Quarterly Market Commentary

March 2024

Views on the current state of the economy, particularly south of the border, are increasingly being perceived in the eye of the beholders, who are allowing their political views to cloud the objectively quantified ones.

The cold fact is, the economy in the United States is, all in all good- and compared to the rest of the world, it's pretty good. Toxic politics in the world's superpower is big perpetuated by social media, compounded by algorithms, and it's having a negative impact on wealth investors globally. The solution for this malaise is a clearly defined, empirical decision-making process. Further, it is incredibly important to remain mindful that our emotions are being challenged in a way that they have been before.

Let's consider some basic facts right up front:

- U.S. inflation has declined meaningfully and is currently at 3.2% on a year-over-year basis, down from a high of 9.1% in July 2022 (6% a year ago).
- U.S. Q4 GDP was much better than expected at 3.2% and domestic demand remains very strong at 3.1%.
- The labour market remains incredibly tight, even after some recent softness. The unemployment rate, at 3.9%, is close to its historical low.
- The consumer remains strong.

Never in the past has so much biased information been so readily available, targeted and tailored to investors in bulk. As per our meeting, almost 60% of Americans use social media to get their information, a number that unsurprisingly skews higher the younger you are. We live in an age where you can do a Google search based on your worst fears, and an algorithm is sure to feed you something to reinforce those fears, via comments and "news".

To put this in perspective, the Economist did a deep dive on this and it's impact on consumer sentiment as measured by the University of Michigan Consumer Index. Historically, changes in consumer sentiment have been a useful economic benchmark and this survey is the longest running measure of this. Comparing the period between 1980 and 2019 to the post-pandemic period, they found that the relationship between consumer sentiment and the 13 traditional data points that make up the survey – like inflation, unemployment, and oil prices – had been broken.

Prior to the pandemic, the relationship between these indicators and consumer sentiment were relatively stable. These 13 economic inputs could be used to explain approximately 86% of the variations in the index, but since 2019, that is no longer the case. If these correlations had remained stable, the index in September 2023 would have come in at an extremely high 98, some 30 points above the number that was actually published.

The hard data shows that Americans are doing a lot better than they think, and what's worse, the Economist suggests that these bad vibes may be the new normal. It seems that the good news that many investors see when they peruse their banking and investment apps is quickly forgotten in the seconds it takes them to be distracted by a negative post on X, Facebook, or Instagram.

The human condition is all about harnessing reason to overcome our base instincts, which reduce every consideration down to tribalism. For us in the industry, it's our job to help dispel the false narratives all around us, and to present the facts because, while it's true that narratives may dominate over the short term, real economic facts – and ultimately earnings growth on the corporate side – are still what drive returns over the long term. It's our job to help clients move away from portfolio management based on emotion (how I feel about things) and back towards a process based on facts and reason (how I think about things). And the fact is, when we look at the environment we're moving into, it's actually pretty good.

- The clearest indication of rising business confidence can be seen in the purchasing manager indices (PMI). Recent data suggests PMIs have now bottomed.

- Inflation is approaching target. The latest core inflation data measured by the Fed fell from 2.9% in January to 2.8% in February. That's within the Fed's 1% to 3% range and they have already confirmed 3 rates cuts for 2024.

- The labour market remains very strong, but it is cooling. That might sound like bad news, but a looser labour market will help bring inflation down closer to the 2% target.

- Consumer spending has been one of the most stubborn data points, due mainly to high wage growth in the tight labour market. However, it appears the consumers are beginning to slow their spending.

- We also discussed the Magnificent Seven. There is a growing fear out there that the tech consolidation we have seen in the past two years is beginning to look a lot like the dot-com bubble that burst in 2000. Some of these stocks are expensive, but more importantly, they are strong businesses that offer exposure to solid financial metrics and attractive growth prospects. I am not saying that they are appropriately priced, or even represent opportunity right now. I am more suggesting that the current environment looks nothing like the dot-com bubble.

We all have biases. We are lovers of math and our biases are derived from empirical thinking and that can have its shortcomings. A lot of great research has been done to suggest how one feels is incredibly important to how we think. A better blend of both can lead to better, and smarter, decisions. By making investment decisions based on how you feel about the economy can have a considerable long-term impact on your financial goals.

