

# PALOS

## 2021 SEMI-ANNUAL MANAGEMENT REPORT OF FUND PERFORMANCE

### **PALOS EQUITY INCOME FUND**

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FOR THE PERIOD ENDED JUNE 30, 2021

**Portfolio Manager**

Palos Management Inc. ("Palos")

**Charles Marleau, CIM**

Chief Investment Officer

**Amelia Li**

Senior Analyst

*This semi-annual management report of fund performance ("MFRP") contains financial highlights but does not contain either the interim or annual financial statements of the Palos Equity Income Fund (the "Fund"). You can get a copy of the interim or annual financial statements at your request, and at no cost, by calling 1-514-397-0188 or toll free 1-855-PALOS-88 (1-855-725-6788), by writing to us at Palos Equity Income Fund, Investor Relations, 1 Place Ville-Marie, Suite 1670, Montréal, Québec H3B 2B6 or by visiting our website at [www.palos.ca](http://www.palos.ca) or SEDAR at [www.sedar.com](http://www.sedar.com). Unitholders may also contact us using one of these methods to request a copy of the Fund's proxy voting policies and procedures, proxy voting disclosure record or quarterly portfolio disclosure.*

## **A Note on Forward-looking Statements**

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements.

Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made in relation to the Fund. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events.

The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

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**MANAGEMENT DISCUSSION OF FUND PERFORMANCE**

This management discussion of Fund performance represents the management's view of the significant factors and developments during the past six months that have affected the Fund's performance and outlook since December 31, 2020, the Fund's most recent fiscal year-end. The Fund is a mutual fund managed and advised by Palos Management Inc. (the "Manager"). For information on the Fund's longer-term performance, please refer to the Past Performance section of the report. This report should be read in conjunction with the Annual Management Report of Fund Performance for the year ended December 31, 2020.

**Results of Operations**

As at June 30, 2021, the total net asset value of the Fund was \$28,740,197, an increase of 12.4% from December 31, 2020. This includes \$915,448 in net withdrawal and \$35,685 in distributions net of reinvested distribution in the Fund by its unitholders.

The Fund's benchmark index, the S&P/TSX Composite Total Return Index, which includes reinvested dividends, saw an increase of 17.2% for the first six months of 2021. The value increase in the index, without accounting for reinvested dividends, was + 15.7%. The strongest performing sectors were the energy sector (+33.7%), Health Care (+21.7%), Information Technology (+21.6%) and Financials (+21.1%). The weakest sectors were Materials (-1.2%), Utilities (+2.9%) and Industrials (+6.1%) with only the Materials sector showing a negative performance year-to-date.

In the energy sector, the fund saw outsized gains against the S&P/TSX Energy Index which returned 37.0% including dividends. In the first half, returns on the fund's five largest energy holdings were: Canadian Natural Resources Ltd. (+50.6%), Tourmaline Oil (+108.9%), Keyera Corp. (+52.5%), Topaz Energy (+30.6%), and Tamarack Valley (+102.4%). As of June 30, these five stocks accounted for 6.4% of the fund. The turnaround in the oil sector can be attributed to the rebound in energy prices. Benchmark crude oil, as measured by the West Texas Intermediate (WTI) futures contract, closed the second quarter at \$73.47/barrel, well above the \$48.52/barrel closing price at the end of 2020 for a gain of 51.4% in the half. In similar fashion, Natural Gas prices rose with U.S. NYMEX natural gas higher by 47.1%.

In the information technology sector, the fund's two largest holdings saw impressive gains. Online commerce provider Shopify Inc., which has surpassed Royal Bank as Canada's largest company by market capitalization, was higher by 26.1% while Montreal based Lightspeed POS Inc. was higher by a whopping 222.1%. Lightspeed continues to show impressive growth both organically and via acquisitions. The company continues to build out its services platform and expand its global presence.

Financials have remained as the fund's highest weighted sector. Royal Bank of Canada (4.1% weight), Bank of Montreal (3.9%), Bank of Nova Scotia (3.7%) and TD Bank (3.7%) are the top four core holdings on a percentage basis. First half 2021 returns for the S&P/TSX Banks sub index was 25.2% including dividends, outperforming the S&P/TSX Composite Index by 8%. As the post-pandemic economy continues to recover, Canadian banks are well positioned to benefit from increased investment and financing needs. We are also attracted to the banks given their reliable dividend growth history and the safety factor inherent in the Canadian banks.

