TALL OAK

CAPITAL ADVISORS

Quarterly Report

2023

Q2

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MARKET REVIEW

Global markets maintained an upward trajectory in the second quarter of 2023, building on strong performance in Q1. The US market led the charge, displaying decent performance, while emerging markets lagged.

There were several market-friendly economic indicators this quarter. Overall job creation in the US and Canada continued to be resilient. While the creation of new jobs is welcome, the US labour market trend now appears to be slowing with wage pressures easing. US house prices also posted their largest annual drop in 11 years. Concurrently, a survey of US small and medium-sized businesses revealed that hiring, sales expectations and credit availability have at a minimum slowed, which are also positive indicators in the inflationary fight.

Despite the overall strength in the US indices, there was notable variability in their performance. The NASDAQ 100, the S&P500, the DOW and the Russell 2000 were up 12.8%, 8.7%, 3.4% and 4.8%, respectively when measured in USD. However, when factoring in the appreciation of the Canadian Dollar against the US Dollar (2.1% in-quarter), the returns in US dollars were somewhat subdued. Stock performance broadened somewhat during the quarter. Technology stocks continued their advances with Apple becoming the first company to reach a market cap of US$3trillion. The consumer discretionary and communication services sectors also performed well while the energy and utilities sectors underperformed.

The S&P/TSX Composite Index ended the quarter up 1.1%, with modest results due to its high exposure to the banking and oil sectors but it is still significantly up from the October market low last year.

Quarterly Returns

Index or Proxy	%
EQUITIES	
S&P 500 Total Return	8.7
Dow Jones Industrials Average	3.4
NASDAQ Composite Index	12.8
S&P/TSX Composite Index Total Return	1.1
iShares MSCI ACWI ETF	3.1
iShares MSCI EAFE ETF	-0.7
BONDS	
iShares 20+ Year Treasury Bond ETF	-2.5
iShares Core Canadian Universe Bond Index ETF	-0.7
US SECTORS	
Communication Services	12.8
Consumer Discretionary	14.3
Consumer Staples	-0.2
Energy	-1.8
Financials	4.8
Health Care	2.5
Industrials	6.0
Information Technology	16.9
Materials	2.8
Real Estate	0.8
Utilities	-3.3

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

MARKET REVIEW

The All-Country World Index modestly increased 3.1% (CAD terms) somewhat held back too by a slower than expected post-pandemic recovery in China. Emerging Markets and European markets were down in the quarter in Canadian dollars, falling -1.8% and -1.0% respectively. Japanese stocks advanced to their highest level in 33 years while the yen weakened. A slower than expected post-pandemic recovery in China saw Chinese equities fall as did those in Hong Kong, while Indian equities made gains.

All major central banks, with the exception of the Bank of Japan, kept raising interest rates over the quarter. In June, the Fed held rates steady but signaled they were prepared to raise rates in the months ahead if the economy and inflation didn't cool more. Here at home, the Bank of Canada raised its target overnight rate in June and July saying the path towards its 2% inflation target would take longer than planned due to resilient consumer spending. Bond Markets continued to be volatile. The benchmark US 2-year Treasury Yield rose 0.71% in the quarter with a low to high range of 130bps. Such a fluctuation is a rarity in financial history. As a lead indicator for market expectations of central bank interest rate paths, this type of volatility wreaks havoc on the bond markets and poses challenges for long-term corporate planning. The Canadian Bond Universe, as measured by FTSE Canada, experienced a negative return of -0.8% during the quarter. Similarly, the Barclays US Treasury 1-5 year index recorded a loss of -0.9%

Why does the Bank of Canada have a 2% inflation target?

Inflation tends to be close to 2% when the economy is running near its capacity – when demand for goods and services is roughly equal to what the economy supplies.

If demand is greater than what the economy supplies, this can push inflation above the target.

If demand is less than capacity, this can pull inflation below 2 percent.

Over time, the Bank of Canada has found that a target of 2 percent promotes balance in the economy and growth that people can count on.

Source: Bank of Canada

TALL OAK CAPITAL APPRECTION POOL

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.

