TD Wealth

Quarterly Market Commentary

June 2017

Our managed portfolios continued to reflect strong results during the second quarter. The S&P/TSX Composite Index is now negative for 2017, but we are very pleased with how the portfolios are currently positioned and we are looking forward to the balance of the year.

It has been our view that 2017 would be a period of sustained growth in the global economy after the accelerating growth that characterized 2016. Consistent with this view, PMIs in the U.S., Europe and China moved higher in June. All but two of the 30 country PMIs we track are above 50 illustrating the synchronous nature of this economic growth. This is in stark contrast with 2014, when the accelerated growth of the previous year was rapidly reversed when PMIs dropped sharply in most countries with the important exception of the U.S. The resulting 'great divergence' in 2014 led to the mid-year launch of the U.S. dollar, which would ultimately contribute to the weakness in the U.S. economy in 2015. These divergences in growth are not apparent today.

Commodity prices were corrected in the first half of 2017 despite the evidence of synchronized global economic growth. This correction was partly due to concerns that China's deleveraging campaign might reduce growth more than economists were projecting, a fear that now appears to be dissipating. Some degree of price correction would be normal after the strong commodity gains in 2016. The best gains in industrial commodity prices (and resource stocks) always occur when global growth is accelerating as seen last year. But until global growth begins to slow again, perhaps in the second half of 2018, industrial commodity prices should continue to rise.

The recovery in commodity prices over the last two weeks could signal the beginning of the second half strength we project. The broad based nature of the gains is a significant feature of this rally as the increased breadth would be consistent with the macro driver of synchronized global, rather than the individual, supply/demand status of individual commodities.

It remains our view that U.S. and global growth will continue to re-accelerate in 2017, reaching a level of growth in 2018 which we expect to be the highest since 2010. Global growth fears, which dominated in 2015 and early 2016, have been replaced by confidence as the U.S. consumer continues to spend and the inventory corrections in the U.S. and most other countries around the world have ended.

During the second quarter, we sold Enbridge. It was first purchased on December 9, 2013 at a price of $43.61. We sold the position on May 15, 2017 at price of $54.82, resulting in a return of 25.7%, not including the dividends. It can be difficult for some investors to sell such a strong winner, but Enbridge broke one of our thresholds, which triggered the sale. Enbridge closed at $51.66 on June 30, 2017.

We added Keyera Corp to the portfolio in the second quarter. We view Keyera as one of the premier natural gas midstream operators in Alberta, whose facilities are generally in the deeper, and more productive, western part of the Western Canadian Sedimentary Basin. In our view, the company's new projects demonstrate its ability to capture the benefits of a shift towards liquids-rich gas production and increasing natural gas liquids volumes. It is also worth noting that the company just increased the monthly dividend by 6% when we added it to the portfolio.

Some of our names that we continue to hold and favour for 2017 include:

ENERCARE

During the second quarter, we were pleased to see that Enercare increased their dividend by 10%. We believe that Enercare remains an attractive long-term holding - it is a well run and stable company with a portfolio of rental assets that have generated stable and recurring cash flows. This income supports the attractive dividend and provides good growth opportunities.

CANADIAN NATIONAL RAILWAY

CNR hosted a well attended Investor Day in June. The meeting reinforced our view of CN's differentiated business model, which balances operational and service excellence. The company's customer-centric approach to service has generated meaningful new business since 2010, particularly in service-sensitive areas, including intermodal and automotive (most recently Yang Ming, Canadian Tire, Rona/Lowe's, Mazda, and Maple Leaf Foods), and also in bulk (export potash and grain), while maintaining its industry-leading operating ratio. The presentations at Investor Day included a heavy emphasis on the technological investments that CN is making to extend its competitive advantage. These include the consolidation/standardization of operational data to enable predictive maintenance, prioritizing infrastructure investments, and enhancing safety through analytics. CN guided to average annual EPS growth of ~10% over the next five years, based on "economy-plus" volume growth, same-store pricing above rail inflation, and a "mid-50s" operating ratio (subject to stable fuel prices). These parameters are generally in line with our view of the company's earnings potential, after allowing for conservatism in guidance. The prospect of "economy-plus" volume growth is supported by a robust pipeline of business opportunities totaling ~$1.1bln-$2.2bln or ~8-16% of our 2017 revenue forecast (~160bps-320bps/year over five years). The revenue potential of upcoming port expansions at Prince Rupert (exclusively served by CN), and Vancouver (jointly served) is most significant; however, the list is well-diversified, consistent with CN's franchise, and includes Canadian grain and petrochemicals among the list of prospects. We view CN as a relatively low-risk, high-quality industrial company, and continue to believe that it should be a core holding.

