TD Wealth

Quarterly Market Commentary

December 2017

Happy New Year! We would like to wish you and your family all of the very best for 2018.

2017 was another good year for our managed portfolios! We are pleased to report that all of our mandates outperformed the S&P/TSX Composite Index, which generated 6.03% last year. We remain pleased with how the portfolios are positioned for the New Year.

Real GDP accelerated in most countries in 2017 resulting in strong, synchronized global growth. We believe that there will be more divergence in growth during 2018, with some countries slowing while others accelerate or maintain a steady level of growth. On balance, areas of weakness should be offset by strength elsewhere allowing global growth to be sustained near 2017 levels. Equity markets should do well in 2018, but the combination of weaker growth in some regions, high valuations, and ongoing Fed tightening should lead to a return of volatility in the equity markets from the unusually low volatility experienced in 2017. We expect one or two significant equity market corrections in 2018 which would be more normal than the 2017 experience.

The prospect of sustained good growth in the United States prevents the 2018 Developing Markets (DM) slowdown from being more pronounced, and erases our previous concerns about aggregate global growth prospects in 2018. Rebuilding and replacement demand after the hurricanes led to a surge of business sales growth that shrank inventory levels that had been building. The rebuilding stimulus won't likely be sustained, but the U.S. business sector begins 2018 with much leaner inventories than had been the case prior to the hurricanes. The economy therefore benefits from the need to replenish inventories at the same time that new fiscal stimulus is being applied, offset by escalating monetary restraint and the fading stimulus of hurricane rebuilding. On a fourth quarter, year over year basis, Fed officials expect U.S. growth of 2.5% in 2018, matching the 2.5% growth in 2017. The consensus, still being upwardly revised to account for tax reform legislation, has similar 2018 expectations of 2.4% U.S. real growth over the four quarters of 2018.

Emerging market (EM) economies are expected to sustain a high level of growth in 2018, as a modest slowing in China is offset by accelerating growth elsewhere, notably India, Brazil, Indonesia and Mexico. On balance, we calculate a consensus expectation of 5.25% real GDP growth in 2018, essentially unchanged from the 5.31% growth recorded in 2017.

We expect global growth in 2018 will continue very near the high level of growth recorded in 2017. While annual measures of global growth will likely budge, monthly and quarterly measures of global growth such as industrial production, the PMIs and quarterly real GDP should weaken in a growing number of countries in the second half of 2018, while remaining at aggregate levels that should still be considered good growth. Slower growth in some regions of the world, combined with high valuations and continued Fed tightening should lead to a return of equity market volatility. The bull market is intact so we expect to continue to recommend investors 'buy the dip' when corrections occur.

Some of the names that we continue to hold and favour for 2018 include:

ENERCARE INC.

In its core Home Services portfolio, Enercare continues to deliver improved aggregation trends concurrent with pricing/mix improvement and we believe that the company is well-positioned to take advantage of a convergence of home services. Meanwhile, Service Experts continues to exceed our expectations, while the sub-metering business continues to have a strong pipeline of embedded growth. WE believe that the embedded growth in sub-metering and the roll-out of rentals at Service Experts could result in a combined ~$2.00-$3.00 per share of additional value. Additionally, Enercare pays an attractive 4.9% dividend yield and we believe that the company's current valuation offers investors a good entry point into the name.

We believe that Enercare is an attractive long-term holding, as it is a well-run company with good growth opportunities and a portfolio of rental assets that have a history of generating stable and recurring cash flows supportive of the attractive dividend.

CANADIAN NATIONAL RAILWAY

CN characterized Q4/17 as somewhat challenging. We believe that three issues were at play: 1) volume growth is slowing as CN laps more difficult prior year comparables (similar to its peers); 2) the company entered Q4/17 with some capacity challenges as a result of YTD volume growth that has well surpassed initial expectations; and 3) winter weather conditions have arrived early in western Canada. Beyond these temporary resource issues, we see higher-than-expected volume growth as a "high-quality problem", and we would argue that CN has higher visibility to 2018/2019 volume growth vs. its Class I peers, based on: 1) the diversity of CN's franchise; 2) the company's low exposure to coal (~4% of revenue); and 3) the ~$1.1bln-$2.2bln revenue growth pipeline (2018-2020) that CN presented at its June 2017 investor meeting.

We view CN as a relatively low-risk, high-quality industrial company, which should be a core holding.

BCE INC.
For investors who covet stability, predictability, and yield, BCE delivered on plan yet again in Q3. Subsequent to consensus expectations coming down a bit pre-quarter, BCE delivered slight beats on most financial and subscriber metrics in Q3.