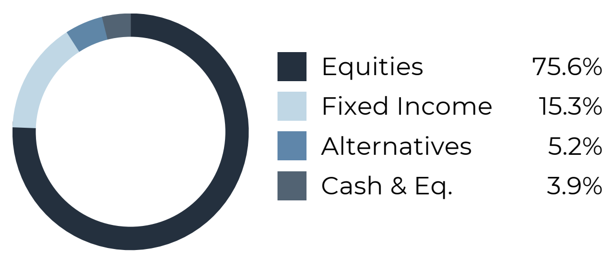
The team has flexibility with the asset mix, strategically taking advantage of market opportunities.

Current Positioning

Our current asset allocation is approaching our long-term target of 75% based on gross equity exposure. However, when considering our hedges, this level is adjusted down to below 70% on a net basis. We maintained a below-average equity exposure in the second quarter due to the evolving economic landscape and the narrowness of the market.

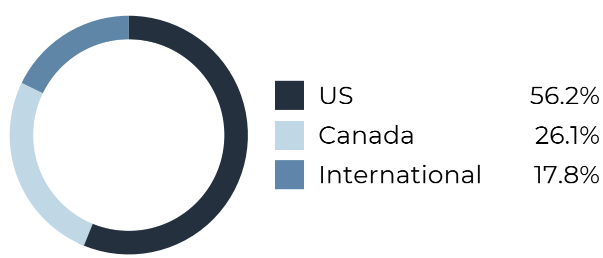
We find high-quality Investment-Grade corporate issues particularly appealing in this environment. These short-duration issues offer attractive yields exceeding 7% while presenting limited downside risks. We are maintaining our international equity exposure as valuations in Europe and Asia appear more favourable when compared to the United States.

Asset Allocation



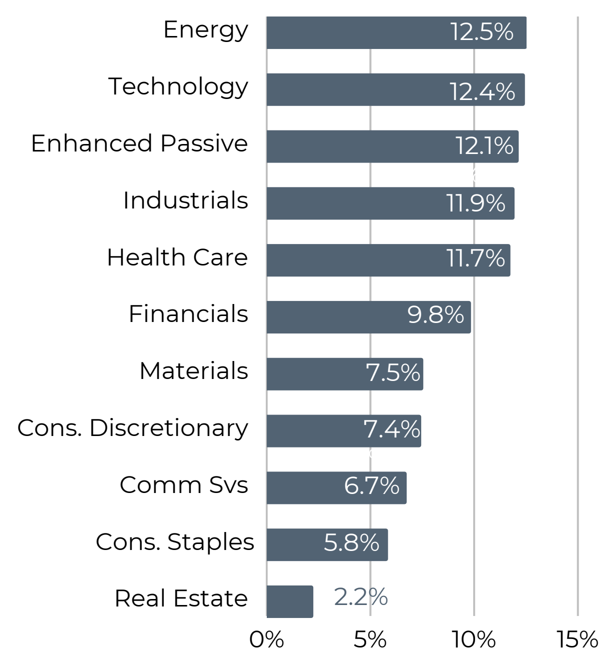
Regional Breakdown

EQUITIES



Sector Breakdown

EQUITIES



As at March 31, 2023

TALL OAK CAPITAL APPRECTION POOL

Q2 2023

Top Positions

EQUITY	%
iShares Core MSCI Europe ETF	3.0
Activision Blizzard Inc.	2.2
Invesco S&P 500 Equal Weight ETF	2.1
McDonalds Corp Ltd	2.1
Pepsico Inc	2.0
Marriott Intl Inc Cl A New	2.0
Microsoft Corp	1.9
Berkshire Hathaway Inc. Cl A	1.9
Cameco Corp	1.8
Johnson & Johnson	1.8
Adobe Inc	1.7
iShares MSCI Emrg Mkt ETF	1.7
Unitedhealth Grp Inc	1.7
Mastercard Incorporated	1.7
Equinix Inc REIT	1.7
Intact Finl Corp	1.7
Eli Lilly & Co	1.7
Cdn Ntrl Res Ltd	1.6
ASML Holding NV	1.6
Boston Scientific Corp	1.5

