Bluewater Team
January 12th, 2026

Mackenzie Bluewater Q4 2025 team commentary

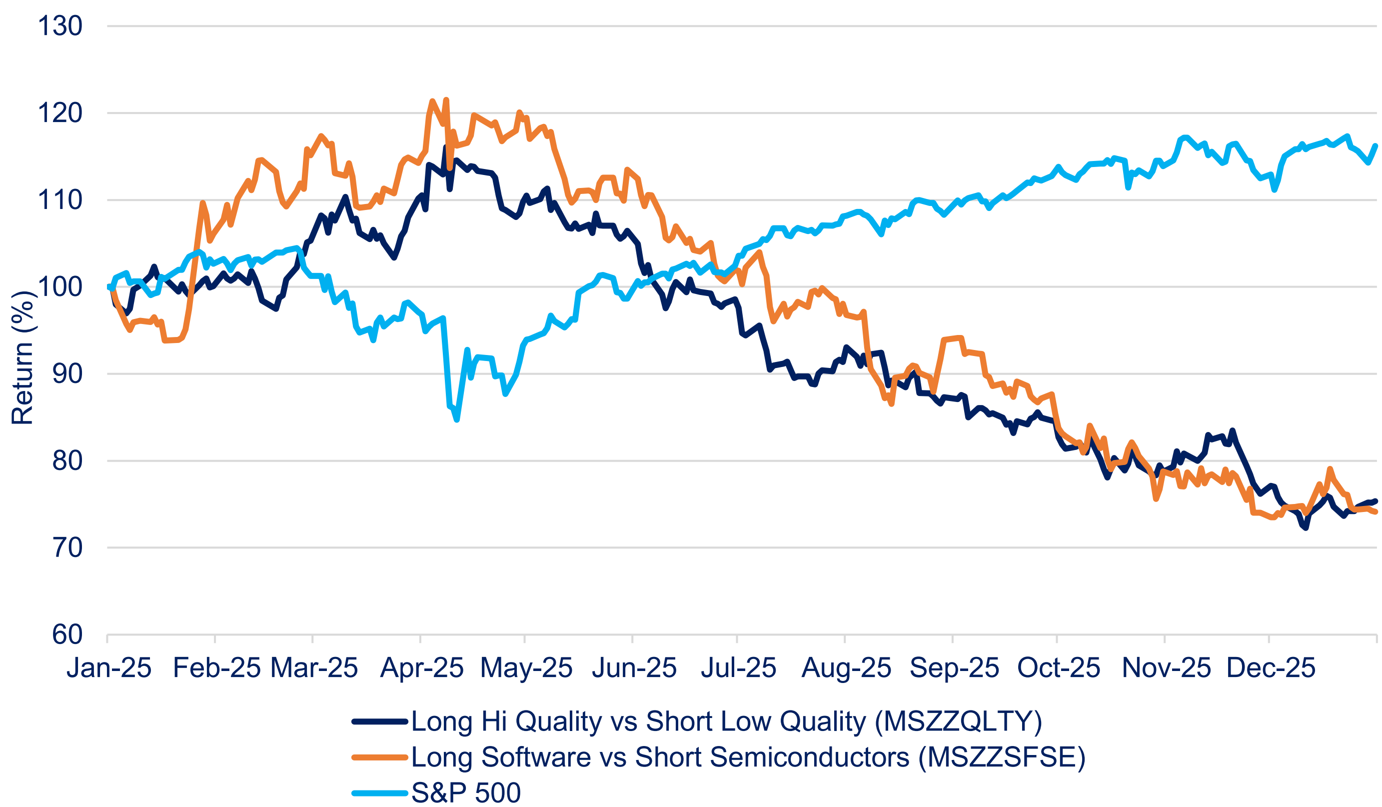
2025 Review

Bluewater was built on a clear and consistent philosophy: to own a concentrated portfolio of high-quality, durable compounders supported by deep research, long-term conviction, and disciplined portfolio construction. This approach has served clients well over time by aiming to deliver strong long-term outcomes and meaningful diversification within broader portfolios.