NEW FLYER INDUSTRIES
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 a strong industry outlook, record backlog, and continued opportunities for cost-rationalization. Furthermore, New Flyer has a demonstrated track-record of creating value through disciplined mergers and acquisitions, and we expect this to continue being a part of the story going forward.

CIBC
Our positive outlook on CIBC reflects relative valuation and performance. We also favor CIBC's recent approach to building franchises rather than building silos and entering into creative financing transactions. CIBC is trading at an 11% discount to the group on 2018E EPS, versus an average discount of 9% over the past five years. We believe that the market has more than priced in: a) concerns surrounding CIBC's mortgage growth; b) the capital hit associated with the PrivateBancorp deal; and c) earnings dilution associated with PrivateBancorp.

TELUS CORP.
Telus increased the dividend by 2.54% this quarter. We are now using a five-year discounted cash flow model to value the wireline segment. We have gained greater confidence in the company's ability to both increase EBITDA margins and lower capex over the next 3-5 years, owing to industry-leading investments in FTTH networks and services.

MAGNA INTERNATIONAL
Despite the cautionary outlook on Getrag this quarter, we do not believe the impact should be material to offset Magna from growing in excess of the industry over our investment horizon. Additionally, we view Magna as well-positioned to participate in the car of the future, with a financial position of strength enabling the company to remain active with its Normal Course Issuer Bid, potentially increase its dividend, and/or pursue additional merger and acquisition opportunities.

EMERA
Emera increased the dividend by 8.13% this quarter. 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.
We believe that Algonquin offers a compelling valuation in the context of an extensive growth pipeline that includes development activity, potential acquisitions, utility rate-base investments, and potential international investments via Atlantica Yield and the AAGES joint venture. Management has built a strong merger and acquisition track record through the growth of its unregulated and regulated businesses. Given the company's diverse investment opportunities, conservative payout ratio, and manageable leverage, we view management's 10% annual dividend growth target as realistic.

CANADIAN TIRE
Canadian Tire increased the dividend by 38.5% this quarter and announced a Normal Course Issuer Bid to repurchase $550 million of its shares through 2018.

Canadian Tire remains a preferred name within our coverage universe based upon our investment thesis that the market continues to undervalue Canadian Tire's Retail operations, that the strategy and initiatives in place in our view position the company for earnings per share growth, and that the material active normal course issuer bid provides a degree of downside protection to the share price.

PREMIUM BRANDS
Premium Brands was very active in the quarter. They announced the acquisition of Buddy's Kitchen Inc., Raybern Foods, and a non-material 50% interest in Shaw Bakers for $200 million. As a result, we are raising our 2018 and 2019 EBITDA estimates by 7-8% to reflect the anticipated accretion.

Premium Brands is not finished yet, as management suggested that several transactions are nearing closing within the next 3-6 months. Combined with strong organic growth, contributions from previous acquisitions, and good management execution, we have little hesitation in recommending investors buy Premium Brands shares, provided that it is in line with their investment objectives and risk tolerance.

ALIMENTATION COUCHE TARD
In our opinion, consensus estimates still look too low. Despite the challenging industry backdrop, we expect the CST and Holiday acquisitions, significant synergies, and modest (yet ahead of peers) organic growth, to deliver >20% earnings per share compound annual growth rate through fiscal 2020.

After moving sideways for much of the past 18 months, sentiment has turned more favourable of-late as management meetings appear to be giving investors comfort with respect to Couche- Tard's long-term growth potential (regardless of the expectation that fuel demand will start declining 1-2% annually beyond 2025). With a forward Price-Earnings ratio of only 16x and >20% earnings per share compound annual growth rate through F2020, we still see meaningful upside to the shares.

TRANSCANADA
TransCanada has extended its 8 - 10% compound annual growth rate dividend outlook by one year through to 2021. The company has also reiterated its forecast that the dividend compound annual growth rate will be at the upper end of the range through 2020. The dividend is supported by earnings and cash flow growth, as well as strong coverage ratios.

We believe that a positive final investment decision on Keystone would be a catalyst for the stock. TransCanada has a strong incumbency in the two most prolific natural gas basins in North America (the Marcellus/Utica and Montney), combined with access to large markets, in our view. 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, in our view. We believe that TransCanada's scale, energy infrastructure expertise, low-risk business model, and financial strength are competitive advantages when pursuing new assets.

TORONTO DOMINION BANK

We continue to favour the bank's U.S. exposure and strong domestic personal and commercial business. The advantages of the U.S. exposure relate to: a) the positive effects of rising interest rates; b) slightly stronger forecast economic growth and continued market share gains; and c) the moderating expense growth expected to play-out from the restructuring initiatives in the U.S. In periods when personal & commercial business (rather than capital markets) drives earnings growth, TD has historically outperformed its peers.

If you should have any questions or comments, please do not hesitate to contact us.

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