The Valuation Gap Investors Can't Ignore

In this paper, we share a valuable yet sometimes overlooked indicator which, over the past 15 years, has signaled future outperformance of the FGP Canadian Equity Fund multiple times.

We have written in the past about the case for investing in Canada. We still believe the country is well positioned to take advantage of shifting themes. Using FGP's expertise in Canadian equities is one way to benefit from investing in Canada.

Canada Remains an Attractive Market

Equity valuations appear elevated despite unresolved trade issues, particularly in the United States. Compared with equities south of the 49th parallel, Canadian equities are generally more appealing as they are supported by the following factors:

- higher dividend yields;
- more attractive valuations; and
- a more favourable equity risk premium: lower long bond yields in Canada than in the U.S. means the spread between the earnings yield and the risk-free rate is more advantageous in Canada.

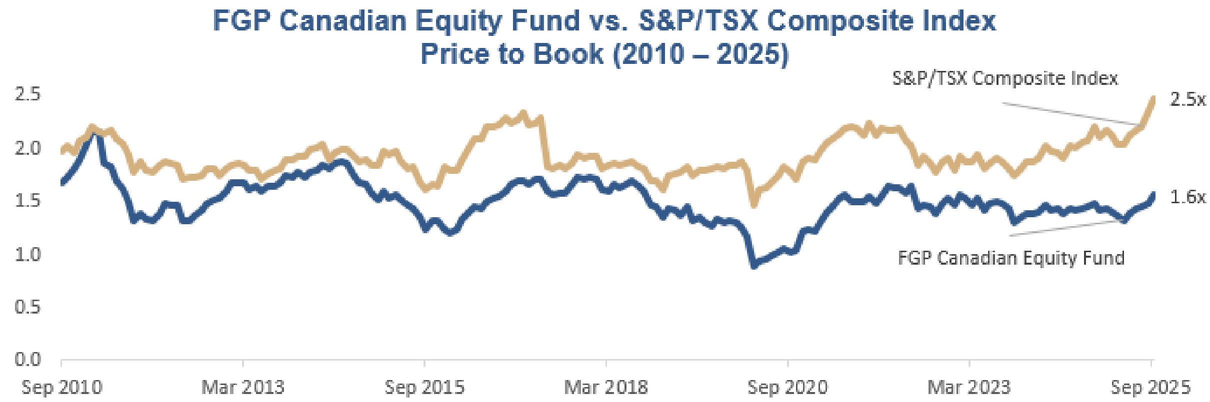
We are encouraged by the newly elected Canadian government's pro-growth posture. Bill C-5, which enhances interprovincial trade and accelerates key national projects, is a potential tailwind for several of our portfolio holdings. In our opinion, the outcome of the Canada-U.S. trade negotiations could also be a potential domestic catalyst, albeit still with risk.

While markets are experiencing some short-term political noise, our all-weather investment approach remains unchanged: look for high-quality companies that generate earnings growth and growing dividends and invest in these companies at reasonable valuations. This strategy has rewarded patient investors. In the five years to September 30, 2025, the FGP Canadian Equity Fund outperformed its benchmark, the S&P/TSX Composite Index, by an annualized 4.8%. During that period, the Fund's downside market capture was 77% compared with 85% for the eVestment Canadian All Cap Equity Universe.

FGP Canadian Equity Strategy: Poised for a Rebound

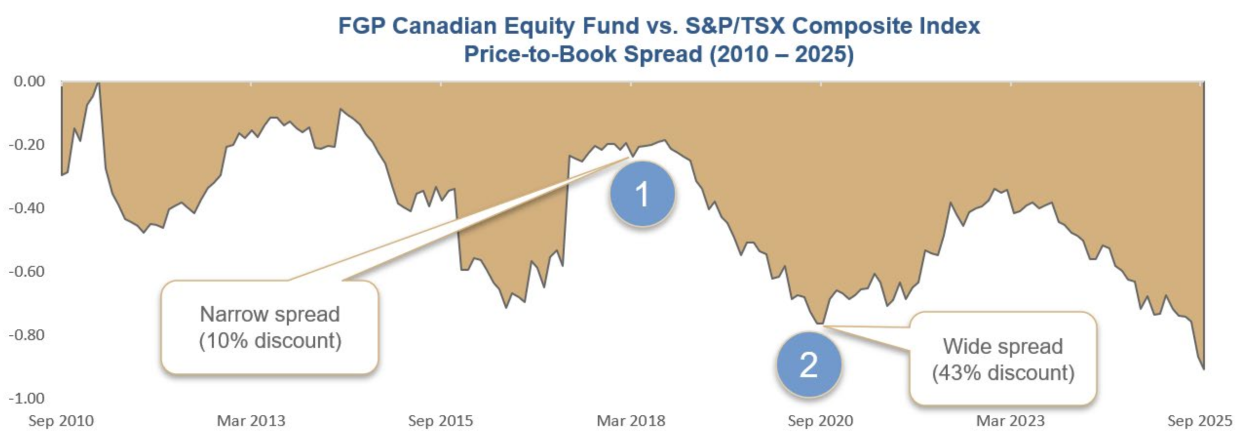
As value managers, our portfolios should be less expensive than the market. Our research has shown that when the FGP Canadian Equity Fund was much less expensive than the S&P/TSX Composite Index, the Fund outperformed over the subsequent three years. When the Fund was only a little less expensive than the market, it underperformed.