Of course, market structures and investment regimes change, and shifts in risk appetite can lead to periods of underperformance. We experienced some of that in calendar 2025. When results disappoint, we find it helpful to separate the drivers into two categories:

1. **Stylistic headwinds.** At times, markets temporarily reward characteristics that sit outside of our quality bias. In these periods, the right response is typically to stay disciplined and look for dislocations where valuations move away from underlying fundamentals.
2. **Structural change.** When the economy, industry fundamentals, or market structure evolve, it can create an opportunity to strengthen our process - expanding our ability to evaluate the opportunity set - while maintaining the same standards for business quality and durability.

Morgan Stanley paired indices vs S&P 500



Source: Bloomberg as of December 31, 2025. 100 = January 1, 2025.

Calendar 2025 was a challenging year for many quality-growth-oriented investors. In several parts of the market, returns were narrow and risk-seeking, influenced by a mix of (i) enthusiasm around AI-related infrastructure spending, (ii) strength in more speculative, lower-quality segments of the market, and (iii) cyclical exposures tied to expectations for an industrial rebound.

One way to see this dynamic is through the **Morgan Stanley Quality Pair Index**, which compares higher-quality stocks to lower-quality stocks. In the U.S., lower-quality stocks outperformed higher-quality stocks by approximately **25%** in calendar 2025, an unusually wide gap. A concentrated quality portfolio can lag when markets are driven by narrow, speculative leadership, but we believe that same discipline has been critical to delivering strong results over full cycles.

Our response is to stay disciplined. At our core, we believe that companies that can consistently and durably grow free cash flow per share over time have tended to outperform across cycles. After a difficult year, we do not believe the right decision is to dilute our quality bias. Importantly, these environments can also create opportunities to add to exceptional businesses at valuations we do not often see. Quality is rarely “cheap,” but we are beginning to find selective opportunities in certain pockets of the market.

To highlight how the opportunity set has shifted, much of the past decade’s most reliable sources of durable growth were found in software and proprietary data businesses benefiting from digital transformation. These companies offered scalability, expanding margins, recurring revenues, and strong free-cash-flow generation; an environment where market breadth mattered and active stock selection was consistently rewarded.

Artificial intelligence has reshaped that landscape as shown in a similar Morgan Stanley Pair Index comparing software and semiconductors in the above chart. While many software and data companies still offer attractive growth with relatively resilient business models, a larger share of incremental investment (and in some cases economics) has accrued to semiconductors, hardware, and the infrastructure required to enable AI at scale. Historically, we approached many of these areas conservatively given cyclicality, capital intensity, and volatility. Some of those characteristics remain. However, in select pockets, industry structure and business models have evolved in ways that improve durability: markets are becoming more oligopolistic, revenue streams are more recurring, competitive moats are more defensible, and demand is increasingly supported by structural, not purely cyclical, drivers.

At the same time, equity markets have become far more concentrated. The largest companies now dominate index performance, with the top ten stocks accounting for about 40% of the S&P 500. In this environment, our challenge was not poor security selection: it was that exposure mattered more than it typically does. We owned high-quality businesses, but being underexposed to a narrow group of mega-cap compounders created a meaningful performance gap.

Evolution, not revolution

To ensure our philosophy continues to translate in this market architecture while remaining grounded in quality and discipline we have been evolving how we operate across three dimensions:

People

The speed of change across industries, particularly in technology, demands deeper domain expertise and greater research capacity. Over the past year, we have strengthened coverage in areas where innovation and capital investment are reshaping industry structure. The goal is simple: more specialized insight, faster learning cycles, and better-informed decisions across the portfolio.

To support that, we have expanded the team with several targeted hires and expect to continue investing to deepen expertise in areas where the opportunity set is changing quickly. We are already seeing benefits in idea generation and in our ability to identify both opportunities and risks earlier in the research process.

In parallel, we are integrating our Canadian and global capabilities into a more unified, sector-oriented platform. This improves our ability to assess competitive dynamics, supply chains, and technological change globally, often leading to better insights even when evaluating a “Canadian” name.

