



TALL OAK
CAPITAL ADVISORS

Quarterly Report

2023

Q3

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Global equities declined over the quarter despite strong gains in the first half of 2023. Government bonds also posted negative returns as the Fed's "higher for longer" theme started to sink in.

U.S.

In the U.S., a strong start in July was overshadowed by rising interest rates, leading to lower stock and bond market returns. Although economic growth remained robust, challenges mounted, such as a potential government shutdown, rising energy costs, and the resumption of student loan repayments. The labour market remained solid despite some softening in job growth. The housing market faced challenges due to limited inventory and rising mortgage rates. Homeowners hesitated to sell despite high prices, while potential buyers were deterred by the cost and the prospect of higher rates. Consumer spending concerns grew as pandemic-related savings were depleted, forcing consumers to rely on higher credit card balances to sustain their spending habits. The U.S. national debt reached US\$33 trillion for the first time, and Fitch downgraded the U.S. credit rating from AAA to AA+.

From a sector perspective, ten of eleven sectors were in the red. Energy performed well amid surging oil prices, while the information technology and real estate sectors were the weakest.

The S&P 500 Index, Dow Jones Industrial Average and NASDAQ Composite Index declined 3.6%, 2.6% and 4.1%, respectively, in U.S. dollar terms. The U.S. dollar gained over 3.0%, posing challenges for corporations.

Quarterly Returns

Index or Proxy	%
EQUITIES	
S&P 500	-3.6
Dow Jones Industrials Average	-2.6
NASDAQ Composite Index	-4.1
S&P/TSX Composite Index	-3.0
iShares MSCI ACWI ETF	-3.7
iShares MSCI EAFE ETF	-4.9
BONDS	
iShares 20+ Year Treasury Bond ETF	-13.3
iShares Core Canadian Universe Bond Index ETF	-3.8
US SECTORS	
Communication Services	2.8
Consumer Discretionary	-5.0
Consumer Staples	-6.6
Energy	11.3
Financials	-1.6
Health Care	-3.1
Industrials	-5.6
Information Technology	-5.8
Materials	-5.2
Real Estate	-9.7
Utilities	-10.1

Source: FACTSET, Morningstar, Raymond James Ltd., local currency terms unless otherwise stated

Canada

After raising its overnight rate by 25 basis points to 5.0% at its July meeting, the Bank of Canada (BoC) held interest rates steady in September. The central bank cautioned that the Canadian economy has “entered a period of weaker growth” and that “excess demand is easing” despite inflation and wages remaining higher relative to the BoC’s preferred levels.

With overly indebted households facing higher mortgage rates and increasing debt-service ratios, the Canadian economy has become more vulnerable to a downturn. Further interest rate hikes are uncertain, as the BoC may be limited by household vulnerability to high interest rates.

The S&P/TSX Index fell 3.0% during the quarter and saw flat performance year to date. Out of the eleven sectors, health care and energy were the two positive performers. Utilities and communication services were the biggest laggards.

Europe

In the eurozone, shares fell 5.1% amid concerns about rising interest rates, particularly affecting the consumer discretionary sector. Equities rose 1.0% in the UK, benefiting from a weak sterling.

Asia

Asian equities (excluding Japan) declined due to concerns over the Chinese economy. China’s debt and property market problems intensified, and the government still seemed reluctant to undertake aggressive stimulus measures. Japan’s economy demonstrated resilience, with tourism recovering and services spending returning to

pre-pandemic levels. Japanese equities were one of the strongest performers year to date. However, the Nikkei 225 Index fell 4.0% over the quarter.

Emerging Markets

Emerging markets faced challenges from a strong U.S. economy and Chinese economic weakness. Equities fell 4.1% in USD terms over the quarter.

Fixed Income

Central banks made varying interest rate decisions, with the European Central Bank possibly nearing its rate peak, and the Bank of England ending a series of rate increases. The Bank of Japan maintained a low short-term interest rate. The BoC met and held its interest rate unchanged in September at 5%, after increasing it 0.25% in both June and July. The U.S. Federal Reserve (Fed) raised interest rates in July to a range of 5.25% to 5.5%, while during the September meeting, they held rates steady at their 22-year high.

The fixed income market struggled as interest rates rose, leading to the worst quarter for domestic bonds. The FTSE Canada Universe Index fell 3.9%, with corporate bonds outperforming government bonds. Global government bond yields peaked before retreating, with the U.S. 10-year Treasury yield rising to 4.57%.