FIXED INCOME AND ALTERNATIVES	%
Picton Mahoney Special Situations Credit	4.5
US Treasury Bill 14DEC2023	1.1
US Treasury Bill 16NOV2023	1.1
US Treasury Bill 19OCT2023	1.1
JP Morgan Chase 4.15% 16SEP24	0.7

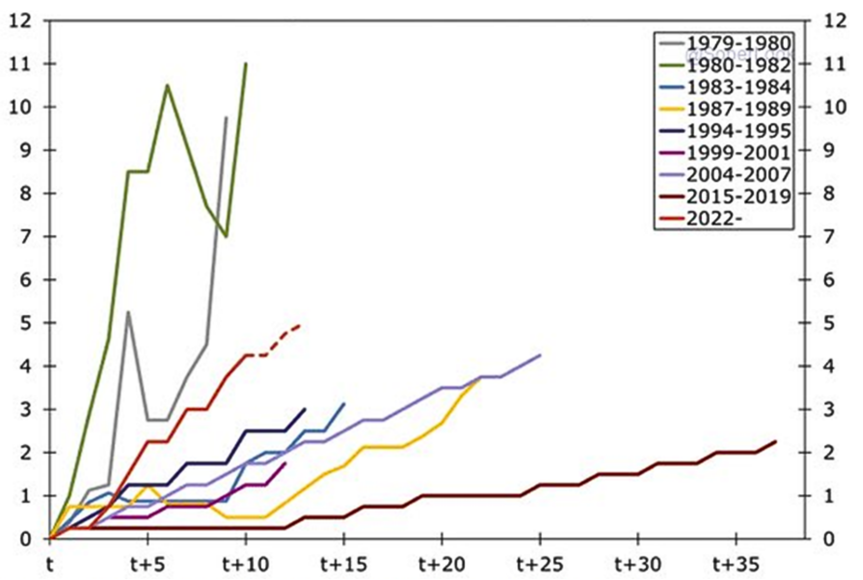
UNRAVELLING THE EFFECTS OF RISING RATES

In our previous reports dating back to 2021, we continually discussed the role of rising interest rates and heightened inflation, along with our projections for the markets in what we perceive as a new regime, which we believe commenced in 2022. This new phase was triggered by the Federal Reserve and other global central banks taking aggressive measures to combat inflation and address extraordinarily low interest rates. Since then, interest rates have risen more than 500 basis points, or 5%. This rapid and steep change in the cost of borrowing has been unparalleled in the available historical data, comparable only to periods experienced during the 1970s.

At the time, our thesis posited that although the supply chain disruptions caused by the pandemic would eventually subside, inflation, as we observed it, would not be transitory, nor would it easily return to the levels witnessed over the past three decades. Our forecast suggested that prolonged higher inflation would lead to a real interest rate normalization process, resulting in substantially higher interest rates compared to the relatively low rates experienced over the past ten years since the Global Financial Crisis. This normalization process would be a shock to the markets, consumers, and businesses reliant on borrowing. During the pandemic, high-valuation, long-duration equities had become extremely popular, but they were expected to face challenges as discount rates rose. The environment created by higher interest rates was reminiscent of the early 2000s - not ancient history, but a stark departure from the world of investments accustomed to a prolonged era of exceptionally low borrowing costs.

PACE OF FED FUND RATE HIKES

Percentage Point Change, t=Month Prior to hiking cycle start through the last rate hike of the cycle



Source: Federal Reserve Board and Wells Fargo Economics, 2023

Many believed that these imbalances would bring about significant upheaval and changes. Over the long term, we were optimistic about the normalization process, but we anticipated that it would take considerable time to adjust, given the substantial capital invested at historically low rates, now operating under entirely different economic conditions. The disruption in the markets became evident when large-cap tech stocks and the bond market, represented significantly in most portfolios, experienced substantial declines of -21.8% and -52.2%, respectively, in 2022. We perceived this as the initial phase of a protracted adjustment period during which all assets would reestablish their valuation ranges in light of the new normal and our interest rate normalization thesis.

