Aventine Investment Counsel

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September 2022 Commentary

Quarterly Manager Letter

Current News and Updates

Q3 2022

QUARTER IN REVIEW

	Q3	YTD
Aventine Balanced Composite:	**-2.5%**	**-17.4%**
Aventine Canadian Equity Fund:	**-11.1%**	**-34.2%**
Aventine Dividend Fund (USD):	**-4.1%**	**-20.3%**
S&P 500 Total Return:	***-4.9%***	***-23.9%***
Russell 2000 Total Return:	***-2.2%***	***-25.1%***
TSX Composite Total Return:	***-1.4%***	***-11.1%***

September 30, 2022 – Q3 Commentary

State of the Market

The current investment environment continues to be challenging, as persistent inflation and unwavering hawkishness from central banks continue to weigh on the global economy, officially marking 2022 as *the worst year on record for both stocks & bonds*. By its nature, raising interest rates to slow demand and, in effect reduce inflation, is a blunt approach. When applied unrestrictedly, the results can be resoundingly painful, as demonstrated by the market falling to new lows in September as many investors came to worry that a severe recession was inevitable.

Source: MarketDesk. Note: Returns represent total returns, which include dividends. 2022 YTD performance as of 5/11/2022.

Despite the overwhelmingly negative sentiment surrounding markets, we find confidence in the proven track record of fundamental investing over the long term, including in many bear markets. We recognize, however, that bear markets have the ability to elicit an emotional response, and we acknowledge how challenging it can be to remain steadfast to one's discipline day after day. We remind investors that the equity and bond markets have already priced in a high degree of downside risk via multiple contractions, EPS downgrades, and higher discount rates. Thus, markets do not need conditions to get significantly better to post gains; however, they do need conditions to get "less bad." As such, we constantly monitor the trajectory of inflation and the market expectations about Central Bank terminal rates as key signals to turn more optimistic and deploy further capital. Over the past several weeks, we have been encouraged by the green shoots we have seen taking shape in these areas.

Market participants are eager to compare today's environment to the 1970s due to the 'raising rates into record inflation' narrative. However, it is crucial to recall that the 1970s was not a perpetual 10-year bear market. Instead, over this period, each time inflation peaked and began to decline, the market rallied dramatically. From the end of 1974, when the first wave of inflation peaked and began to decline, to the end of 1984, when the economy had captured the initial gains from having defeated inflation, the S&P 500 returned an astonishing 14.8% a year.

In our view, the probability of an abrupt Fed pivot prior to rates reaching their terminal level is highly improbable. The Fed's mandate is to control two things: growth and inflation. To monitor the progress of each component, central bankers inordinately rely upon a collection of economic data points that, by their nature, are backward-looking. On this basis, the case for raising rates to date has been easily argued, as inflation peaks while growth metrics remain robust. However, moving forward, we expect a rebalancing of the Fed's priorities.

Everyone loves to speak about central banks being "behind the curve" when it comes to inflation. However, we believe they are well ahead of the curve when it comes to slowing the economy. Hiring plans and consumer confidence are near all-time lows. Similarly, the US Dollar is approaching significant stress levels, and the yield curve remains severely inverted.

While we predict growth declines to materialize also, we see the overall economy as more resilient than many believe. Specifically, we note: (a) strong job openings providing a buffer for higher levels of unemployment and sustained household income generation; (b) elevated backlogs and order books composing a solid foundation for sales in 2023; (c) consumer demand remaining robust, in contrast to past recessions such a March 2020 or the Great Financial Crisis; (d) government financial support for infrastructure spending and inflationary reduction; and (e) sound household balance sheets.

Central Banks have historically been responsive to their actions' breaking' certain elements of the economy. On this point, we see three key areas of vulnerability that could spur an abrupt pivot: weak employment data, weak inflation data, or the freezing of credit markets. Unfortunately, as time goes on, global economic uncertainty regarding the progression of these factors continues to grow.

