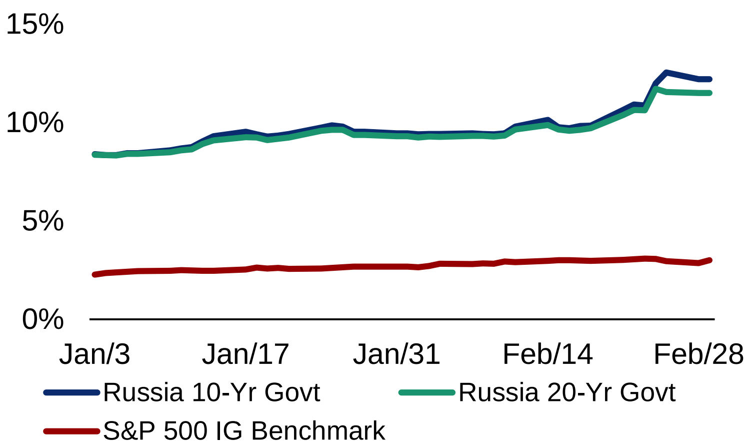


Figure 1 illustrates the credit yields of the Russian and the global credit markets since the beginning of 2022. While Russian sovereign bond yields sharply expanded from 8% to 12% since the new year, the S&P 500 IG Bonds yield rose from 2.28% to 3.01%, pointing to our first observation that the North American credit market is relatively resilient against the backdrop of a collapsing Russian market. The chart also shows an overall upward trend in bond yields that predate the outbreak of the Ukrainian crisis; such an upward trend can be attributed to concerns around excessive inflation and the magnitude of the forthcoming Fed rate hikes. Issuers' fundamentals remain strong amid the uncertain macro environment. As per Moody's, the global speculative-grade default rate has picked up modestly recently but is likely to stay in a reasonable range.

Further assessing the impact of the war on North American markets, we note that, while Russia plays an outsized role in the EU markets whose petroleum imports from Russia accounts for around €67bn per year it has less exposure to the US oil and gas industry. To carefully monitor the aftermath of the potential sanctions on Russia's oil and gas sector and the subsequent supply constraints, our Economist Analyst delved into three possible scenarios in the front section of this report.

Given the little exposure US credit markets have to the recent military conflict, up to now, we view that the recent surge in yields is mainly reflective of an overall uncertain inflationary environment coupled with elusive monetary policy. However, the Ukrainian crisis further highlights the pre-existing market concerns and could lead to short-term expansion of corporate yields.

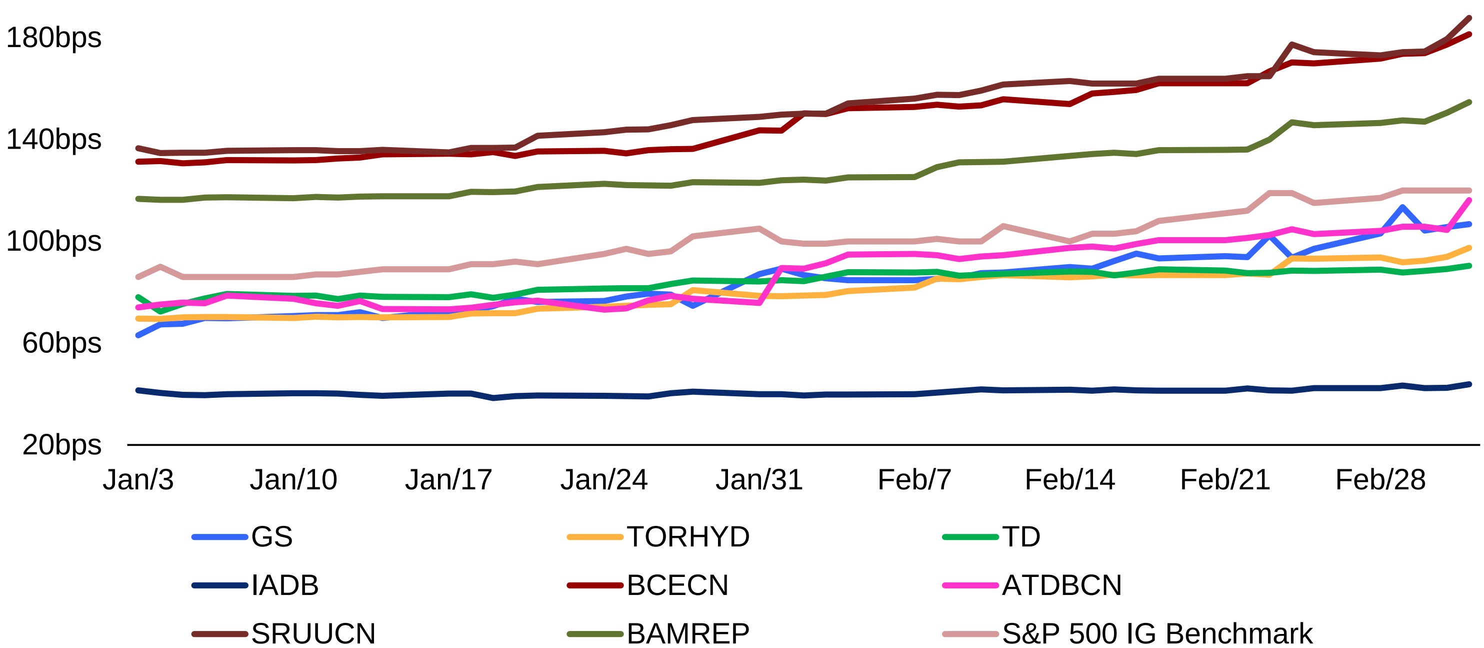
Under the worst-case scenario, aggressive sanctions on the oil and gas industry will likely exacerbate the de-globalization trend, lead to stagflation, and result in deteriorating credit fundamentals of North American issuers. As such, we shall carefully examine the defensibility of corporate bonds in the face of stagflation and prioritize non-discretionary issuers.