Technology

We are embedding more advanced data and analytics tools into our research, portfolio construction, and risk management. These tools expand our analytical reach and improve how we identify, size, and monitor investments. They do not replace fundamental judgment; they strengthen it by helping us see risks and concentrations earlier and more clearly.

Practically, this gives us better visibility into where the portfolio may be exposed to the same underlying drivers, even when holdings appear diversified by sector classifications, so exposures can be managed with finer precision.

Diversification

We have modestly broadened diversification across our portfolios. Importantly, this is not a change in philosophy (we remain a concentrated, high-conviction strategy) but it helps reduce single-theme risk and allows us to pursue a wider set of durable growth opportunities across sectors, regions, and market capitalizations. Position sizing remains disciplined, and conviction driven. The result is a portfolio that is better positioned to participate across a wider range of market environments, without compromising our quality and valuation discipline.

Our objective remains unchanged: to own businesses capable of compounding earnings and free cash flow through cycles. We do not own companies simply because they are large benchmark weights, but we also do not avoid a company solely because it is. In today’s market, some of the largest index constituents exhibit the durability, competitive advantages, and free-cash-flow characteristics we seek, and in certain cases can be reasonably valued relative to their fundamentals. When those businesses meet our standards for quality and valuation, we are prepared to own them.

Where we are going

This evolution does not represent a change in our philosophy or standards. No investment enters the portfolio unless it meets our requirements for quality, durability, and sustainable free-cash-flow generation. Quantitative tools do not replace judgment; it reinforces it by making risks clearer and decisions better informed.

Markets evolve. Businesses evolve. Our philosophy does not, but the tools and structure supporting it must keep pace. By combining expanded domain expertise, more advanced analytics, and the same disciplined process, we believe we are better positioned to identify and underwrite the next generation of durable growth businesses, wherever they emerge.

Our commitment remains the same: superior, risk-adjusted, long-term compounding through ownership of the highest-quality businesses in the world.

Built to compound

Despite the recent underperformance, much of it reflects what we did *not* own rather than any deterioration in the businesses we do. The companies in the portfolio are executing well, in many cases at or above our expectations. We own a roster of durable, high-quality growth businesses, and over time it is their fundamentals - earnings growth, cash generation, and competitive strength - that drive compounding and provide downside protection during periods of market volatility. History reinforces why this matters, over long periods, there is a 96% correlation between earnings growth and share price returns. Several of our holdings delivered exceptional returns during the quarter, reflecting this linkage between business performance and market outcomes.

We continue to position the portfolio around structural change, while actively managing risk as those dynamics evolve. **Amphenol** was a significant contributor to performance, benefiting from accelerating demand tied to hyperscale data centers, AI accelerators, and high-speed networking. At the same time, we exited **Gartner** as our assessment of risk changed. The rapid advancement of AI tools increasingly threatens its moat and pricing power, and we chose to step aside rather than underwrite that uncertainty. Capturing opportunity while managing downside risk is central to our approach.

In Canada, government-driven spending programs provide visible, multi-year tailwinds. Infrastructure investment supports engineering and construction firms such as **Stantec**, while rising domestic and global defense budgets benefit **CAE**. After a period of transient challenges in its defense segment, CAE now has a new management team, a sharper focus on profitable growth and capital efficiency, and a materially improved demand backdrop as defense spending accelerates in Canada and across Europe. Both companies contributed meaningfully to performance.

Finally, strong outcomes were not limited to companies tied to secular growth themes. We also own businesses benefiting from company-specific drivers. **Loblaws** delivered strong performance as consumers continued to shift toward discount formats, while its pharmacy business benefited from growth in specialty drugs, including GLP-1s, and regulatory changes expanding the role of pharmacists. These results reinforce the value of owning high-quality businesses with multiple paths to value creation.

Through periods like this, we remain committed to our time-tested investment process and philosophy. While we continuously refine and enhance our approach, those changes are evolutionary, not revolutionary. The discipline and conviction that have underpinned our long-term success remain firmly in place.

Opportunities in 2026

Several tailwinds support a constructive medium-term outlook. Major central banks have pivoted toward easing as inflation normalizes, improving financial conditions for households and businesses. Importantly, the narrowness of the AI-driven market is creating opportunities elsewhere, with quality stocks broadly out of favour and select areas trading at valuations that discount overly pessimistic outcomes.