On balance, economic cycles are not immune from the laws of physics and, like all things, are naturally pulled lower by gravity. Although unpleasant, these corrections are necessary and

beneficial in the long term. These periods serve to prune the economy, reprioritize individuals' consumption and employment decisions, and emphasize internal investment by companies. While we note that investing through these stages of the cycle can be difficult, we believe that resilient company earnings, suppressed valuations, improving visibility, and less cumbersome year-over-year comparables set up for a more positive 2023.

If this occurs, we believe it will mark a turn in investor positioning and initiate significant redeployment of capital into the market, namely the reallocation of cash to risk assets. We are in unprecedented times, and it is essential to be ready to act when others are not in order to compound wealth in the future.

Questions do remain about the breadth of the rally in stocks, however. There is no doubt that the recent equity market rally has been driven by the technology sector. In fact, the 5 largest weights in the S&P are technology companies and are up nearly 33% year-to-date, while the Index as a whole, as well as the Russell 2000, remain in negative territory.

Aventine Canadian Equity ("ACE") Fund

This year, companies with "growth" (Nasdaq, -35%) and "small-mid cap" (Russell 2000 Index, -32%) style exposures have been hit particularly hard. This has disproportionately hurt the ACE Fund in 2022 (-34%) and continues to present headwinds to our near-term results. We continue to balance our quality portfolio with a high level of cash, short positions, and put options, leaving the fund ~70% net long as we prepare for the possibility of continued volatility.

Perhaps the most uncertain and unnerving period for investors in recent years was March of 2020, when commerce effectively stopped, businesses were mandated to close, consumers were confined to their own homes, and the COVID endgame was a mystery. We shared a familiar feeling this past September, not because we were frantically trying to recalculate the impact of a pandemic on our portfolio companies' financial results, but because we were witnessing a similar level of indiscriminate selling in the market and across our portfolio.

Currently, a handful of our holdings are trading at distressed valuations, implying the worst possible outcomes. We want to emphasize that on balance, our holdings' fundamentals have been resilient and, in some cases, have improved throughout 2022. We are confident that the management teams we have entrusted with our capital will successfully navigate these turbulent times and will come out stronger on the other side.

From a stock-specific perspective, ATS Automation (ATA-CN, 2022 Revenue = $2.2B) announced a $167M USD order for the construction of turnkey battery assembly systems for the EV market. Trisura Group (TSU-CN) continues to execute after having successfully completed a capital raise of $150M CAD to continue funding premium growth and significantly beating Q2 earnings estimates. Open Text (OTEX-US) completed its largest acquisition to date with the $6B purchase of Micro Focus International (MCRO-UK).

Finally, we exited our position in Haivision Systems (HAI-CN) in Q3, settling on the conclusion that the shift in the predictability of their business following their recent acquisitions, which led to back-to-back quarters of declining margins and organic growth, was irremediable.

Aventine Dividend Fund

The Aventine Dividend Fund suffered its worst quarter to date in Q3, with a reported 4% decline, edging out the S&P 500, which was down 5% over the same period. This brings the YTD Fund return to -20% vs. the S&P 500 at -25%. Fortunately, for Canadian investors, these returns have been offset by a strengthening USD which is up over 9% in 2022, relative to the CAD.

During the quarter, we saw valuation compression in three of our core holdings. While this created a disappointing drag on our quarterly returns, we believe this widening in valuation asymmetry presents our fund with an unparalleled opportunity for above average future returns.

First, Volkswagen AG (VWAGY-US) shares were down 11% in the quarter, despite the completion of the IPO of their Porsche brand. This issuance generated over €9 Billion in cash for VWAGY, while the company retained 75% ownership. In the days following the IPO, the market cap of Porsche soared to exceed that of VWAGY, a move that seemingly defies the fact that VWAGY is still the majority owner of Porshe and implies that Porshe as a stand-alone brand is worth more than the combined value of Volkswagen, Audi, Skoda, Bentley, Ducatti, Lamborghini, and its percentage ownership of Porche itself. Incomprehensible.