Overall, even though Europe will struggle economically in the face of military conflict, we expect less change in credit fundamentals in North America despite lowered valuations. To be better positioned to discover undervalued bonds, we will focus on the high-yield space where valuation is more reliant on company fundamentals rather than the macro environment. Meanwhile, we continue to monitor the impact of the crisis on our existing holdings, especially the ones with exposure to financial institutions and the energy sector.

Source: Bloomberg, Moody's, Reuters, S&P

Fixed Income Fund
UNDER MILITARY CONFLICT

Figure 2: Fixed Income Fund Holdings' OAS Spread (YTD)



HOLDINGS REVIEW

Figure 2 above shows the OAS of Fixed Income Fund's holdings and the IG benchmark since January. We note a uniform spread expansion across holdings and the benchmark, with Goldman Sachs (GS), Bell Corporation (BCECN), and Alimentation Couche-Tard (ATDBCN) having expanded the most.

According to Moody's, beyond the energy sectors, the overall direct exposure of non-financial companies to Russia is very low. Indeed, no company in the Fixed Income Fund portfolio has >20% revenue exposure to Europe due to the diversified nature of their operations; the most exposed holding is Couche-Tard (ARDBCN) with 19% of exposure to Europe. Outside of oil and gas sectors, Moody's has highlighted that the tobacco, consumer packaged goods and paper and forest products sectors are the most exposed to Russia – none of these sectors to which the Fund has direct exposure. Since many of our holdings are non-discretionary in nature, it is important to highlight the indirect exposure via the transmission mechanism of higher input prices for energy and other raw materials. However, this exposure is not new – higher input costs are a prevalent issue during the pandemic. The ability for issuers to mitigate higher costs ultimately depends on strong pricing power that passes on costs to end markets. Therefore, we will dive deeper among our holdings that have energy exposure, namely Brookfield (BAMREP), Toronto Hydro (TORHYRD), Couche-Tard (ATDBCN), as well as Goldman Sachs (GS), given the relevant impact on the global financial systems. Inter-American Development Bank (IADB) has not seen much impact given its focus on Latin America and the Caribbean.

Source: Bloomberg, Moody's, S&P

Fixed Income Fund
SANCTIONS REPURCUSSIONS

ENERGY PRICE SHOCKS

Diving deeper into the Fixed Income Fund's energy sector holdings, **BAMREP** and **TORHYRD** are not directly prone to negative impacts from the ongoing attacks from Russia. Though BAMREP generates ~25% of its total operations in Europe, it has no operations in Russia. In fact, analysts are hinting at the attack on Ukraine as a clear warning to the US to achieve energy independence through renewables. On March 3rd, 2022, Plug Power CEO Andy Marsh highlighted that "the Russia-Ukraine war 'will accelerate' move to green hydrogen and renewable energy". Plug Power has made a public commitment to produce 500 tons of green hydrogen in the US by 2025 and 1,000 tons globally by 2028 given the strong market demand. This is relevant for BAMREP as they entered an agreement in September 2020 for Plug Power to source 100% renewable energy from Brookfield Renewable to fully power one of North America's first "green" hydrogen production facilities. Thus, we will continue to monitor the market's transition and consumption of renewables.