Here's a graph showing the price-to-book (P/B) ratio of the FGP Canadian Equity Fund in blue and the S&P/TSX Composite Index in gold from September 2010 to September 2025.



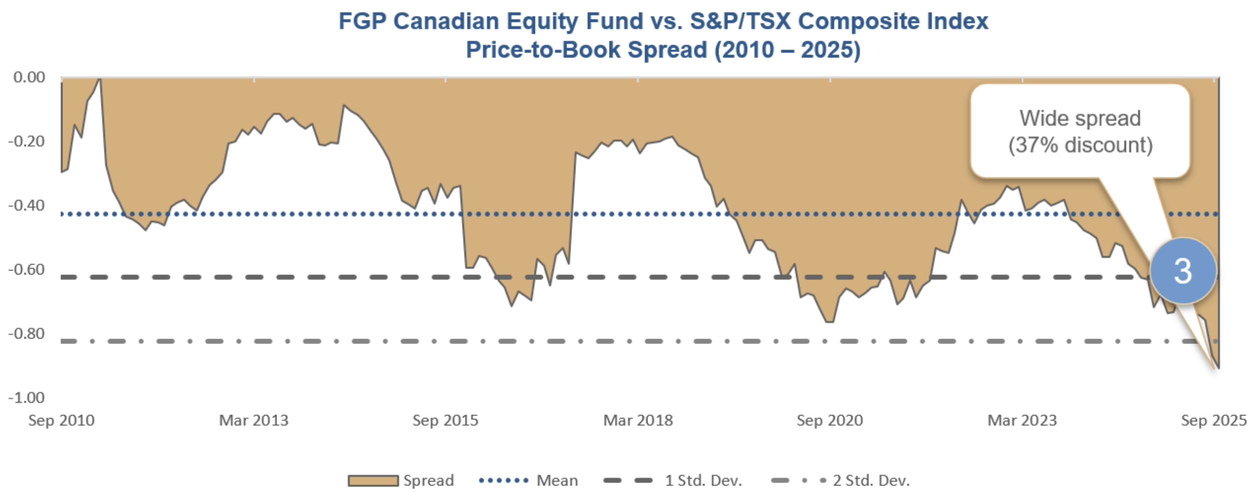
Except for one month in 2011, you can see that our strategy was always more attractively valued (cheaper) than the overall market, sometimes much cheaper. Since early 2023, the valuation discount – or spread - between our strategy and the broader market has widened. Relative P/B spread has historically been a good indicator of value and expected performance. We can look to three modern day crises as examples: the dot.com crisis, the Global Financial Crisis, and the COVID-19 pandemic. In each instance, our strategy outperformed in the subsequent three-year period.

This following graph makes it much easier to see when the Fund was a little bit cheaper (narrow P/B spread) and when it was much cheaper (wide P/B spread). You can see that the last time the P/B spread was very narrow was in 2018 1: At that time, the Fund was valued at a 10% discount to its benchmark as measured by P/B. Over the next three years, the Fund underperformed its benchmark by more than 5% per year (5.5% versus 11.1%, October 2018 to September 2021) due to security selection in the Energy and Information Technology sectors.



In 2020, during the COVID-19 pandemic, the Fund traded at a 43% discount to the S&P/TSX Composite Index 2. Over the next three years, the Fund outperformed its benchmark by an annualized 13% (23.0% versus 9.9%, October 2020 to September 2023) because the high valuations reached in the market in 2020 were not sustainable.

At the end of September 2025 3, the Fund was valued at a 37% discount to the market. This discount is an uncommon **two standard deviation** difference from the market.



For statistics enthusiasts, in the last 15 years, in only 2.5% of the time has the FGP Canadian Equity Fund's relative P/B spread been this large.

Will the Fund outperform again as it did when it was very cheap relative to the benchmark in 2020?

Source: Bloomberg

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