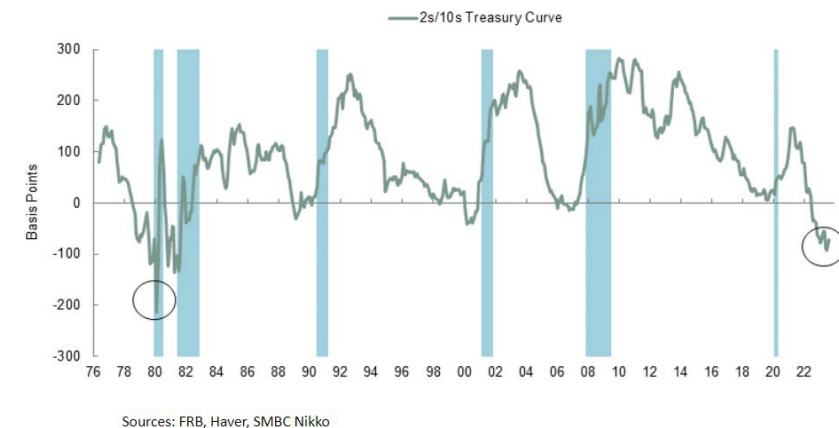
Source: S&P Dow Jones Indices, Raymond James Market Pulse, Russell Investments

UNDERSTANDING YIELD CURVE INVERSION

Q3 2023

The yield curve, a critical economic indicator, plots the rate of interest received on bonds across the time spectrum of maturity dates for a given bond index (i.e., Government bonds or investment-grade corporate bonds). The yield curve usually slopes upward, meaning that long-term bonds typically offer higher interest rates than short-term bonds. For example, since 1976, 10-year bond yields have generally been higher than 2-year yields about 85% of the time, with an average difference of 0.89%.

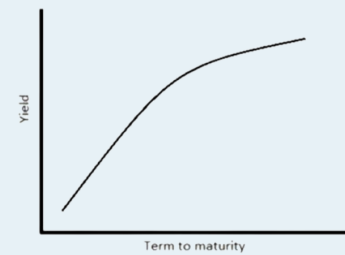
However, when long-term yields drop below short-term yields, it can signal an upcoming economic recession. This is called a yield curve inversion, and it usually happens when investors anticipate lower interest rates. In the U.S. economy, this yield curve inversion has historically occurred before five out of six recessions since 1976, with an average lead time of 15 months. Looking at chart below, we can see that while it did not predict the recent pandemic-induced recession, the yield curve has reliably inverted before economic downturns.



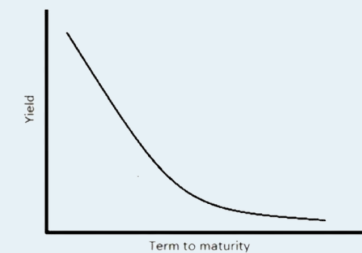
Since July 2022, the yield curve has been inverted for 14 consecutive months, which usually suggests underlying economic issues. So, why

Normal versus an inverted yield curve

Normal Yield Curve



Inverted Yield Curve



hasn't a recession occurred yet?

In the third quarter of 2023, we saw a quick reversal of the inversion (also called "dis-inversion"). For context, in July the curve was inverted by 107.5 basis points (meaning 2-year yields were higher than 10-year yields by this much). As the quarter progressed, we saw longer-term bonds sell off and their corresponding yields rise, bringing the yield curve to its least inverted position in almost a year.



Source: St. Louis Federal Reserve, Raymond James Research

UNDERSTANDING YIELD CURVE INVERSION

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As the graph on page 3 indicates, recession and job losses have historically started after the yield curve was back on an upward slope rather than while the yield curve was inverted. So, while most economies have so far managed to stave off recession, it may very well be on its way. However, it's critical to remember that the yield curve is not the only economic indicator at play, nor does an inversion automatically predict recession.

There are other factors in the mix, including the persistence of inflation, unemployment and wage growth. And some market participants have posited that many traditional indicators may not be accurately predicting inflation. While the unemployment rate has remained below 4% for an extended period, wage growth has been on a gradual decline due to slower benefit growth, rising productivity, and a shifting job market. Moreover, declining union membership and changes in the labour market suggest that low unemployment might not necessarily lead to higher inflation.

Suffice it to say that while many economic and financial indicators are pointing to a recession, and while we remain vigilant, a recession in 2024 is not a foregone conclusion.

Higher For Longer Interest Rates

We also witnessed the U.S. 10-year Treasury at high levels not seen since 2007 and 2001. This has enormous relevance for asset pricing, and in our view, U.S. equities prices do not broadly reflect the impact of higher risk-free rates. Global central banks, especially the U.S. Federal Reserve, have been loud and clear about keeping rates higher for longer to address the stickiness of inflation, specifically as it relates

to housing and wages, which continues to weigh on asset prices and equity valuations.