An example is healthcare. Healthcare has been a difficult area for investors in recent years. Political uncertainty, tariff risk, regulatory noise, China exposure, and post-COVID normalization all weighed on the sector at the same time capital aggressively rotated toward AI-driven growth. The result was sustained outflows from healthcare and meaningful valuation dislocations, even as underlying fundamentals steadily improved.

We view this backdrop as attractive. Balance sheets across the sector are strong, innovation cycles are re-accelerating, and current valuations reflect a far more pessimistic outlook than the data supports. Within Bluewater, we have positioned the portfolio across both pharmaceutical companies, such as **Eli Lilly** and **AstraZeneca**, and medical technology leaders including **Stryker** and **Boston Scientific** to capture this opportunity.

Alphabet is another example of how dislocation can create opportunity. In 2024, many investors abandoned the stock amid concerns that generative AI would structurally disrupt Search. One year later, Alphabet has been the best-performing MAG name and a meaningful contributor to Bluewater's performance.

Search remains one of the most powerful business models ever created, and recent results have reinforced its durability rather than undermined it. Alphabet continues to deliver strong operating performance while demonstrating clear AI execution, particularly through AI Overviews, which are monetizing at rates comparable to traditional search. Core search revenues remain healthy, alleviating concerns around material cannibalization.

Cost structure is a key advantage. Alphabet operates the lowest-cost AI infrastructure among leading model developers, driven by its in-house TPU capabilities. Combined with substantial free-cash-flow generation, this allows the company to fund AI investment internally while preserving financial flexibility and long-term earnings power. Beyond Search, assets such as YouTube, Google Cloud Platform, and Waymo provide meaningful long-term optionality, each benefiting from Alphabet's AI leadership, data advantages, and global scale.

Risks to manage in 2026

While equity markets remained buoyant in 2025, several increasingly complex risks warrant close attention. Market concentration and speculative behavior are elevated, with unprofitable technology names and momentum-driven themes among the strongest performers. Sustained market strength will require a durable acceleration in underlying investment rather than continued multiple expansion.

These dynamics extend to Canada. While the economy has proven more resilient than expected, the outlook is increasingly constrained. Household leverage remains elevated, productivity continues to disappoint, and slowing immigration removes an important tailwind to labour supply and consumption.

MACKENZIE Investments

Although headline labour market data remain constructive, early signs of stress are emerging in unsecured credit and among lower-income households, even as higher-income consumers remain relatively insulated. This points toward a more bifurcated, K-shaped recovery and raises the risk of localized credit deterioration even if system-wide stress remains contained.

Externally, geopolitical and trade risks loom large. The United States remains Canada's dominant export market, and the upcoming USMCA renegotiation represents a significant source of uncertainty. Even absent a worst-case outcome, the negotiation process itself is likely to restrain business confidence, capital spending, and hiring until greater clarity emerges.

Internationally, China continues to confront entrenched structural headwinds: adverse demographics, a fragile property sector, and slower productivity growth. Policy stimulus can offer periodic relief, but geopolitical tension particularly US-China relations limits visibility for companies with meaningful exposure.

Conclusion

We view AI as a foundational technological shift - arguably the most important since the commercialization of the internet. That said, it remains early, with real uncertainty around adoption curves, capital intensity, and the durability of emerging business models. Our portfolio positioning reflects this reality: aligned with the structural digitization of the global economy, but deliberately avoiding extremes.

We focus on companies with durable competitive advantages, strong fundamentals, and sustainable free-cash-flow generation, businesses that can participate in AI-driven upside without relying on speculative assumptions. This allows us to capture long-term opportunity while managing the inherent uncertainty that accompanies transformative technologies.

The majority of Bluewater holdings remain idiosyncratic, high-quality compounders across a broad range of industries and geographies. By emphasizing businesses capable of growing free cash flow at above-market rates and investing at disciplined valuations, we embed downside protection into the portfolio. This approach enhances resilience through volatility and macro uncertainty and has consistently preserved capital in difficult environments while compounding returns for clients over the long term.

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