More often than not, the noise from social media only matters over the short term. Over the long term, what's really important is not always having the correct facts but having the correct process. That process starts with a lot of self-reflection – an examination of one's personality and financial priorities. It also requires professional investment management with an investment philosophy that can stand the test of time.

I think that, amid all the noise this year, investors run the risk of allowing their emotions to cloud their better judgement. It's incumbent on professionals to step in, present the unbiased facts, and also to provide some reassurance that, while the forecasts are never perfect, the process and the strategy remain correct. Ultimately, investment decisions need to be based on the foundation of empiricism.

As you know, all of our positions have to pay a dividend to be part of our portfolio. We favour dividends because they are often the sign of a financially healthy and stable business that is committed to rewarding shareholders. Last quarter, 60% of our holdings increased their dividends:

- Enbridge increased the dividend by 3.1%
- Crescent Point Energy raised the quarterly dividend 15%
- TC Energy announced a 3.2% increase
- Bank of Montreal increased the dividend by 2.7%
- Restaurant Brands announced a 2.6% increase
- Maple Leaf Food announced a 5% increase
- Brookfield Renewable announced a 5% increase
- Tourmaline increased the base dividend 7.1% and declared an additional special dividend of $0.50 per share
- Canadian Natural Resources announced a 5% increase
- Definity Financial announced a 16.7% increase
- Royal Bank raised the dividend 2%
- TD Bank increase the dividend 2.4%

We made some changes to the portfolio in the first quarter. We trimmed down our weighting in Microsoft due to strong performance. In addition, we trimmed up our weighting in Canadian Tire.

We also added Tourmaline Oil Ltd. to the portfolio.

Tourmaline Oil Corp.
Tourmaline is one of our top picks in the Canadian natural-gas space given its industry-dominant position, large Montney growth potential, global-market exposure, near-term fiscal cash flow, and negligible debt.

Q4 production of 557 mBOE/d was as expected by both TD and consensus (556 mBOE/d). Cash flow per share of $2.62 exceeded both TD ($2.43) and consensus ($2.48). The beat was primarily driven by better-than-expected realized pricing.

The Company increased the base dividend 7% to $0.30 per quarter (from $0.28), which equates to a 2% base dividend yield. Incrementally, it declared a $0.50 Q1 special dividend. Combined, declared Q1 dividends of $0.80/share were ahead of our previous estimate of $0.73.

Assuming 85% of 2024 estimated fiscal cash flow is returned to shareholders via dividends, we anticipate an average quarterly special dividend of $0.50/share under a strip pricing scenario. In our view, holders of Tourmaline today can expect a 5% cash yield through year end 2024.

Apple Inc.

Apple reported revenue and earnings per share that easily beat consensus expectations for Q1. Stock weakness following the results release reflected the decline in sales to China and profit-taking on the appreciated shares.

Apple grew smartphone unit sales at a double-digit pace in calendar 4Q23, faster than the overall market; average selling prices, however, appeared to be down year-over-year. Apple was number one in smartphone market share in the holiday quarter of 2023 as well as in 4Q22. For the first time ever, however, Apple was also number one in global market share for 2023 - displacing Samsung from the leadership position it had held since 2010. Apple is also the global leader in smartphone revenue share, with comfortably more than half of global revenue and commands the lion's share of smartphone global profits.

With iPhone gaining ground in more nations and among younger users worldwide, we expect iPhone to build on current market-share momentum. Apple in fiscal 1Q24 also benefited from seasonal strength in iPad and in wearables. And the company's service business continues to deliver solid growth and strong margins.

The installed base of Apple products once again reached an all-time high spanning all product categories and regions. Apple followed up its September 2023 iPhone 15 rollout with the launch of M3 processors for Mac in October.

We regard Apple as one of four companies (along with Qualcomm, Intel, and AMD) that are uniquely positioned in the fast-developing market for on-device generative AI. The new family of M3 processors for Mac, along with Bionic app processors for iPhone, show that Apple is positioning itself in that market. Apple is a product perfecter rather than a product pioneer, and we expect its on-device Gen AI offerings to dazzle. Apple's perpetually refreshed roster of highly desirable products provides a unique advantage over industry rivals.