In the first half we added several new positions to the fund's portfolio. In February, the fund participated in a private placement of shares in Spartan Delta Corp. (TSX: SDE). Spartan is a Canadian oil & gas exploration company with operations in the Clearwater play, which is regarded as a premier play in the Canadian oil patch. The shares were acquired at a price of \$4.00. SDE closed the first half at \$6.03 (+50.8%). Also in the oil patch, the fund added Topaz Energy Corp. (TPZ: TSX) which is an energy infrastructure company that was spun off from Tourmaline in October 2019. Through June 30 TPZ shares were higher by 30.63% including dividends.

In March, the fund participated in the initial public offering (IPO) of shares in Payfare Inc. (PAY: TSX). Payfare provides financial transaction processing services to workers in the gig economy. This includes mobile banking, micro-lending, rewards programs, and money transfer services to workers in the rideshare industry. The IPO was priced at \$6.00 per share and PAY ended the first half at \$10.00 (+66.7%).

The fund's comparison with index performance is provided for reference only. It is important to note that the index includes the effect of reinvested dividends, but unlike the Fund's return it does not reflect the effect of fees and expenses for professional management.

**Diversification**

The fund is well diversified across all eleven sectors with Financials (28%), Industrials (15%) and Energy (10%) carrying the largest weightings. The fund held 88 different equities on June 30, as well as a 9.9% exposure to fixed income securities which was comprised of a 3.2% weighting in the iShares 1-5 year Laddered Government Bond ETF (CLF: TSX) and a 3.2% weighting in the iShares 1-5 year Laddered Corporate Bond ETF (CBO: TSX). The fund also has a 3.3% weighting in convertible debentures.

**Recent Developments**

As we enter the second half of the year, investors are keeping an eye on inflation, interest rates, and the progress in battling the COVID-19 pandemic.

On the inflation front, market pundits continue to debate whether inflationary pressures will be transitory or permanent. Fed Chair Powell is firmly in the camp that the recent uptick in inflation is a result of temporary factors (e.g., supply chain bottlenecks, semiconductor shortages, higher demand/reduced supply of some commodities). In comments made before the Financial Services Committee, Powell reaffirmed his stance that until the labor market improves, monetary policy will not be tightened. Easy monetary policy is supportive of equity prices.

With regards to interest rates south of the border, a widely followed indicator is the yield on the U.S. 10-year Government Note. After closing out 2020 at 0.92%, the yield rallied to just above 1.7% in March. The sharpness of the move had money managers concerned that higher interest rates were on the horizon. Many believed that Powell would react by raising rates and reducing asset purchase programs. However, by the end of June the 10-year yield was hovering around 1.45% and in fact touched 1.13% in mid-July.

While fatalities and hospitalizations have plummeted, the emergence of the Delta variant is fueling concerns that another wave of the Coronavirus is imminent. While vaccination rates continue to rise, consensus amongst health experts is that at least 75% must be fully vaccinated to achieve herd immunity. At the end of June, approximately 55% of U.S. citizens had received their first dose and 47% were classified as fully vaccinated. In Canada, 68% of the population had at least one dose and 31% were fully vaccinated. Globally, the numbers are significantly lower (23% had one dose and 11% were fully vaccinated). While we are optimistic that the worst is well behind us, the economic consequences of another wave are firmly on the minds of investors. Concerns surrounding the economic impact of another wave are keeping a lid on any enthusiasm for a post-pandemic boom. In our view, while this may have a negative effect on investor sentiment (i.e., fear), we are confident that governments around the globe are committed to reopening the economy. The odds for a return to lockdowns and restrictions are extremely low and mitigating personal risk of infection will lie in the hands of those who do not get vaccinated.

As we enter the second half, economists continue to lift their projections for significant economic growth. Given the commitment of policy makers around the world to be extremely accommodative, and determined to achieve employment comparable to pre-pandemic levels, it is difficult to imagine that the economy will not see significant growth. We believe equity markets are currently taking a “summer pause” from the first half rally, and we are confident that once the summer doldrums are behind us there is a strong likelihood that markets will show strength through the remainder of 2021 and possibly beyond.

### Related Party Transactions

Palos Management Inc., which acts as the investment fund manager and portfolio advisor to the Fund, is deemed to be a related party to the Fund. Palos Management Inc. and the Fund were not party to any other related party transactions during the last year.

