

# Equity Team Commentary: Focused on Quality

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Craig Jerusalem, CFA, MBA, Senior Portfolio Manager, Head of Global GARP

Tudor Padure, CFA, Portfolio Manager, Equities

Catharine Sterritt, Portfolio Manager, Opportunities Funds

Natalie Taylor, CFA, Portfolio Manager, Global Equities



## Key takeaways:

- Major policy changes, including the passage of the One Big Beautiful Bill Act (OBBBA) and the expiration of tariff relief, drove major North American indices to record highs, but now face some unanswered questions.
- The OBBBA's extension of tax cuts and restoration of 100% Bonus Depreciation provided significant benefits to companies, especially Canadian firms with substantial U.S. operations, while the subsequent increase in tariffs introduced new risks and inflationary pressures.
- Elevated market speculation prompted a shift to a more defensive investment approach, focusing on high-quality companies and reducing exposure to cyclical and growth names.
- Despite ongoing macroeconomic and political uncertainty, corporate earnings have remained robust, particularly in Canada.

July delivered exceptionally strong equity performance, bookended by major policy developments and punctuated by a series of headline-grabbing distractions. While political theatrics sought to divert attention from pressing issues, it was the passage of the One Big Beautiful Bill Act (OBBBA) on July 4th and the expiration of tariff relief on August 1st that truly shaped market direction—initially driving equities higher, with the potential for increased volatility ahead. Investors responded enthusiastically to the OBBBA's focus on deregulation and lower taxes, propelling the S&P 500 up 2.2%, the Nasdaq 3.7%, and the S&P/TSX 1.7% in July, with all three indices reaching record highs.

The OBBBA's permanent extension of the Tax Cuts and Jobs Act and Inflation Reduction Act averted looming tax hikes, while the restoration of 100% Bonus Depreciation allows companies to immediately deduct capital investments in infrastructure, technology, and manufacturing. This is particularly advantageous for Canadian firms with significant U.S. operations, such as Brookfield, Element Fleet, and GFL, which stand to benefit meaningfully from these changes.

However, the month closed with a significant headwind: tariff rates increased for most U.S. trading partners—including a 35% rate for non-USMCA compliant Canadian exports—posing risks to investor sentiment and adding inflationary pressures. (It is important to note that a significant portion of Canadian exports remain protected from tariffs under the USMCA.) We also observed a concerning resurgence of speculation, evidenced by heightened options activity, unjustified rallies in meme stocks like Kohl's, Krispy Kreme, and GoPro, and a wave of capital raises targeting Bitcoin and other speculative cryptocurrencies.

Given this challenging mix of elevated valuations, increased speculation, and a growing disconnect from fundamentals, we adopted a more defensive posture in our funds. We increased our exposure to high-quality companies—such as Intact Financial, Waste Connections, and Fairfax Financial—following what we viewed as unwarranted negative reactions to otherwise strong quarters and robust outlooks. To fund these additions, we trimmed positions in cyclical and growth names that had performed well and were nearing our target prices, ensuring our portfolios remain well-positioned for a range of market outcomes.

Beyond macroeconomic and political developments, the month was marked by significant corporate news. Alimentation Couche-Tard decisively ended its pursuit of 7&I, redirecting its focus toward smaller, strategic acquisitions, enhancing its food offerings, and—most notably—resuming its share buyback program. The scale of the buyback is substantial, representing approximately 12% of the company's float, which should provide meaningful support for the stock amid a period of softer U.S. same-store sales growth and normalizing fuel margins. Given this renewed strategic focus and the company's strong track record, we reduced our underweight position, reaffirming our confidence in this historically high-quality business.

The North American rail sector continued to transform, with further consolidation announced between Union Pacific and Norfolk Southern. While a potential merger between Burlington Northern and CSX appears to be the next logical step, the implications for Canadian rail operators remain uncertain. Such developments could intensify competitive pressures, particularly for CP in the critical Chicago-to-Mexico corridor.

In healthcare, our sole holding, DRI Healthcare, received a significant catalyst with the FDA approval of Sebetralstat. This milestone meaningfully reduces risk in DRI's growth outlook and validates their strategy of investing ahead of regulatory approvals given the handsome payoff.

In the materials sector, copper experienced unprecedented volatility—surging 15% early in the month before suffering its largest single-day decline on record. This dramatic reversal was triggered by the Trump administration's decision to impose import tariffs exclusively on semi-finished copper products, while exempting refined copper, creating significant market dislocation.

It was also an eventful month for telecommunications. Telus announced a \$2 billion investment to expand broadband infrastructure in Quebec and Ontario and entered into a strategic partnership to sell a 49% stake in its tower assets to The Caisse for \$1.26 billion. Despite these positive developments and a quarter that met expectations with several encouraging catalysts, investors reacted negatively, driving the share price lower—a response we believe does not reflect the company's underlying strength and strategic progress.

As headlines about tariffs and the ongoing dominance of Truth Social and X capture the news cycle, our focus remains steadfast: identifying and investing in high-quality companies best equipped to navigate market volatility. Despite persistent negative sentiment, stubborn inflation, and unpredictable political leadership, corporate earnings have consistently outperformed market expectations, demonstrating robust growth. With 40% of TSX companies having reported Q2 results, the average year-over-year earnings growth rate has exceeded 12%—surpassing the S&P 500's rate of approximately 8%. One notable challenge has been the recent market leadership by the lowest quality quintile of companies since the April lows—an unusual dynamic typically seen at the onset of a market recovery, not when indices are at record highs. Despite this, we remain disciplined in our approach, avoiding the temptation to chase speculative, unpredictable companies. Instead, we are committed to investing in businesses with the most consistent earnings and sustainable growth prospects. History shows that, over the long term, stock prices ultimately reflect earnings growth, with short-term deviations presenting opportunities that we intend to continue capitalizing on.

## About the authors



**Craig Jerusalem**

CFA, MBA, Senior Portfolio Manager,  
Head of Global GARP



**Tudor Padure**

CFA, Portfolio Manager, Equities



**Catharine Sterritt**

Portfolio Manager, Opportunities Funds



**Natalie Taylor**

CFA, Portfolio Manager, Global Equities



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