Bank of Montreal

BMO reported first quarter earnings of $2.56 versus TD's estimate of $2.95 and consensus of $3.02. Our positive outlook on BMO is supported by our expectation that the Bank Of The West (BOTW) transaction and a strong focus on cost control will support industry -leading Pre-Tax, Pre-Provision Earnings growth in 2024/2025 as the expense synergies play out. Relative valuation does not reflect the significant improvements in the business model/mix over the last five years.

Brookfield Renewable Partners L.P.
Several elements distinguish Brookfield Renewable from its peers: scale; broad investment opportunity set; ability to act on large/complex transactions; operating/procurement expertise; management depth; a strong funding platform; and high exposure to positive corporate power purchase agreement momentum. Brookfield's premium has narrowed since early 2021.

Cogeco Inc.
We continue to believe that Cogeco Inc. remains undervalued when compared with Cogeco Cable, while Cogeco Cable itself has asymmetrical upside for investors relative to downside risk. A lot of negativity from U.S. broadband trends and a potentially expensive multi-year wireless network build in Canada are priced into Cogeco Cable and, subsequently, Cogeco Inc. We also continue to believe that a potential collapse in the Cogeco holdco could be a catalyst both for Cogeco Inc. and Cogeco Cable shares to break away from very low valuation levels.

Canadian Natural Resources Ltd.
The company boasts the most sustainable business model within our coverage, in our view, and we continue to view it as a core energy holding. We highlight 100% return of fiscal cash flow through buybacks plus ratable dividend increases, best-in-class capital flexibility given significant portfolio diversity, and infrastructure dominance (i.e., cost structure advantage and an abundance of drill-to-fill opportunities) as key tenets of our investment thesis.

Canadian Tire Corporation, Ltd.
We believe all Canadian Tire stakeholders are pleased to have this quarter behind us. We knew the combination of a material accounting change, dealer destocking, slowing consumer discretionary spend, and unseasonable weather were all going to weigh upon the Retail results. That they did, and then some. The positive, however, is that despite this challenging environment, the Retail segment illustrated progression with its operating margin that should be a positive upon a recovery in revenue.

This was a weak quarter. That stated, there were no surprises in the drivers of the weakness. In fact, the largest contributors to the miss relative to our expectation appear to be weather and the impact of dealer destocking. On the positive, the Retail segment appears to have its Selling, General & Administrative Expense under control that should lead to future operating leverage.

Crescent Point Energy Corp.
The company formally increased the base dividend 15% starting in Q1, bringing the yield to 4.7%. The company's unchanged strategy is to return 60% of fiscal cash flow to shareholders via a combination of the base dividend, share repurchases, and potentially special dividends. Based on 2024E strip pricing, we forecast there is an incremental 4% of the company's market cap to be returned to equity holders.

The company offers exposure to high-impact Montney and Duvernay assets, strong organic production growth, significant return of capital and modest financial leverage which we see improving through fiscal cash flow growth.

Definity Financial Corp.
Q4/23 operating EPS of $0.86 was up 31% y/y (forecast: $0.71; consensus: $0.71), reflecting strong net earned premium growth of 8% (in line with estimate), 29% growth in underwriting income, supported by 90.6% combined ratio (better than our forecast) and solid net investment income (up 25% and better than expected). Definity incurred $11.1 million in restructuring expenses, excluded from operating EPS.

The increase in investment income reflects higher reinvestment rates and the benefit of trading into higher-yielding securities (drives realized losses, but improves investment income). Definity raised the dividend 16% year over year, well above our forecast growth of 9.1%.

Enbridge Inc.
Enbridge held an investor day on March 6, 2024. ENB released its 2023-2026 financial outlook, as well as discussed the company's recent performance, long-term strategy and outlook, portfolio of secured projects, and funding plan.

Management's extension of its outlook for medium-term growth demonstrates the sustainability and stability of its business model, in our view. When combined with Enbridge's scale, diversification, resilient business model, long-life assets, and ability to pivot to meet continued industry changes, including a transition to a lower-carbon future, we believe this should warrant a premium valuation. Over the long term, we expect Enbridge to continue to have a strong competitive incumbency, due to its geographic footprint, scale, connectivity, and diversification. We believe this positions it to play a role in North America's contracted and regulated energy infrastructure evolution to support global long-term climate-change goals, continued security for energy demand, and exports.

First Capital REIT
The optimism we have been hearing from management continues to show up in quarterly results, with near-record renewal leasing spreads of +13.5%, and occupancy almost back to pre-pandemic levels. Importantly, most of the handful of spaces/properties that have pulled occupancy lower in recent years has now been leased or are under contract/conditional agreement.