Second, our largest holding, Brookfield Infrastructure Partners (BIP-US), suffered a 6% decline in the quarter. On face value, we believe that BIPs assets remain unrivaled, especially during current economic conditions. While we anticipate the pace of asset sales and capital recycling activity to reaccelerate in the coming quarters, in the interim, shareholders continue to realize sizeable benefits from BIPs' unique ability to increase Funds From Operations (FFO), with their portfolio of critical infrastructure assets whose cost of use is linked to inflation.

Finally, on the last day of the quarter, Nike (NKE-US) fell 13%, bringing its 3-month return to -18.4%. While Nike reported strong consumer demand for its products, the Company reported higher-than-expected apparel inventory levels in its North American markets and announced that it would cut prices in certain geographies to right-size the portfolio. We believe the downside movement was disproportionate to Nike's global performance, with undue weight and unjustifiable extrapolations from Walmart and Target's recent inventory writedowns obscuring the rationality of investors' revisions.

Throughout 2022, the Dividend Fund's outperformance has been primarily driven by its defensive positioning. Currently, the fund holds a large amount of cash and is 65% net invested when we account for short positions and options. We remain well-suited to take advantage of any further market deterioration and are opportunistically adding to positions when appropriate.

Core Strategy

Over the previous quarter, we continued to benefit from the resiliency of our Core Equity strategy. As a reminder, this strategy is designed to provide long-term, conservative exposure to client portfolios that positively complement our equity funds during bullish markets but offer muted sensitivity to downside volatility during bear markets. We continue to realize the

contributions of this positioning, aiding our efforts to provide diversified exposures to clients' overall portfolios.

While we seek to hold securities in perpetuity, benefitting from their stable, sustained growth, we actively recycle capital when valuations exceed their intrinsic values. During the quarter, we capitalized on two such opportunities, Waste Connections (WCN-CN) and Empire (EMP/A-CN).

During the pandemic, WCN benefitted from the resurgence in market demand, realizing significantly elevated collection volumes, heightened raw material resale rates, and favorable pricing dynamics. As we assessed the valuation, we concluded that many of the catalysts that had previously been tailwinds over the past year were beginning to invert into headwinds. In effect, we predicted that profitability would suffer, transitory investors would exit, and a multiple re-rating would become justifiable. In tandem, these effects would overshadow any future positive catalysts and drag down growth for a prolonged period. This decision proved to be well-timed, with the stock falling ~10% in the subsequent days.

Analogous to WCN, EMP/A's grocery stores serve an essential function in society, enabling the Company to benefit from stable demand and favorable price elasticities throughout the pandemic. Shareholders also benefitted from its progress on new store expansion, essential store revitalizations, distribution center restructuring, and the integration of premium portfolio brands into core markets. However, we determined that EMP/A's continued progression was nearing its peak. We began to recognize that consumers' sensitivity to inflation-driven price increases was reaching critical levels and that customers were increasingly 'trading down' to lower-cost alternatives. Materialized, this would lead to margin compression, lower profitability, and market share losses due to EMP/A's insufficient exposure to lower-tier discount offerings. Subsequent to closing this position, the stock declined 18%.

Fixed Income

The credit market has suffered throughout 2022, leaving few places for investors to hide. However, we believe that the opportunity set in fixed income is dramatically improving, especially as Central Banks close in on their terminal rate level. Bonds remain significantly discounted, offering outsized risk/reward opportunities for investment-grade companies with high single-digit yields. When assessing the bond universe, we continue to look at both traditional and non-traditional sources of fixed-income.

At the time of writing, we are actively realizing the benefits of investing in selective, non-traditional fixed-income opportunities, specifically, the Pembina Pipeline Corp Fixed Rate Reset (Floor) ("FRR") preferred series. For those unfamiliar, FRRs are subject to possible redemptions every five years. If redeemed, the parent company can repurchase the shares at par ($25). If not redeemed, the security's coupon 'resets' at the five year interval at a value equal to its 'spread' + the government five-year rate. We initiated these positions after assessing that both the probability of being called and our forecasted reset coupon estimates were likely to generate superior returns regardless of the redemption decision. This position also provided a hedge for further rate hikes and indirect exposure to elevated energy prices. In October, management announced the redemption of specific Pembina preferred shares, causing the entire series to appreciate materially on a higher probability of redemption over the next six months.