At present, as indicated by the chart on the following page, the yields of US 2-Year Treasury bonds remain elevated, hovering around multi-year highs at the time of this writing. Although there has been a recent

US 2-YEAR NOTE YIELD

Source: FACTSET, 30-JUN-23

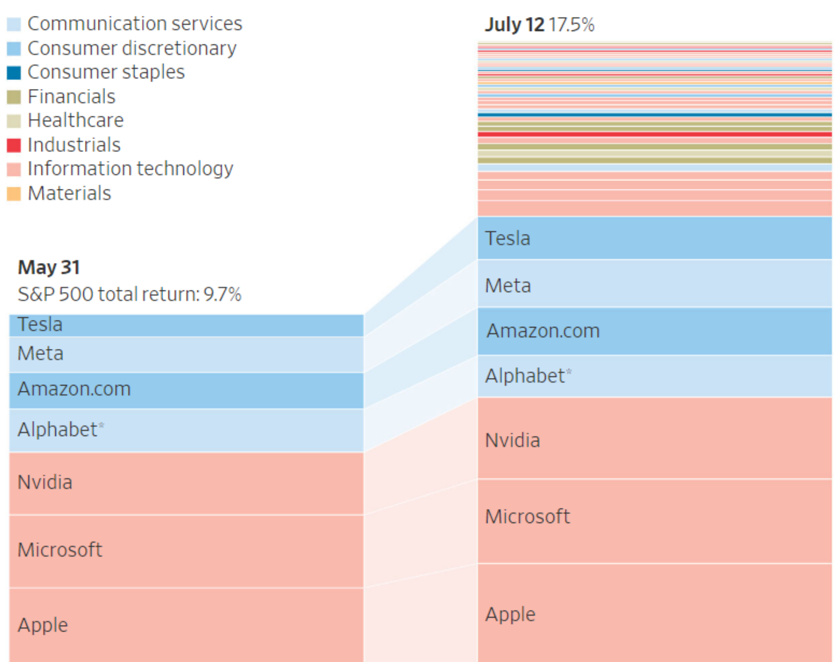
CORE INFLATION

decrease following a lower-than-expected Consumer Price Index (CPI) reading, the Federal Reserve will likely increase rates this month (July), with the Bank of Canada following suit in the coming months. In short, interest rates are higher, and while inflation is falling, it still lingers at elevated levels, especially the core figures. The astronomical levels of 8-9% inflation are well and truly gone, but stubbornly high core inflation, coupled with wage growth and a tight labour market, makes it challenging to envision an interest rate cut this year and possibly well into the next. The possibility exists, but it would likely be driven by a significant economic and labour market weakening - a scenario that currently receives little attention from most market participants.

Indeed, as highlighted in our previous report, the term "Goldilocks" is now frequently used to describe the current market conditions. A soft landing is the prevailing consensus. As investors, we are often queried about the ongoing bull market, the surging tech stocks, and the media's constant focus on the latest strong performances of companies like NVIDIA, META, Tesla, and Apple. While we admire these companies, we refrained from investing in them in 2021 and 2022 to avoid the devaluation resulting from slowed growth. Although we may have erred in being out of these stocks this year, our conviction in Microsoft, select semiconductor companies, and Alphabet remained unwavering, as we believed their valuations could withstand rising discount rates.

The current bull market is unlike any we have witnessed before. One would have to look back quite far in history to see a comparable concentration of returns experienced in the first half of 2023 (see below). Therefore, when asked about the ongoing bull market, as multi-asset investors who build and manage highly diversified portfolios, it is challenging for us to recognize it as such. To us, it feels more like markets are rebounding from their lows. The pandemic-induced consumer savings are running low, and inflation and higher interest rates are adversely affecting the middle class, new homebuyers, and renters across the country.