This year has seen a significant disparity in equity valuations. Smaller-cap companies within the Russell 2000 Index have experienced notably less favourable performance compared to the larger-cap companies in the S&P 500 Index. From the end of the first quarter to the present, the S&P 500 Index has seen a modest increase of 2%, whereas the Russell 2000 Index has suffered a decline of 6%. Additionally, 10-year U.S. Treasury rates have surged by approximately 140 basis points, rising from 3.5% to 4.9%. It's essential to note that this observation does not offer a perspective on what the ideal equity valuation should be at this moment. Rather, it highlights that, given minimal divergence in cross-capitalization fundamentals, the straightforward mathematical impact of higher interest rates on valuations would have predicted a relatively proportional decline in both large- and small-cap valuations.

Tall Oak Capital Advisors' investment approach benefited from the "risk-off" environment in the third quarter. We benefited from our defensive and diversified asset allocation to large-cap, high-quality companies. Higher energy prices also helped increase the value of our diversified basket of high-quality energy companies. As we normally notice in a risk-off scenario, the U.S. dollar increased during the quarter, which translated into higher Canadian dollar values for our U.S. holdings.

As yields moved higher in the quarter and with the expectation that they will stay higher for longer, we took advantage by lengthening duration in our fixed income holdings, allocating to longer-dated corporate bonds that offered very attractive long-term yields.

Going forward, it is our belief that financial market volatility is likely to continue while we wait for the full effects of higher interest rates to filter through the global economy. We are already seeing some of the impact of a “higher for longer” rate environment, particularly for variable rate borrowers on both the consumer and corporate sides. However, the effect of longer-term debt refinancing (mortgages and corporate bonds) is not likely to be realized until 2024 and 2025.

Given higher interest rates and recent movements in the yield curve, we are positioned defensively. There is a great deal of uncertainty and risk in today’s markets, and we are not comfortable taking an overly aggressive stance in this environment. There are too many unknowns.

However, though we are still defensive in our positioning, we are looking for – and finding – investment opportunities. The yield curve inversion and recent changes have created opportunities in fixed income markets. We continue to hold underweight allocations to equities in the financials and utilities sectors and prefer to take advantage of the juicy yields being paid in these issuers through the corporate bond markets and avoid the volatility of the equities in these industries. We will take advantage of higher yields and look for attractive fixed income investments that can “pay us while we wait” for equity valuations to become more attractive and have more clarity on the potential for a Fed-induced recession.

Our diversified barbell asset allocation approach continues to focus on high-quality companies that grow and pay dividends over time, while also allocating to high-quality cyclical and industrial companies at

reasonable valuations that can continue to grow through the current market cycle. Despite the higher interest rate environment putting pressure on equity valuations, we are seeing opportunities in thematic positioning, in energy and energy transition, health care, and in dividend-paying stocks.

Thematic Investing: Uranium’s Role in Energy Transition

One area of interest to us is the uranium market, which operates under distinct and unique dynamics:

- **Growing Demand for Nuclear Energy:** The push for nuclear energy as a clean and efficient power source is increasing due to concerns about climate change and energy security. The Russia-Ukraine conflict has highlighted vulnerabilities in the nuclear industry’s supply chain.
- **Rebounding Uranium Consumption:** Uranium consumption in nuclear reactors has surged, surpassing pre-Fukushima levels. This increase is driven by new reactor installations, despite years of low uranium prices leading to cutbacks in primary production.
- **Supply Concentration and Security Concerns:** The uranium supply side is heavily concentrated, with state-owned enterprises from countries like Kazakhstan, Russia, and Uzbekistan dominating production. Recent supply disruptions, such as those in Niger, have raised concerns about supply security.

As financial funds and companies recognize the potential of uranium, investor interest is growing. Furthermore, the potential demand from

OUTLOOK AND PORTFOLIO POSITIONING

Q3 2023

Small Modular Reactors (SMRs) is poised to bolster the uranium market in the long term, offering cleaner energy alternatives.

Cameco Corp. is one of our top equity holdings and, in our view, the most compelling way to invest in what we feel is a multi-decade theme. This Canadian-based company specializes in uranium exploration, mining, refining, and marketing, with over three decades of industry experience and a solid reputation as a reliable uranium producer.

