AVENTINE
INVESTMENT COUNSEL

Aventine Investment Counsel
June 2023 Commentary

Quarterly Manager Letter

Current News and Updates

Q2 2023

QUARTER IN REVIEW

	Q2	YTD
Aventine Balanced Composite:	**0.4%**	**3.7%**
Aventine Canadian Equity Fund:	**-0.9%**	**1.1%**
Aventine Dividend Fund (USD):	**2.5%**	**4.7%**
S&P 500:	***8.3%***	***15.9%***
Russell 2000:	***4.8%***	***7.2%***
TSX:	***0.3%***	***4.0%***
Tactical Balanced Benchmark:	***0.4%***	***3.7%***

COMMENTARY

The year 2023 has been a year underpinned by consistently changing macro narratives. As Bloomberg recently reported:

January's hard-landing expectation gave way to February's no-landing scenario, which was abruptly reversed when banking-sector turmoil surfaced in March. April's uncertainty was punctuated by raging equity-market optimism in May. Market pricing for Fed policy action in the second half of the year evolved fairly dramatically, and the 40 bps of rate cuts that were discounted six months ago have totally disappeared. Instead, a modest aggregate tightening is now in the price.

Meanwhile, against this backdrop, the stock market staged one of its best first halves on record. The S&P 500 jumped 15.9%, the best since 2019, second best this century, and 12th-best since 1926. The tech-heavy Nasdaq Composite soared 31.7%, its strongest start since 1983 and third best since 1972.

Unfortunately, most of this positive performance has been driven by just a handful of stocks. In fact, only 23% of individual equities have outperformed the broader market over the three

months through June, easily the lowest share on record going back to 1986, and the S&P 500 Equal Weight Index has been trading sideways since mid-2022. Nevertheless, historically, when the S&P 500 rises at least 10% in the first half of the year, over the following six months, the index has risen 75% of the time by a median of 9.7%. In contrast, the Canadian S&P/TSX Composite was only up 0.3% in Q2 as resources continued to deflate across the board while banks and other defensive sectors struggled under the rapid recovery in short term interest rates during the quarter.

This positive price action and sentiment in the US demonstrates that investors are getting numb to the continued calls for a recession and are instead focusing on resilient macroeconomic data supported by a very strong labour-market. Consumers, therefore, continue to spend on travel, restaurants, and other luxury items, despite their increasing cost. While the resulting decrease in savings should eventually begin to impact spending, the real risk is that it may cause resurging inflationary pressures in the second half of the year. From the standpoint of central banks, the primary risk involves loosening policy too soon, only to see inflation reaccelerate. While we maintain that Canadian and US Central Banks are close to ending their tightening cycle, we believe rates may remain elevated well into 2024, which does not appear to be priced in.

We have been benefitting from the positive price action in risk assets but continue to take steps to protect portfolios from downside risks, given the continued uncertainty. We are maintaining a higher-than-average cash position while continuing to be nimble with our positioning. Furthermore, we have increased the exposure to fixed income in client accounts, taking advantage of historically elevated yields and higher than average volatility in the asset class.

Aventine Canadian Equity ("ACE") Fund

The ACE Fund had a volatile Q2 returning -0.9%, and bringing the year-to-date Fund return to 1.1%. It was a very active quarter for the Fund as we made significant changes to our holdings. We dramatically enhanced the quality of the portfolio to improve the predictability of earnings, increase liquidity, and lower the Funds overall volatility. We believe these changes should dramatically improve the risk adjusted return of the Fund going forward, especially given the macroeconomic backdrop. While we continue to believe that the best value in the market resides in the smaller-cap, less well-known companies, the economic recovery required to cause multiple expansion in this segment of the market is taking longer than we anticipated. As a result, we are complementing our existing structural holdings in this area with positions in in companies who can compound capital across all economic regimes.

We added several high-quality positions to the Fund over the quarter, including:

Alimentation Couche Tard (ATD-CN):
Couche-Tard is a high-quality business with a very strong balance sheet. This results in potential for not only M&A, but for strong shareholder returns through both dividends and share buybacks. Their scale has enabled industry leading fuel margins which is allowing them to continue to consolidate the fragmented convenience store industry.