NEW FLYER INDUSTRIES INC.

During the second quarter, New Flyer raised the dividend 37%. New Flyer is generating strong free-cash-flow currently, with its capital-light business model, and we expect this to continue in the near-term given the strong industry outlook, record backlog, and continuing opportunities for cost-rationalization and optimization as it consolidates its bus and coach operations. Furthermore, New Flyer has a demonstrated track-record of creating value through disciplined M&A, and we expect this to continue as part of their story going forward.

BCE INC.

During the second quarter, BCE increased the dividend by 5.1%. BCE continues to execute well on wireless metrics and wireline cost control (including acquisition synergies) and we see healthy 5% dividend growth being sustainable for at least the next two years. If interest rates remain low, and if we assume that there are no disruptive changes in the competitive landscape for wireless or broadband, then the stock will likely remain a stable income generator.

NATIONAL BANK

The bank increased it's quarterly dividend from $0.56 to $0.58, which represents an increase of 3.6%. During the second quarter, core earnings per share was higher than expected. We characterize the quarter as in line largely because the securities gains were elevated. The improvement in the capital ratio and solid P&C operating earnings were also positive developments in the quarter.

TELUS

Telus had a fantastic second quarter. They increased the quarterly dividend to $0.4925 per share. That's up 2.6% from $0.48 in this year's first quarter payout, and up 7.1% from last year's second quarter payout of $0.46 per share. The increased dividend is in line with the Telus policy of raising the dividend by 7% to 10% annually, subject to conditions. The potential for stable cash flow generation, sustainable dividend and strong operating metrics provide investors with a relatively defensive position and solid diversification benefits.

MAGNA INTERNATIONAL

Magna reported strong first quarter results in May that exceeded expectations. In addition, management has increased its 2017 guidance, including its free cash flow outlook. We believe that Magna is well-positioned to achieve growth well in excess of the industry over our forecast horizon. This should be aided by its global and operational capabilities, the maturing of its investment in Getrag, and the material ramp taking place within its complete vehicle assembly unit. This should result in attractive fiscal cash flow generation and sustain Magna's solid financial position. There is no change in our view that the mid- to long-term outlook for Magna appears positive. This includes our view that Magna is well-positioned to actively participate in the evolving car of the future. We continue to argue that Magna warrants a multiple that, at a minimum, is in line with its peer group.

EMERA INC

TD hosted Emera Inc.'s management team for a series of investor meetings. Discussions with investors included topics on the TECO acquisition, operational performance of the businesses, the company's capital program, and future growth opportunities along with updates on its financing and balance sheet plans. We view the TECO acquisition positively as it is providing Emera with accretive regulated growth in earnings and cash flow, along with the potential to expand further in the U.S. It is also the company's first foray into natural gas distribution, and provides a new platform of growth. On a consolidated basis, TECO Energy has increased the regulated earnings in Emera's business mix and contributed to the company's geographic diversification. We believe that Emera's investments in: 1) transmission; 2) reducing the carbon intensity of its portfolio; 3) gas generation and transportation; and 4) utilities will contribute to the company's ability to grow earnings per share and dividends by high single digits through to 2020. When coupled with a relatively low-risk business model and attractive dividend yield, we expect Emera to be appealing to investors looking for income and growth.

ALGONQUIN POWER & UTILITIES CORP.
In our view, Algonquin offers a balance of accretive expansion opportunities and transparent dividend growth potential (we believe that management's annual 10% dividend growth target is sustainable over our forecast horizon). Management has demonstrated an ability to navigate across multiple regulatory environments. We believe that Algonquin offers a compelling valuation in the context of an extensive growth pipeline (via development activity, acquisitions, and utility rate base investments), conservative payout ratio, and manageable leverage.

ROYAL BANK
We believe that Royal Bank represents a core holding in a Canadian equity portfolio. Royal Bank has a history of generating consistent, strong retail results and the shift to more predictable corporate lending, underwriting and M&A revenue from pure trading revenues will likely support a premium multiple. Royal Bank is known for its strong global presence and profitable capital markets presence. Royal Bank also has a track record of generating above-average industry growth. Investing in Royal Bank provides shareholders with exposure to Canada's largest bank with high-quality operating segments across all business lines.

