TD Wealth

Quarterly Market Commentary

March 2018

The global economy remained fundamentally strong as we entered 2018. Growth in 2017 was at the fastest pace since 2010, and was broad-based with the U.S., Canada, Europe and China, all posting strong GDP numbers. Just as importantly, this growth has been delivered with low inflation as both wage growth and consumer prices have been subdued. This has proven to be a magical combination for equity markets as the strong economic growth has translated to robust earnings, and benign inflation has kept interest rates low and supported equity valuations. Earnings growth in 2018 is likely to stay strong, supported in part by the recent changes to U.S. tax legislation.

As we entered February, market volatility spiked globally with most equity markets giving up January gains. Market weakness continued throughout the month, offering investors very few places to hide from the long-awaited volatility. Over the past few years, volatility has been muted, with global markets experiencing 20 straight months without a 5% adjustment – the longest period on record.

The market pullback was not a huge surprise, given the increase in bond yields in late 2017 and early 2018, concern over rising inflation and fear that the U.S. Federal Reserve might raise interest rates more rapidly than previously expected. Higher interest rates tend to depress equity valuations and this is what unfolded in February.

We are pleased with how our portfolios performed against the markets during this quarter. We took advantage of the market volatility with our trim function. Our active portfolio monitoring and rebalancing services ensure that your portfolio remains aligned with your investment objectives, even in volatile markets. We trimmed up TransCanada, AltaGas, Cogeco Inc. and Alimentation Couche-Tard. In addition, we trimmed down Premium Brands. This investment has worked out very well for us as this is the second time that we have trimmed it down due to exceptionally strong performance. We initially purchased this position on June 8, 2016 at $55.36 per share. Our first trim was done at $82.15 on March 28, 2017, and our second trim was done at $115.38 on March 28, 2018. These rules allow us to maintain a highly-structured approach to investment selection, removing all emotion and ensuring that volatility is minimized.

We are pleased to report a significant number of dividend increases this quarter. As you know, we only invest in dividend-paying equities in the platform. In periods of extreme volatility, patience is a virtue and easier to achieve when invested in good-quality companies with real earnings and balance sheets. In other words, stocks with a dividend pay investors to be patient. During this past quarter, we saw these holdings increase their dividend: Canadian National Railway (+10%), BCE (+5.2%), CIBC (+2.3%), Magna (+20%), Royal Bank (+3.3%), Algonquin Power (+8%), Transcontinental (+5%), Altagas (+4.3%), Suncor (+12.5%), TransCanada (+10.4%), TD Bank (+11.7%), Enercare (+4%), and Premium Brands (+13.1%). Obviously, these dividend increases indicate that these companies are doing very well and are able to reward their shareholders.

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

ENERCARE

The company reported Q4 results in the quarter that fell in line with our expectations and they raised the dividend by 4%. We remain of the view that the outlook for Enercare for F2018 and beyond is favourable. The company has several sources of long-term growth (roll-out of the HVAC rental model, embedded growth in sub-metering, the roll-out of the connected home program, and tuck-in acquisitions) and we continue to believe that Enercare could deliver overall organic growth of 4–6% per year and potentially 10–12% annual growth, including acquisitions. 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 the ability to generate stable and recurring cash flows supportive of the attractive dividend.

CANADIAN NATIONAL RAILWAY

CN has been coping with well-publicized capacity issues since last fall as a result of: (1) much higher-than-expected 2017 volume growth, which was particularly concentrated on certain key segments of the network (western Canada/U.S. Midwest) and (2) unusually harsh winter weather in western Canada. In addition, the company has appointed JJ Ruest as the interim President and CEO. He has been with CN for 22 years and is well-known to customers, investors and CN's supply chain partners. We are confident in CN's ability to regain momentum, and we see CN as having much better visibility to volume growth versus its peers in 2018–2020. We view CN as a relatively low-risk, high quality industrial company. It is also worth noting that Canadian National Railway raised their dividend by 10%.

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 and optimization as it consolidates its Motor Coach Industries/New Flyer Industries operations. Furthermore, New Flyer has a demonstrated track record of creating value through disciplined mergers and acquisitions, which we expect to continue going forward.