Restaurant Brands International (QSR-CN):
Restaurant Brands operates fast food restaurants including the Tim Horton's, Burger King, Popeyes, and Firehouse Subs banners. The Company is large and stable and due to its 99% franchised system, produces significant free cash flow. We view M&A as likely in the near term which could be an additional catalyst to the stock. Due to the nature of its customers, the company is practically recession proof and they recently hired Patrick Doyle, the former CEO of Domino's Pizza, as Chairman, which is a significant positive.

Hydro One (H-CN):
It is inevitable that electrification and pressure to expand the existing power grid will be a big tailwind for Hydro One. Their business is extremely defensive and allows for a consistently growing dividend. As we approach the terminal interest rate levels in Canada, we believe this is an extremely attractive entry point.

Danaher (DHR-US):
Danaher is a market leader in the diagnostics, biotechnology and life sciences products space and provides the Fund with important healthcare sector exposure. The Company is excellent at compounding free cash flow through M&A and with the stock down 10% YTD on the post-pandemic slowdown in the medical sector, this is an attractive entry point.

If you would like a more detailed update on the ACE Fund positioning or to learn more about specific holdings and our view, please do not hesitate to reach out.

Aventine Core Strategy

The Core Strategy had another successful quarter bringing the average position performance to 10.5% YTD with an average gain of 1.4% in Q2. The biggest gains in the quarter came from

Constellation Software (CSU-TO, +8.1%) as the company benefited from tailwinds in the Technology Sector. We also saw nice gains in Premium Brands (PBH-TO, +5.3%) during the quarter as it became clearer that their recent inventory build and working capital miss was for a new quick serve sandwich program with big potential. We believe the next few quarters will continue to shed light on this program and will also showcase an improving balance sheet and free cash flow profile which should be rewarded by investors.

On the negative side, we were held back by Royal Bank (RY-TO, -1.8%) and RioCan (REI-US, -4.2%) as a jump in interest rates impacted sentiment for both the banking and real estate sectors. We continue to see long term value and dividend growth with both positions and were actively adding to underweight positions.

We did not make any major changes to the strategy during the quarter.

Aventine Dividend Fund (US Equity)

The Aventine US Equity Fund had a solid second quarter returning 2.5% and bringing the YTD return to 4.7%. This quarter the US Equity Fund materially benefitted from its position in Information Technology, alongside the broader S&P 500. While we believe that the recent sector rally has exceeded near-term fundamentals and remains extended from a risk perspective, our performance demonstrates the benefits of a diversified portfolio.

During the quarter, the Fund was impacted by general sector rotations resulting from hawkish monetary policy and potentially weakening consumer finances. Specifically, we noted demand pressure in consumer discretionary stocks, such as Nike (NKE-US; -9.7%). Additionally, we saw weaknesses in Health Care stocks, including Agilent (A-US; -12.8%), which was attributable to normalizing post-COVID growth rates and associated investor outflows in a risk-on environment. While a reversion back to the long-term growth rate is inevitable, we believe the recent overcorrection will be short-lived.

Moving forward, we look to continue positioning the portfolio into undervalued sectors poised to benefit from peaking fiscal policy measures and better-than-expected economic performance. Here, we look at holdings such as S&P Global (SPGI-US; +4.9%) and Brookfield Infrastructure Partners (BIP-US; +6.4%) as leading indicators. Both companies saw strong performance during the quarter as the market recognized the inherent pricing power imbedded within their assets and their attractive valuations. In keeping with this theme, during the quarter we began to build a position in Nutrien (NTR-US). NTR is a world leader in the production and distribution of diversified fertilizers and has traded at an unprecedented discount relative to obscured channel demand, underlying strong fundamentals in Agriculture, and favorable geographic presence relative to European peers. We look forward to further detailing this investment in our next letter as we build our interest into a formal Fund position (>2%).