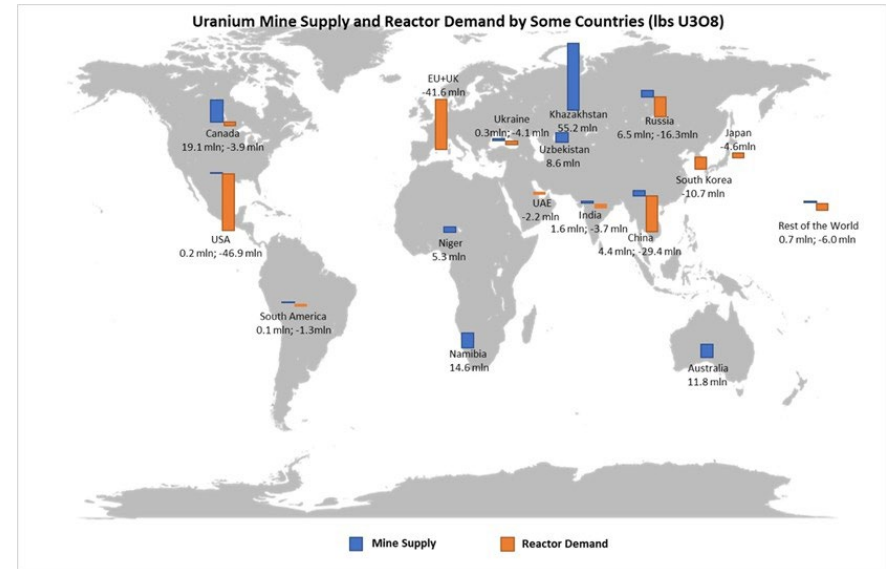
As the world focuses on reducing carbon emissions and addressing climate change, nuclear power stands out as a key part of the solution, offering significant benefits to Cameco. Emerging economies and established nuclear powerhouses are expanding their nuclear energy capacity, driving up the demand for uranium. Cameco's diverse customer base and global reach uniquely position it to meet this growing demand.

The uranium market is characterized by concentrated supply, with a few producers dominating the landscape. Cameco is among these key players, contributing to supply stability and strengthening its market presence.

Cameco is committed to environmental and social responsibility, aligning perfectly with the growing trend of ESG (Environmental, Social, and Governance) investments. This factor makes the company an attractive option for those interested in sustainable investing.

In our view, Cameco offers a unique investment opportunity in the energy sector. As the world turns to cleaner and sustainable energy sources, nuclear power and uranium are gaining prominence.

in the energy transition, Cameco presents a compelling choice to consider.



Source: WNA, Raymond James Ltd.

Thematic Investing: The Promise of New Weight Loss Drugs

In the ongoing quest for effective weight loss solutions, recent breakthroughs in pharmaceuticals are providing new hope and exciting prospects for individuals battling obesity. These groundbreaking medications are revolutionizing the approach to weight management and promising transformative results.

Among the leading stars in this emerging field are Eli Lilly's tirzepatide and Novo Nordisk's semaglutide. Originally developed to address Type 2 diabetes, these drugs have garnered immense attention for their

remarkable ability to help individuals shed significant amounts of excess body weight.

At the heart of this breakthrough lies the unique mechanisms of action of these medications. Both tirzepatide and semaglutide belong to a class of drugs known as glucagon-like peptide-1 (GLP-1) receptor agonists. These drugs mimic the function of GLP-1, a hormone naturally produced in the gut that regulates blood sugar and appetite. By imitating this hormone, tirzepatide and semaglutide set off a chain reaction in the body. They stimulate the pancreas to produce more insulin, slow down the digestion process, and induce feelings of fullness. The result is not only improved blood sugar control but also substantial and sustained weight loss.

The success of these weight loss drugs has paved the way for broader applications. Initially designed to tackle Type 2 diabetes, tirzepatide and semaglutide have now gained approval as treatments for obesity. These drugs have rapidly gained popularity in the pharmaceutical landscape. With the rising demand for these medications, pharmaceutical companies are scaling up production to meet the growing need.

The advent of new weight loss drugs signifies a significant stride forward in the ongoing fight against obesity. These innovative medications offer new possibilities for those grappling with weight management, providing an effective and novel approach to shedding excess pounds. With ongoing research and development, the path to effective and lasting weight loss appears brighter than ever before.

At Tall Oak, we continue to own both Eli Lilly and Novo Nordisk in our strategy to take advantage of what we feel could be a multi-year thematic profitable investment for our clients.

Investment Objective

To achieve long-term capital appreciation with a focus on diversification and downside protection by investing across asset classes in Canadian and Global companies with market cap exceeding \$500 million.