CANADIAN TIRE
Canadian Tire remains a compelling risk/reward investment, in our view. We believe that the Retail valuation remains attractive, Canadian Tire is on track to achieve our financial forecasts, there are additional real estate assets to monetize, and the Retail balance sheet remains in a position of strength. It is our view that the active Normal Course Issuer Bid commitment provides a degree of downside protection to the share price, and that as Canadian Tire further surfaces value from underappreciated assets and achieves our financial forecast that the applied multiple to the Retail division is poised to expand.

COGECO INC.
Cogeco Inc. increased the dividend by 15.3% during the second quarter. We believe that the value of Cogeco Inc. shares is underappreciated by investors and argue that the share-price gap between Cogeco Inc. and Cogeco Cable is still too wide. Even if we attach zero value to the radio operations and the annual stream of management fees, Cogeco Inc. shares are still trading at a discount to the underlying value of the publicly traded subordinate voting shares in Cogeco Cable.

PREMIUM BRANDS
Premium Brands is off to a great start in 2017. In our view, Premium Brands remains an excellent company with a strong earnings profile. Organic revenue growth is still expected to exceed management’s targeted 4% to 6% range, driven by new sales, product development initiatives, and leveraging investments made to expand capacity, many of which are already bearing fruit. Gross margin expansion was impressive and we expect it to continue, driven by improving efficiencies and ongoing product mix enhancement. Premium Brands is still very active on the M&A front and expects several more accretive deals by the end of the year, which should boost earnings further. In our view, Premium Brands remains an excellent company with a strong earnings profile.

ALIMENTATION COUCHE-TARD INC.
Couche-Tard shares have increased modestly YTD, though we expect better performance over the remainder of 2017, with the CST deal closing and earnings growth poised to accelerate over the coming quarters. With a P/E of under 17x F2018E EPS, valuation remains attractive in relation to: 1) ~30% forecast earnings growth over the next year; 2) 21x-22x valuation for its closest peers; and 3) FCF yield of ~6% in F2018 and ~6.5% in F2019. With the balance sheet de-levering rapidly, we see the potential for additional acquisition announcements by year-end, with chains in the U.S., Europe, Mexico, and Asia being potential targets. Couche-Tard shares could also benefit from fund flows as it is less affected than other stocks under coverage by the planned Ontario minimum wage hike and Amazon's proposed acquisition of Whole Foods.

SUNCOR ENERGY
Suncor remains our favored name within our integrated coverage for the following reasons: 1) The conclusions drawn from our recent FCF yield analysis were a clear positive, with Suncor ranking in the top quartile on 2019 free cash flow yield. 2) Suncor should increasingly be benchmarked against the global majors, in our view. It generally ranks as superior on the basis of growth potential, sustainability, and reserve life index. 3) Suncor continues to represent good value, in our view.

TRANSCANADA CORP
TD recently hosted TransCanada Corp management for investor meetings. In our view TransCanada has a strong incumbency in the two most prolific natural gas basins in North America (the Marcellus/Utica and the Montney), combined with access to large markets. Growing connectivity over time should provide customers with increasing optionality as it moves approximately a quarter of North American natural gas demand. The company's 91,500 km of pipelines have increasing value as new pipelines become more difficult to build. We believe that TransCanada's scale, energy infrastructure expertise, low-risk business model, and financial strength are competitive advantages when pursuing new assets. Investors also have an option in the Keystone XL project that should grow in value over the next year. Big picture, strengthening oil & gas fundamentals should benefit TransCanada's growth outlook and mitigate any impact that rising interest rates might have on sector valuations.

TORONTO DOMINION BANK
We continue to favour the bank’s U.S. exposure, strong domestic P&C business, and lower exposure to oil & gas relative to its peers. The advantages of the U.S. exposure relate to: a) the effects of rising rates; b) stronger economic growth and the resulting benefits on loan growth; and c) the moderating expense growth expected to play-out from the restructuring initiatives in the U.S.

If you should have any questions or comments, we welcome any feedback. Finally, we are accepting new clients. If you know of any family, friends, or colleagues who could benefit from our complete offering, we would be most grateful if you would pass our names along to them.

Source: Portfolio Advice & Investment Research (PAIR), as at June 30, 2017

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