The Fund’s independent Review Committee (the “IRC”) has considered whether Palos Management Inc.’s roles as investment fund manager and portfolio advisor constitutes a conflict of interest requiring standing instructions and has concluded that it does not. Nevertheless, the IRC will review the arrangement from time to time to ensure that Palos Management Inc., in its dual capacity as investment fund manager and as portfolio manager, is performing adequately in both roles. In its analysis, the IRC will consider the following criteria, among others: the performance of the Fund relative to other funds in the same category, and the quantum of the fees paid to the Manager in relation to the performance of the Fund and the amount of assets under management in the Fund. Palos Management Inc. has relied on the approval of the IRC in proceeding in this manner

**Manager, Trustee and Portfolio Advisor:** Palos Management Inc. is the manager, and portfolio advisor of the Fund. Computershare Trust Company of Canada is the trustee of the Fund.

**Custodian:** NBIN Inc., a subsidiary of National Bank, is custodian of the Fund.

**Registrar:** SGGG Fund Services Inc. is the registrar of the Fund and keeps records of who owns the units of the Fund.

### MANAGEMENT FEES

Management fees paid by the Fund are calculated monthly, based on 1/12<sup>th</sup> of the annualized management fee per series applied to the NAV per series as at the last business day of the preceding month.

Series	Trailer commissions (%)	Other (%)
A	0.75	0.75
F	0.00	0.75

Other – includes day-to-day administration of the Fund, portfolio advisory services and Manager’s compensation.

FINANCIAL HIGHLIGHTS

**Series A**

The following tables show selected key financial information about the Fund and are intended to help you understand the Fund's financial performance for the past six years.

The Fund's Net Assets per Unit <sup>(1)</sup>	June 30, 2021	2020	2019	2018	2017	2016
<b>Net Assets, beginning of period</b>	<b>\$6.38</b>	<b>\$5.72</b>	<b>\$5.35</b>	<b>\$6.68</b>	<b>\$6.38</b>	<b>\$5.93</b>
<b>Increase (decrease) from operations:</b>						
Total revenue	0.09	0.16	0.18	0.17	0.18	0.17
Total expenses	(0.10)	(0.15)	(0.17)	(0.16)	(0.16)	(0.17)
Realized gains (losses) for the period	0.57	0.20	0.01	0.27	0.40	0.30
Unrealized gains (losses) for the period	0.59	0.52	0.74	(1.20)	0.30	0.66
<b>Total increase (decrease) from operations <sup>(2)</sup></b>	<b>1.15</b>	<b>0.73</b>	<b>0.76</b>	<b>(0.94)</b>	<b>0.72</b>	<b>0.96</b>
<b>Distributions:</b>						
From income (excluding dividends)	0.00	0.00	0.02	0.00	0.00	0.00
From dividends	0.00	0.01	0.00	0.00	0.00	0.00
From capital gains	0.05	0.01	0.00	0.23	0.34	0.13
Return of capital	0.00	0.08	0.38	0.17	0.06	0.37
<b>Total Annual Distributions <sup>(3)</sup></b>	<b>0.05</b>	<b>0.10</b>	<b>0.40</b>	<b>0.40</b>	<b>0.40</b>	<b>0.50</b>
<b>Net Assets, end of period</b>	<b>\$7.49</b>	<b>\$6.38</b>	<b>\$5.72</b>	<b>\$5.35</b>	<b>\$6.68</b>	<b>\$6.38</b>

- (1) The information is derived from the Fund's unaudited financial statements as at June 30, 2021 and audited annual financial statements as at December 31 of each year.
- (2) Net assets and distributions are based on the actual number of unit outstanding at the relevant time. The increase/decrease in net assets from operations is based on the weighted average number of units outstanding over the fiscal period. This table is not intended to be a reconciliation of opening and closing net assets per units.
- (3) Certain distributions were paid in cash to unitholders who ask for cash payment. For the other unitholders, the distributions were reinvested in additional units of the Fund.