TOP CONTRIBUTORS TO THIS YEAR'S S&P 500 RALLY



*Alphabet contribution combines Class A and Class C shares
Source: S&P Dow Jones Indices

PORTFOLIO REVIEW

RETURNS IN AN ATYPICAL BULL MARKET

Describing this bull market is particularly difficult due to its atypical nature. By now, most individuals with even a cursory interest in financial news are familiar with the concept of the "Magnificent Seven" - the group of stocks responsible for the majority of this year's returns. As investors, it is essential to step back and assess what has worked well and what has not. When we assess the portfolio, we know that owning more of the seven stocks that have driven market gains this year was crucial and merely having two out of the seven was insufficient. Instead, we held stable, high-free cash flow (growing free cash flows are frequently a prelude to increased earnings), non-cyclical assets. We prioritized healthcare companies with robust balance sheets, promising growth prospects, and attractive dividend yields. Our decision to own more oil and hard assets was driven by a desire to mitigate inflation exposure. The energy sector's free cash flow yield hit the top of a 20-year range and we believed this would provide an attractive downside cushion, which did not materialize in the first half of the year.

S&P 500 ENERGY SECTOR - FREE CASH FLOW YIELD

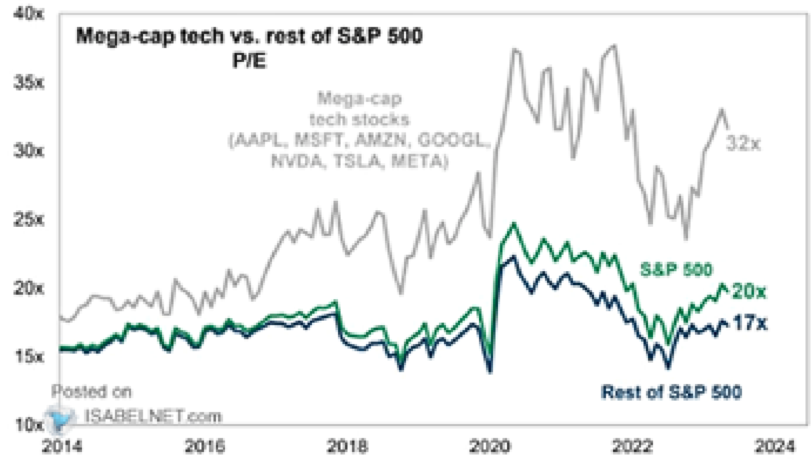
Source: Bloomberg, 23-MAY-23

FROM EXPECTATION TO ACTUALIZATION

We had foreseen continued rising interest rates. After a brief pause around the collapse of three large US banks and the demise of Credit Suisse, rates did indeed resume an upward trajectory. The robust job market and consumer spending of their pandemic savings contributed to this trend. Mortgage rates have surged to levels not seen in years, while most leading economic indicators suggest a slowdown. Notably, the 3-month/10-year US Treasury bond spread and the 2-year/10-year yield spread, which have historically proven to be reliable long-term recession predictors, have both remained negative for months.

As expected, leading indicators have continued to deteriorate, and earnings estimates have followed a downward trajectory, with projected earnings for the S&P500 declining from $242.58 at this time last year to $216.86. We anticipate further reductions in earnings as the year progresses. However, we did not anticipate a market re-rating higher amidst these headwinds. All year-to-date market gains are primarily a result of multiple expansions rather than growing profits, which typically drive market performance. It is plausible that the market is looking beyond the next six months and into 2024, anticipating a turnaround in earnings expectations. While the potential for growth exists, we believe there are sufficient headwinds to adhere steadfastly to our approach of seeking well-valued companies with excellent growth prospects and a well-diversified portfolio.

S&P 500 TRADES AT A 20X P/E IN AGGREGATE, BUT 17X EX. THE TOP 7 STOCKES



Source: Compustat, Goldman Sachs Gloal Investment Research 20-JUL-23

OUTLOOK AND PORTFOLIO POSITIONING

We have long foreseen an economic slowdown, and it appears that a contraction is imminent in both corporate capital expenditures (capex) and consumer spending during the latter half of 2023. The employment market has remained robust, and certain pockets within the industrial and technology sectors continue to benefit from sustained growth.

In our current portfolios, we have strategically represented industrial growth through commodities, energy, and industrial equipment. Over the past year, we witnessed some of the largest fiscal spending bills in history, such as the Inflation Reduction Act and the Chips Act, which have contributed significantly to increased industrial spending and onshoring. This surge in capital equipment company spending, combined with nearly $700 billion in spending bills, is expected to continue supporting the US economy even as the housing sector slows. However, the risk is that all this spending will stoke inflation, keeping the Federal Reserve on watch for potential tightening measures.