In regards to **ATDBCN**, it has recently suspended operations in Russia (38 shops out of 14,200 footprints and >320 staff members), which account for an insignificant portion of its total operations. However, its business model is reliant on oil prices. As part of our initial pitch, we have conducted an extensive sensitivity analysis and found the company has a robust cost pass-through structure. As fuel prices rise, ATDBCN has strong pricing power to pass on heightened input costs to consumers, though inflation expectations may play a heavy role in the fuel volume sold. With this, we see opportunities in the energy sector (especially in HY) as the bond spreads dramatically expanded while company fundamentals remain relatively unchanged, creating fairer valuation and strategical entry points for DCM.

FINANCIALS TURMOIL

Against an already fraught wartime backdrop, the restricted access of Russia to the SWIFT system further stirs up turmoil within the financial institution sector, causing a modest dip in equity and bonds of the global financial players.

According to the Bank of International Settlements, US banks have insignificant exposure to Russian banks when compared to European banks. As such, we expect little spillover effect from weakened economic and financial conditions in Russia to North American markets. Nevertheless, it is imperative to re-assess the risks of our only US bank holding, **GS 2.013% 2029**. With the absence of idiosyncratic risk, we identified two major systemic risks associated with the GS bond: margin deterioration as a result of additional operating costs following the SWIFT sanctions, and the headline risk due to Goldman Sachs' arbitrage play on some Russian distressed debt securities.

That being said, GS' bond investors seem confident about the bank's ability to navigate through geopolitical headwinds, as evidenced by the bond's OAS spread that widened by the same magnitude (19bps) as the S&P IG Benchmark since February 7th. DCM's view is consistent with the market in that GS has the balance sheet and cash flow generation ability as a cushion to these temporary challenges.

Among the US asset managers, GS has a relatively smaller fund exposure to Russia, Since the start of the invasion, GS has actively sought to de-risk by reducing its exposure to Russia in its GQG international equity fund from over $1.7bn six months ago to about $222mm now. As such, we have confidence in the Bank's risk management capabilities.

Source: Bank of International Settlements Bloomberg, Global News, Moody's, Reuters, S&P, Yahoo Finance!

DISCLAIMER

The Desautels Global Equity Fund, the Desautels Fixed Income Fund, the Desautels Alpha Squared Fund, and the Desautels SRI Fund (hereafter: the Desautels Funds), together with Desautels Capital Management Inc., have been established as a pedagogical venture in order to offer students in the Investment Management Program in the Desautels Faculty of Management at McGill University some meaningful and realistic experience of the investment management industry and of investment research and analysis by working for Desautels Capital Management Inc. All outstanding shares of Desautels Capital Management Inc. are owned by McGill University. Desautels Capital Management Inc. has a separately constituted board of directors, all of whom are independent from McGill, and constitutes a separate legal entity having responsibility for its own affairs. The role of McGill University towards Desautels Capital Management Inc. is limited to the following activities: (i) appointing independent directors to Desautels Capital Management Inc.'s board of directors; and (ii) providing limited financial resources and support to Desautels Capital Management Inc., such as office space and allowing certain of its officers and employees to serve as officers of Desautels Capital Management Inc. or to carry out certain other functions.

Neither McGill University nor the Board of Governors of McGill University has the authority or power to act on behalf of Desautels Capital Management Inc. or the Desautels Funds, or to incur any expenditures on behalf of Desautels Capital Management Inc. or the Desautels Funds. Neither McGill University nor the Board of Governors of McGill University shall be liable for any debts or obligations of Desautels Capital Management Inc. or the Desautels Funds. McGill University is not involved in the daily activities of Desautels Capital Management Inc., including making investment decisions, and therefore does not take any responsibility for Desautels Capital Management Inc.'s activities. More specifically, McGill University has no liability under the Units, does not guarantee or otherwise stand behind the Units nor does it guarantee performance of the Desautels Funds. Any function or activity of Desautels Capital Management Inc. carried out by individuals who are also officers or employees of McGill University is carried out exclusively in the name of Desautels Capital Management Inc. and McGill University shall have no liability as a result thereof.

Neither the information nor any opinion expressed in this Annual Report constitutes an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments (e.g. options, futures, warrants, and contracts for differences). This Annual Report newsletter is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this Report and should understand that statements regarding future prospects may not be realized. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this Annual Report.

All opinions, projections and estimates constitute the judgment of the author as of the date of the newsletter and are subject to change without notice. Prices also are subject to change without notice. Desautels Capital Management Inc. is under no obligation to update this Annual Report and readers should therefore assume that Desautels Capital Management Inc. will not update any fact, circumstance or opinion contained in this Annual Report. Neither Desautels Capital Management Inc., nor any director, officer or employee of Desautels Capital Management Inc. accepts any liability whatsoever for any direct, indirect or consequential damages or losses arising from any use of this Report or its contents and, in some cases, investors may lose their entire principal investment. Past performance is not necessarily a guide to future performance. Levels and basis for taxation may change.

Program Partners

CIBC MELLON

BLG Borden Ladner Gervais