While cash on hand is once again earning more than 4.5% for the first time this decade, we encourage clients to consider the deployment of capital into fixed-income products, traditional or non-traditional.

Alternatives

Despite restlessness in public markets, we continue to realize the benefits of our multi-faceted, diversified Alternatives overlay in client accounts. Alternatives investments offer investors low-correlated return opportunities that complement their total asset allocations. Hand-selected and actively monitored by the team at Aventine, we believe these investments add significant value to client portfolios.

Concluding Thoughts

Moving forward, we will remain conservatively positioned across our equity exposures, opportunistically raising cash, and rebalancing the portfolio to adjust to changing market conditions. We will continue prioritizing companies with leadership positions, stable end-market exposures, best-in-class management teams, healthy balance sheets, strong cash flow generation, and attractive valuations.

Additionally, we continue to redeploy funds into fixed-income opportunities to capitalize on suppressed valuations and high yields in anticipation of a *less* volatile rate environment. We prioritize securities with high coupons when considering yield metrics to secure beneficial returns regardless of the rate environment.

Finally, we continue to allocate Alternatives in clients' portfolios, which are more immune to public market volatility and bear a lower correlation. We believe that our firm's exposure to Canadian Farmland presents an optimal recessionary and stagflationary hedge. We also note the increasing attractiveness of our credit funds and look forward to discussing our due diligence on a new offering and in the Private Equity Secondaries space in the upcoming quarter.

Message from the Team

Thank you for your continued support of Aventine as your Investment Manager and Investment Counsellor. Please do not hesitate to reach out to learn more about our investment strategies. We are always excited to discuss our clients' accounts with them and how we may be of greater value.

Best as always,
James, Jim, David, Shannon, and Nicho

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Aventine Performance Update

September 30, 2022

Aventine's Partners and their families are among the largest investors across each of our strategies.

Aventine Balanced Composite

Inception: June 1, 2009

Aventine Balanced is our core portfolio for separately managed accounts following a "balanced" mandate. It is an actively managed, endowment-style portfolio that offers investors diversified exposure to a broad variety of markets and asset classes. This diverse portfolio produces below average volatility and high income generation as we include asset classes such as private debt, mortgages, traditional and non-traditional fixed income, all-cap equities, alternatives and portfolio protection through prudent risk management strategies.

	Q3	2022
Aventine Balanced Composite	-2.5%	-17.4%

Annualized	3 Year	5 Year	Inception
	4.2%	3.5%	6.2%

Additional performance information and disclosures on composite construction is available upon request.

We encourage new clients to join Aventine by investing in our customized portfolio solutions which are tailored to your specific goals.

To learn more about how our independent approach to managing wealth differs from traditional models please feel free to contact us anytime.

This email communication is intended to provide you with information about the Aventine Balanced Composite (the "Composite"), the Aventine Canadian Equity Fund and the Aventine Dividend Fund (the "Funds") managed by Aventine Management Group Inc. The Funds are distributed by prospectus exemption in various jurisdictions across Canada, please contact Aventine Management Group Inc. to discuss if you may be eligible to invest. Important information about each Fund is contained in its Offering Memorandum which should be read carefully before investing and may be obtained from Aventine Management Group Inc. upon request. The Offering Memorandum does not constitute an offer or solicitation to anyone in any jurisdiction in which such an offer or solicitation is not authorized, or to any person to whom it is unlawful to make such an offer or solicitation. All investors should fully understand their risk tolerances and the suitability of the Composite and the Funds prior to making any investment. Rates of return presented for all periods greater than one year are the historical annualized compound total returns for the period indicated. For periods less than one year the rates of returns are a simple period total return. Rates of return do not take into account income taxes payable that would have reduced net returns. The performance presented for the Funds is the performance of the target series of F Class units. The value of the Composite and the Funds is not guaranteed and will change frequently. Past performance may not be repeated. All credited third party information contained herein has been obtained from sources believed to be reliable at the time of writing but Aventine Management Group Inc makes no representations as to its accuracy.

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