We still see good value at the current 14.6x Price/After-Tax Funds From Operation valuation (vs. 20x pre-pandemic in early 2020), and 6.4% implied cap rate (5.5% in early 2020), but the relative valuation premium to RioCan and SmartCentres has now largely recovered.

Maple Leaf Foods Inc.
If the company hits (and sustains) its margin targets, it should trade at much higher multiples. But the volatility and lack of visibility is shaking market confidence, which we believe will continue to cap valuation near term. With the bar now set lower, Maple Leaf Foods has a better chance of meeting/exceeding estimates over the coming quarters, slowly rebuilding positive momentum.

Microsoft Inc.
Microsoft continues to pursue long-term growth through its AI and cloud investments, and may just hold the premier position in business technology. Although not immune from macroeconomic challenges (such as declines in the PC OEM market and in digital advertising), Microsoft has about as diversified and strong a set of assets as any company in the technology industry - and may even be seen as a haven by investors in uncertain times. The company is one of just a few with a complete, integrated product set aimed at enterprise efficiency, cloud transformation, collaboration, and business intelligence. It also has a large and loyal customer base, a large cash cushion, and a rock-solid balance sheet.

While Microsoft shares were hit by the 2022 Technology sector selloffs, they recovered in 2023 as the company has retaken its rightful place as an industry leader, though this has also driven the valuation modestly higher. Microsoft is also one of the few Tech companies in our coverage group that pays a dividend that we consider safe.

Royal Bank of Canada
The bank reported Q1/24 adjusted earnings per share of $2.85 versus our estimate of $2.79 and consensus of $2.79. Over the past 5-10 years, Royal has traded at a 6-8% premium to the group. We expect expense actions, the HSBC deal, and business mix (large, dominant positions in several business lines) and a resumption of Net Interest Margin advantages to support superior pre-tax, pre-provision growth and higher relative return on equity, and ultimately support Royal Bank's premium valuation.

Restaurant Brands Inc.
The company reported adjusted 4Q23 earnings per share of $0.75, above the consensus estimate of $0.74, up from $0.72 in the prior-year period. Better-than-expected results reflected significantly better franchisee profitability, menu innovations, and improved marketing. We expect the company's e-commerce capabilities, investments in its franchises, strong loyalty program, and international expansion to benefit earnings. We also look for menu simplification to improve order accuracy and increase throughput, boosting restaurant-level margins. We believe that Restaurant Brands International can reach its long-term target of 40,000 restaurants.

Rogers Communication Inc.
We anticipate that Rogers will fare the best in wireless once again in Q1/24 with strong net additions augmented by good execution in base management that will allow for Rogers to be average revenue per user positive, in spite of the last quarter of overlap from the ARPU dilutive Shaw Mobile.

With Q1 now done, we have completed our channel checks of promotional activity in the industry, and our discussions with industry contracts. We have adjusted some of our estimates for Q1/24, with a bit of a shift in our FY24 EBITDA out of Q1 and into subsequent quarters. Excluding the Media segment (where EBITDA arguably does not reflect the value of the Blue Jays), there were very minimal changes to consolidated FY24 or FY25 estimates and no change to our target price.

TC Energy Corp.

Fourth-quarter results were above our estimates, primarily due to a $0.15 per share benefit from a $200 million incentive payment by LNG Canada for completion of pipeline commissioning activities on Coastal Gas Link, and the base business earnings per share was also $0.09 above our estimate. North American pipelines benefited from strong operational results with higher volumes at its Liquids Pipeline business, higher rate base earnings and flow-through charges on Nova Gas Transmission Ltd., and higher contributions from Natural Gas Storage and Bruce Power assets, partially offset by lower revenues and higher operating costs in the Mexico Pipelines business.

With an operationally solid 2023 in the rearview mirror, TC Energy will be busy in 2024 executing on its asset-sale program, sustainably achieving its deleveraging targets, spinning out the Liquids Pipeline segment, and making progress on its capital projects. Regardless, we believe TC Energy's scale, energy infrastructure expertise, and relatively low-risk business operations model position the company in the long term to play a key role in enabling energy transition and reducing global emissions, while ensuring energy security for North America and its global allies.

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