CIBC

CIBC reported a strong first quarter and raised the quarterly dividend by 5%. We also favour CIBC's recent approach to building franchises rather than building silos and entering into creative financing transactions. CIBC is trading at a 13% discount to the group on 2019 estimate earnings per share, 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 PrivateBank deal; and (c) earnings dilution associated with the PrivateBank acquisition.

TELUS CORPORATION

Although we acknowledge that there is some valuation risk if rates keep rising and we fully expect wireless growth to decelerate gradually over the next two years as Shaw/Freedom ramps up, we believe that wireless fundamentals are not broken and the sector is oversold. We believe that high-quality, non-cyclical companies with strong fiscal cash flow and therefore strong and rising dividends should be bought when they go on sale in a market environment like this. TELUS fits the bill, with expected EBITDA growth of 6% in 2018 and the commitment to 7–10% dividend growth.

MAGNA INTERNATIONAL

In our view, Magna reported a strong finish to the year coupled with a dividend increase of 20%. It is our view that Magna is positioned to grow in excess of the industry average and is well positioned for the evolution of the car of the future, which supports our valuation multiple discount to its peers toward the low end of its historical range.

EMERA

Emera reported a stronger-than-expected fourth quarter. Their earnings exceeded expectations, primarily due to lower expenses in the Florida and New Mexico utilities, stronger-than-expected ramp-up of Tampa revenues, and higher contributions from Corporate and Other. 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 long term, although the headwinds from U.S. tax reform could dampen the rate of growth in the medium term. We like Emera for its relatively low-risk business model and attractive dividend yield.

ALGONQUIN POWER & UTILITIES CORP.

The company reported fourth-quarter results that were ahead of expectations and raised the dividend by 8%. 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 JV. Management has built a strong M&A 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 concluded 2017 with a strong financial outperformance attributable to the Retail segment. As its track record in recent years illustrates, its Retail strategy is working and mitigating the threat of competition from non-traditional retailers. Furthermore, we would argue the future opportunity appears positive, as Canadian Tire further embraces technological advancement, utilizes data analytics and loyalty, integrates Canadian Tire Financial Services within Retail, and deepens its private label penetration across banners. We view the risk/reward profile as attractive based on Canadian Tire's modest growth outlook, ability to surface "hidden" asset value, current valuation, and the downside protection that is provided through its material Normal Course Issuer Bid commitment.

COGECO INC.

Although the holding company discount at Cogeco Inc. has experienced some compression over the last few months, we believe that the current discount being applied to Cogeco Inc. shares is unjustifiable, mainly due to the fact that Cogeco Inc. maintains an ~82% controlling interest in Cogeco Cable that should ultimately translate into the stock trading at a premium to Net Asset Value. This, coupled with the recent pullback in both Cogeco Inc. and Cogeco Cable shares, currently offers investors an opportunity to take advantage of Cogeco Cable trading at an attractive valuation through the purchase of Cogeco Inc. shares that effectively limits some of the downside risk associated with Cogeco Cable.

ALIMENTATION COUCHE-TARD

The company reported third-quarter earnings that were below estimates.The entire shortfall comes from surprisingly weak U.S. and Europe fuel margins. However, we still remain comfortable with this name as it trades on a lower price-to-earnings multiple versus its peers. The significant contribution from recent acquisitions and related synergies can support earnings-per-share growth of approximately 30% over the coming year, while the company prepares and implements new national merchandising (e.g., fresh food) and promotional campaigns that should help re-accelerate organic growth (particularly by fiscal 2020) and contribute toward another potential 15% earnings-per-share growth in fiscal 2020.

SUNCOR ENERGY INC.

The company raised the dividend 12.5% this quarter. We feel that Suncor retains one of the best fundamental outlooks within the Senior Energy Producers. While it trades at a slight premium to its peers, a larger premium is warranted given superior growth prospects and returns.

TRANSCANADA CORP.

TransCanada had a strong quarter and raised their dividend 10.4%. 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 91,900 kms 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

TD had a good quarter and raised their dividend 11.7%. TD shares tend to trade at a premium to their peer group due to its relative scale, service advantage and focus on controlling costs. TD continues to grow earnings-per-share through solid cost control and a stabilizing credit picture. Growth for TD should also be supported by the strong Canadian and U.S. commercial franchise. TD's solid capital ratios may allow for share repurchases and/or the financing of any modest acquisition opportunities that may surface.

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