Highlighted below are some of the companies that we have been building our positions in given their robust growth prospects and strong profit outlooks. Each company possesses inherent strength and is bolstered by structural secular tailwinds, which we believe makes them excellent thematic plays with compelling risk-reward potential.

Caterpillar Inc (CAT US)

Caterpillar is a prominent player in the construction and mining equipment manufacturing sector. These sectors are witnessing substantial growth, primarily driven by recent government initiatives aimed at bolstering infrastructure, facilitating the energy transition, and increasing mining activities to meet the demands of essential metals and commodities that are key to the energy transition and electrical future. CAT boasts a robust balance sheet, solid dividends, and an attractive free cash flow yield. We anticipate CAT to surpass earnings expectations in the years ahead, even if there is a mild slowdown, as it is well-positioned from an order book perspective and has a strong balance sheet to withstand such challenges.

Ferguson Plc (FERG US)

Specializing in supplying plumbing and heating products to professional contractors and consumers, Ferguson has a long history dating back to its founding in 1887 in Wokingham, UK with its revenue primarily coming from the US and Canada. Despite its obvious ties to the housing sector, the company's valuation became increasingly attractive due to its revenue and profits diversification beyond residential building, including HVAC, waterworks, and other industrial segments. This exposure to industrial building aligns perfectly with our portfolio strategy, as Ferguson has demonstrated a track record of delivering strong operating margins. The recent increase in dividend and extension of the buyback program further reinforces its commitment to shareholder value creation. Despite near-term housing challenges, the US market is estimated to face an undersupply of 2-4 million residential units, and an aging housing stock supports the company’s remodelling business. Additionally, non-residential growth opportunities, particularly in mega projects such as semiconductor manufacturing, EV and battery plants, and biotech builds, are estimated to generate over $30 billion in revenue for the company over the next five years.

OUTLOOK AND PORTFOLIO POSITIONING

Artificial Intelligence (AI) Sector

Artificial Intelligence is garnering significant attention for its potential impact in the near term. We've long held positions in leading Semiconductor equipment companies, with current investments in leading-edge equipment suppliers like LAM Research and ASML Holdings, crucial players in supplying cutting-edge chips needed to drive the AI future. While larger players like Microsoft and Nvidia receive considerable media coverage, we believe the true core competence lies in the "picks and shovels" – the companies supplying the essential equipment and software. Our confidence remains steadfast in our exposure to LAM Research, ASML Holdings, and Cadence Design Systems. Cadence stands out with its impressive team of 6,800 R&D engineers and over 1,600 global patents, positioning it at the forefront of machine learning, hyperscale computing, autonomous vehicles, and next-generation mobile network semiconductor design. Their expertise in computational software for intelligent system designs solidifies our conviction in their long-term growth prospects.

From January 2023 to the present day, the market has defied expectations, surmounting challenges like higher interest rates and 15 consecutive months of declining leading indicators. This impressive re-rating of markets in a high-rate environment is hard to square with historical norms; however, it is evident that this period is different in many ways.

We have a great collection of companies in our portfolios. They are extremely well-diversified. All of our valuation metrics have never looked more promising, instilling a strong sense of confidence in our portfolios and their global exposure. Despite the current high-interest rate environment, we remain vigilant. While our projections initially suggested a slow second half of 2023, it seems likely that these expectations will be postponed until next year. Inflation remains stubborn, and we believe that even as it stays steady or declines into the 2.5-3.0% range, central banks will maintain a restrictive policy for longer than the market anticipates. The rate normalization process is nearly complete, which we view positively, yet we respect the lag effect of rate increases as we seek investment opportunities worldwide.

The silver lining for investors lies in the attractive valuations outside of large-cap tech companies. We are committed to exercising patience with the outstanding companies we own and refraining from chasing short-term returns and momentum. Our goal is to achieve positive returns this year while remaining vigilant in the face of significant risks.

Thank you for your continued trust and confidence,

Your Tall Oak Portfolio Management Team

DISCLAIMER

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