Ratios/Supplemental Data	June 30, 2021	2020	2019	2018	2017	2016
Total Net Asset Value (\$000's) <sup>(1)</sup>	20,800	17,924	17,011	15,862	19,092	18,649
Number of units outstanding (000's)	2,778	2,808	2,976	2,966	2,857	2,924
Management expense ratio <sup>(2)</sup>	2.53%	2.66%	2.71%	2.52%	2.51%	2.60%
Management expense ratio before waivers or absorptions	2.53%	2.66%	2.71%	2.52%	2.51%	2.60%
Trading expense ratio <sup>(3)</sup>	0.12%	0.33%	0.18%	0.31%	0.29%	0.25%
Portfolio turnover rate <sup>(4)</sup>	41.19%	97.73%	63.56%	86.11%	73.31%	108.62%
Net Asset Value per unit	\$7.49	\$6.38	\$5.72	\$5.35	\$6.68	\$6.38

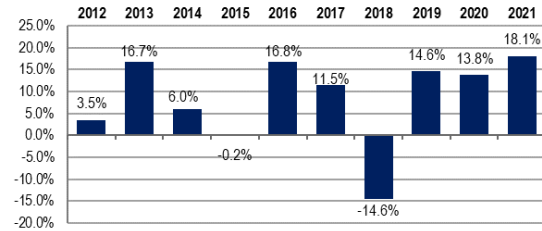
- (1) This information is provided as at the end of the year shown.
- (2) Management expense ratio represents the total expenses (excluding commissions and other portfolio transactions costs) for the stated period and is expressed as an annualized percentage of daily average net asset value during the period.
- (3) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of net asset value during the period.
- (4) The Fund's portfolio turnover rate indicates how actively the Fund's portfolio adviser manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessary a relationship between a high turnover rate and the performance of a fund.

## PAST PERFORMANCE

The following information shown assumes that all distributions made by the Fund in the periods shown were reinvested in additional securities of the Fund and does not take into account sales, redemption, distribution or other optional charges that would have reduced returns. Past performance does not necessarily indicate how the Fund will perform in the future.

### Year-by-Year Returns

The following charts show the investment fund's performance for each of the years shown, and illustrate how the investment fund's performance has changed from year to year. In percentage terms, the charts show how much an investment made on the first day of each financial period would have grown or decreased by the last day of each financial period.



\* For the 6 months period ended June 30, 2021

## FINANCIAL HIGHLIGHTS

### Series F

The following tables show selected key financial information about the Fund and are intended to help you understand the Fund's financial performance for the past six years.

The Fund's Net Assets per Unit <sup>(1)</sup>	June 30, 2021	2020	2019	2018	2017	2016
<b>Net Assets, beginning of period</b>	<b>\$6.96</b>	<b>\$6.17</b>	<b>\$5.69</b>	<b>\$7.03</b>	<b>\$6.67</b>	<b>\$6.13</b>
<b>Increase (decrease) from operations:</b>						
Total revenue	0.09	0.18	0.19	0.17	0.19	0.17
Total expenses	(0.07)	(0.12)	(0.13)	(0.1)	(0.16)	(0.13)
Realized gains (losses) for the period	0.62	0.15	0.01	0.28	0.45	0.30
Unrealized gains (losses) for the period	0.66	0.20	0.79	(1.28)	0.35	0.81
<b>Total increase (decrease) from operations <sup>(2)</sup></b>	<b>1.30</b>	<b>0.42</b>	<b>0.86</b>	<b>(0.94)</b>	<b>0.83</b>	<b>1.15</b>
<b>Distributions:</b>						
From income (excluding dividends)	0.00	0.00	0.06	0.00	0.00	0.00
From dividends	0.01	0.02	0.00	0.00	0.02	0.00
From capital gains	0.04	0.01	0.00	0.23	0.38	0.32
Return of capital	0.00	0.07	0.34	0.17	0.02	0.18
<b>Total Annual Distributions <sup>(3)</sup></b>	<b>0.05</b>	<b>0.10</b>	<b>0.40</b>	<b>0.40</b>	<b>0.40</b>	<b>0.50</b>
<b>Net Assets, end of period</b>	<b>\$8.20</b>	<b>\$6.96</b>	<b>\$6.17</b>	<b>\$5.69</b>	<b>\$7.03</b>	<b>\$6.13</b>

(1) The information is derived from the Fund's unaudited financial statements as at June 30, 2021 and audited annual financial statements as at December 31 of each year.

(2) Net assets and distributions are based on the actual number of unit outstanding at the relevant time. The increase/decrease in net assets from operations is based on the weighted average number of units outstanding over the fiscal period. This table is not intended to be a reconciliation of opening and closing net assets per units.

(3) Certain distributions were paid in cash to unitholders who ask for cash payment. For the other unitholders, the distributions were reinvested in additional units of the Fund.