Investment Philosophy

The team employs a disciplined approach by combining a systematic and fundamental selection process that favours quality companies with growing earnings.

When building a balanced portfolio, the Fund will invest in a mix of fixed income securities and equities across a diverse range of regions and sectors.

The team has flexibility with the asset mix, strategically taking advantage of market opportunities.

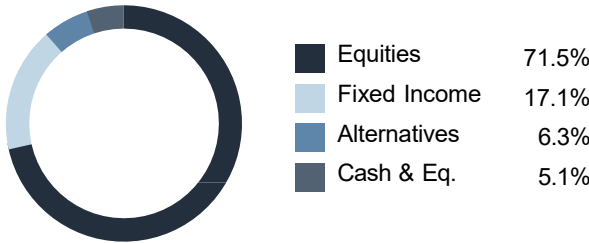
Current Positioning

Current Asset allocation is below our long-term target of 75% for Equities.

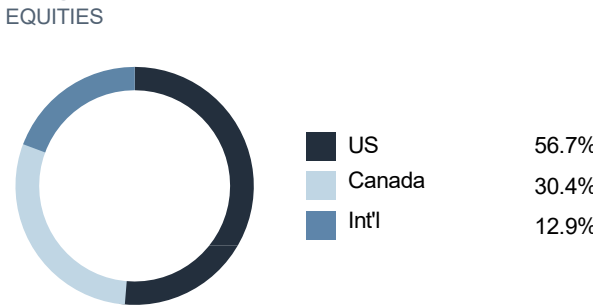
Equities and alternatives are lower, while cash is higher. Fixed Income has increased with exposure to Contingent Convertibles, very long-dated hybrid debt instruments with attractive yields.

International equity exposure is lower as Canadian exposure increased.

Asset Allocation

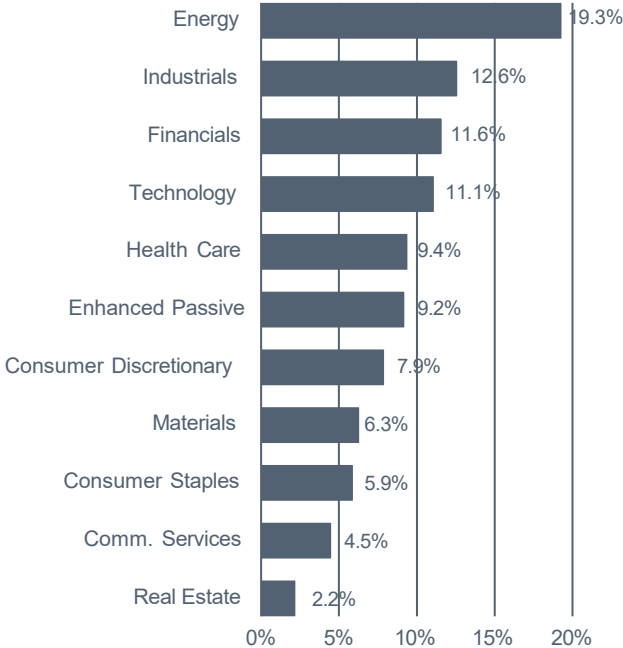


Regional Breakdown



Sector Breakdown

EQUITIES



TALL OAK CAPITAL APPRECIATION POOL

Q3 2023

Top Positions %

EQUITIES

Cameco Corp.	2.3
Marriott International Inc. CI A	2.2
Invesco S&P500 Equal Weight ETF	2.1
Eli Lilly & Co	2.0
Berkshire Hathaway Inc. CI A	1.9
McDonalds Corp Ltd	1.9
Alphabet Inc. CI A	1.9
Canadian Natural Resources Ltd	1.9
Adobe Inc.	1.9
Pepsico Inc	1.9
Microsoft Corp	1.8
United Health Group Inc	1.8
Mastercard Incorporated	1.7
Schlumberger Ltd	1.7
Suncor Energy Inc New	1.6
Caterpillar Inc	1.6
Equinix Inc REIT	1.6
Alibaba Group Holding Ltd.	1.6
Boston Scientific Corp.	1.5
Costco Wholesale Corp New	1.5

FIXED INCOME AND ALTERNATIVES

Picton Mahoney Special Situations Credit	4.5
US Treasury Bill 11Jul24	1.4
TD Bank 3.6% Jr Sub 31Oct81	0.8
RBC Jr Sub 3.65% 24Nov81	0.8
BNS 3.7% Ltd. Rec S1 27Jul81	0.8

DISCLAIMER



TALL OAK

C A P I T A L A D V I S O R S

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