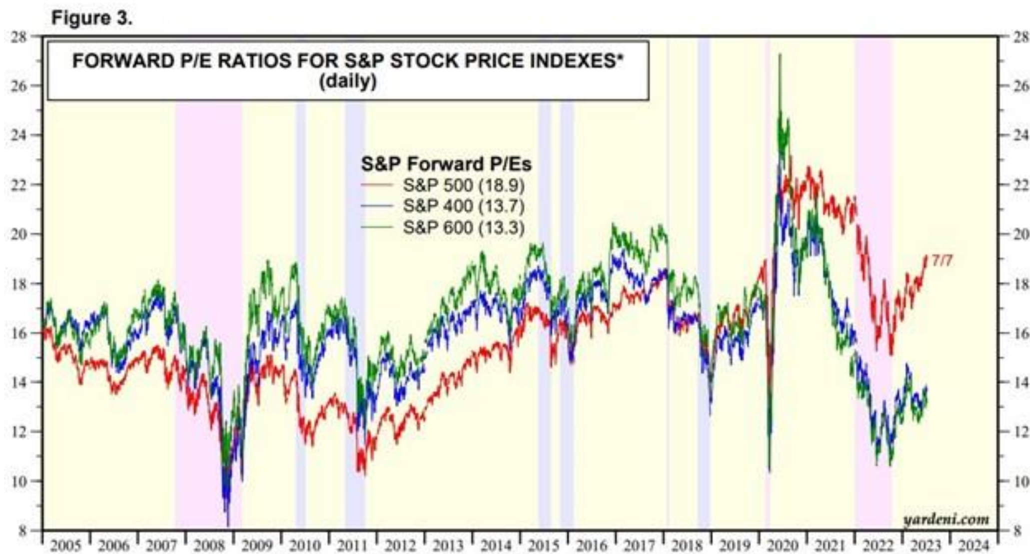
Conclusion

The market faces considerable uncertainty in the coming quarters. The S&P 500's performance thus far in 2023 has been entirely driven by valuation multiple expansion while earnings expectations have declined slightly. As a result, all eyes will be on Q2 earnings and the related company outlooks. At the time of writing the Bank of Canada has raised interest

rates another 25 basis points to 5%, the highest since April of 2001. Simultaneously, inflation, as measured by CPI seems on track to meet the 2% target level without much more heavy lifting. We believe the Federal Reserve will follow suit with one more 25 basis point hike in July before pausing rate hikes for the remainder of the year. This is supported by the fact that Core CPI has dipped below the Federal Funds Rate (lower bound) for the first time since 2019.

We continue to believe that it is prudent to be prepared for a potential mild recession over the coming quarters. As the economy weakens and the downward trend in core inflation gathers pace, we think interest rates will eventually be cut more quickly than markets are pricing in. This is especially true in Canada as previous rate hikes filter through the economy and as we approach the mortgage renewal cycle (5 years). We expect GDP growth to slow dramatically through to the end of the year, and the beginning of next year, before looser monetary policy drives a recovery in late 2024. Consumers are still being supported by the resilience of the labour market, with payroll employment growth still above 200,000 per month (US). We doubt that strength will continue, however, with signs beneath the surface that labour market conditions are cooling. The job openings rate has fallen to a two-year low while the quits rate isn't far from its pre-pandemic trough.

Despite this macro uncertainty, and our view stated above, we see many pockets of the market which remain mispriced. We uncovered a number of tax efficient opportunities in fixed income, and for the first time in a long time, cash is generating a meaningful return. In the equity market, smaller capitalization companies, which have been pricing in a deep recession for over 2 years now, are cheapest relative to their larger capitalization peers in many years. If growth remains resilient, or surprises slightly to the upside, this segment of the market is due for a catch-up trade.



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
June 30, 2023

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

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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.

	Q2	2023
Aventine Balanced Composite	**0.4%**	**3.7%**

Annualized	3 Year	5 Year	Inception
	6.1%	**3.3%**	**6.4%**

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.

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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 tolerance 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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