Ratios/Supplemental Data	June 30, 2021	2020	2019	2018	2017	2016
Total Net Asset Value (\$000's) <sup>(1)</sup>	7,941	7,252	8,509	9,040	11,160	5,707
Number of units outstanding (000's)	968	1,042	1,380	1,587	1,588	855
Management expense ratio <sup>(2)</sup>	1.68%	1.81%	1.86%	1.67%	2.41%	1.74%
Management expense ratio before waivers or absorptions	1.68%	1.81%	1.86%	1.67%	2.41%	1.74%
Trading expense ratio <sup>(3)</sup>	0.24%	0.17%	0.19%	0.31%	0.32%	0.22%
Portfolio turnover rate <sup>(4)</sup>	41.19%	97.73%	63.56%	86.11%	73.31%	108.62%
Net Asset Value per unit	\$8.20	\$6.96	\$6.17	\$5.69	\$7.03	\$6.67

(1) This information is provided as at the end of the year shown.

(2) Management expense ratio represents the total expenses (excluding commissions and other portfolio transactions costs) for the stated period and is expressed as an annualized percentage of daily average net asset value during the period.

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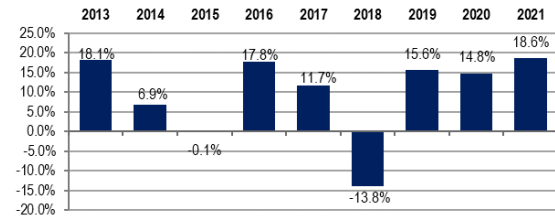
(4) The Fund's portfolio turnover rate indicates how actively the Fund's portfolio adviser manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessary a relationship between a high turnover rate and the performance of a fund.

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\* For the 6 months period ended June 30, 2021



## SUMMARY OF INVESTMENT PORTFOLIO

As at June 30, 2021

### Portfolio by Category

The major portfolio categories and top 25 holdings of the Fund at the end of the period are indicated in the following tables. The summary of investment portfolio may change due to ongoing portfolio transactions of the Fund and a quarterly update is available.

#### Regional Weightings (%)

Canada	98.4%
United States	1.6%
Total	100.0%

#### Sector Weightings (%)

Communication Services	4.6%
Consumer Discretionary	5.0%
Consumer Staples	1.9%
Energy	11.0%
Financials	29.3%
Health Care	1.7%
Industrials	15.7%
Information Technology	6.3%
Materials	9.3%
Real Estate	8.6%
Utilities	5.4%
Cash	1.2%
Total	100%

#### Portfolio Long/Short Breakdown (%)

Long positions	98.8%
Short positions	0.0%
Cash	1.2%
Total	100%

#### Asset Class Weightings (%)

Common Stocks	89.0%
Fixed Income	9.8%
Cash	1.2%
Total	100%

#### Top 25 holdings (%)

Royal Bank of Canada	4.05%
Bank of Montreal	3.85%
The Bank of Nova Scotia	3.73%
The Toronto-Dominion Bank	3.72%
iShares 1-5 Year Laddered Government Bond Index ETF	3.24%
iShares 1-5 Year Laddered Corporate Bond Index ETF	3.22%
National Bank of Canada	2.28%
Shopify Inc.	1.83%
Canadian Natural Resources Ltd	1.65%
Canadian Pacific Railway Ltd	1.62%
Quebecor Inc.	1.42%
Fiera Capital Corp. 5% June 30, 2023 Conv. \$18.85	1.36%
Tourmaline Oil Corp.	1.32%
Canadian National Railway Co.	1.31%
Keyera Corp.	1.28%
TELUS Corp.	1.26%
GFL Environmental Inc.	1.17%
North American Construction Group Ltd 5.50% June 30, 2028 Conv \$24.75	1.13%
Topaz Energy Corp.	1.11%
Cargojet Inc.	1.10%
Tamarack Valley Energy Ltd	1.09%
Lightspeed POS Inc.	1.09%
Brookfield Asset Management Inc.	1.08%
Capital Power Corp.	1.07%
Mullen Group Ltd	1.06%

The total Net Asset Value of the Fund as at June 30, 2021 was \$28,740,197.

The prospectus and other information about the Fund are available on the internet at [www.sedar.com](http://www.sedar.com).

For more information, contact your investment advisor or:

**Palos Management Inc.**

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