Quarterly Market Commentary

July 2023

Most of the leading indicators are flashing red, indication that a recession is likely in the months ahead. But the economy has proved resilient and has not yet weakened into recession as soon as many economists had expected. How should we interpret this?

Our favourite leading economic indicator continues to be the shape of the U.S. yield curve. While the 2 to 10 spread will typically invert first, it is the spread between the 90-day treasury bill rate and the U.S. 10-year treasury bond yield that has been most often used for calculating the lead time between yield curve inversion and subsequent recession. We use the term 'full inversion' to describe the t-bill to 10 inversion which always comes after the 2 to 10 inversion. Data back to World War Two shows an average lead time of 13 months between the full inversion of the yield curve and the subsequent recession. The yield curve fully inverted in late October of last year suggesting the recession might begin in November of 2023 if we use the average 13-month lead time.

Last fall, the majority of economists were expecting a recession would begin in early 2023, much sooner than would be expected based on the yield curve. High energy prices were the main reason why economists had pulled forward their recession forecasts relative to a timeline based solely on the shape of the yield curve. This expectation of an early recession due to higher energy prices is consistent with economic history which clearly shows how energy price spikes have triggered the start of many past economic recessions. As energy prices declined, the prospect of an early recession has reversed with most economists now expecting the recession to begin in 2023 Q4 or 2024 Q1, much more consistent with the yield curve signal.

The equity markets have concluded the recession has been cancelled, while it has simply been delayed relative to expectations. One factor that has fueled this equity market myopia is the rise in expectations for 2024 earnings growth. The expected earnings growth in 2024 has gone up because 2024 earnings expectations have been revised down to a lesser degree than the downward revisions in 2023 estimates. This is hardly a reason for optimism given that the same phenomenon occurred in 2008, when 2009 estimates initially fell less than 2008 estimates, causing an upward revision to 2009 growth expectations that ultimately reversed as the earnings recession got underway.

We expect a relatively mild economic recession and a relatively mild decline in earnings. The S&P 500 earnings growth of 0% in 2024, while not a big negative, will nevertheless create some short term volatility. We think value will do much better than growth and we have increased our cash position in all portfolios to take advantage of possible volatility. We are very comfortable with how we are currently positioned.

As you know, we are value investors that focus on companies that have a history of paying a dividend. We saw a number of dividend increases last quarter, which continue to reward shareholders:

- Bank of Montreal – raised the dividend by 6%
- National Bank – raised the dividend by 5%
- Restaurant Brands – raised the dividend by 1.9%
- Cogeco Inc. – raised the dividend by 10%
- Imperial Oil – raised the dividend by 13.6%
- Royal Bank of Canada – raised the dividend by 2.3%
- Apple Inc. – raised the dividend by 4%

Our current holdings continue to execute very well and we have prepared the following to update you on some of the companies.

Maple Leaf Foods

We believe Maple Leaf has a lot going for it as an industry leader in ESG, well above average Meat revenue growth, the largest branded Canadian market shares in fresh and prepared meats, and dominant leadership positions in RWA pork (North America) and RWA poultry (Canada). Despite strong brand performance, Maple Leaf's margin recovery has been highly punished by unprecedented and unsustainable agricultural market conditions. Market fundamentals have improved through H2/23 and are expected to into 2024, while the elimination of supply-chain inefficiencies and attractive returns from the new poultry and bacon facilities should surface by year-end, leading to the company we forecast: 1) earning 15-16% run-rate EBITDA margins within 3-4 quarters and 2) generating an 9%/11% FCF yield by 2024E/2025E. Under such a scenario, we believe valuation should return to and eventually surpass its 10-year average.

Microsoft

The company continues to look toward long-term growth with its Artificial Intelligence and cloud investments. Microsoft may just hold the premiere position in business technology. Microsoft is diversified and has as strong a set of assets as any company in the Technology industry – and may even be looked at as a haven by investors looking for a flight to quality in uncertain times and market conditions. The company is one of a few with a complete and 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.

Restaurant Brands International Inc.

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.

Royal Bank of Canada

Over the past 5-10 years, Royal has traded at a 6-8% premium to the group. Although we expect the Net Interest Margin advantages enjoyed by the asset-sensitive banks to gradually dissipate, we believe stronger balance sheet growth, the HSBC deal, and business mix (including structural funding advantages) will continue to drive superior pre-tax, pre-provision earnings growth and higher relative return on equity, and ultimately support Royal's premium valuation.

TC Energy Corp.

The company's first-quarter operational results position the company well to meet its 2023 guidance, in our view. Another important part of the quarterly update was that Phase One of Coastal Gas Link remains on track, and although still in the early stages, the Southeast Gateway project is also on schedule. We sense that progress on TC Energy's other priority, to sell assets by the end of the year, will also be key to lifting the uncertainty overhanging the stock. In the long term, we believe TC Energy's incumbency in prolific natural-gas-producing regions in North America, combined with access to large markets, the company's scale, energy infrastructure expertise, low-risk business model, and improving financial strength position it well as societies transition to using lower-carbon energy sources over the long term, while ensuring energy security for North America and its global counterparties.

Apple Inc.

Apple hosted its annual worldwide developers conference (WWDC) beginning on 6/5/23, unveiling both software upgrades and some new hardware as well. The event, which typically focuses on software, was dominated by the launch of the Apple Vision Pro, the company's mixed-reality headset. The highly anticipated headset, Apple's first new major product category since Apple Watch, retails for $3,499 and will be available in 2024.

In other developments, the new iOS 17 operating system for iPhone includes user-friendly updates to FaceTime, messaging, contacts, and other apps. Apple also introduced a new Watch OS 10, which allows display of widgets such as weather and calendar, and AirPods software updates. On the hardware front, Apple introduced a new Mac Pro, its highest-end desktop with the M2 Ultra processor and a 15' MacBook Air, among other products.

BCE Inc.

We have no concerns about balance sheet stability or continued 5% dividend growth at BCE, so we believe this remains a suitable name for risk averse and income seeking investors.

Bank of Montreal

Our positive outlook on Bank of Montreal is supported by our expectation that the Bank Of The West deal will support industry-leading pre-tax, pre-provision earnings growth in the medium term. Additionally, we believe Bank of Montreal's risk culture remains strong - key in the context of deteriorating commercial real estate. In our view, relative valuation does not reflect the bank's improving performance, the benefits of the Bank Of The West deal, and business mix.

Canadian Natural Resources Ltd.

The company continues to boast the most sustainable business model within our coverage, in our view. We therefore continue to recommend it as a core energy holding, especially given the ~10% month-to-date drop in share price. We highlight rapid deleveraging, an aggressive and evolving shareholder return framework (line of sight to 100% return of fiscal cash flow in the Q1/24 timeframe, per our estimates), ratable/sustainable dividend growth, significant capital flexibility, and infrastructure dominance as key tenets of the investment thesis.

Canadian Tire Corporation, Ltd.

We anticipated that the Q1/23 results would come in below consensus as the company invests significantly to drive future growth, and these investments are magnified upon a seasonally weak Retail quarter. That said, heightened costs that we view as temporary has resulted in the lowering of

our 2023 financial forecast. We maintain our outlook however that investment in its key growth drivers, including expanded partnerships of its Triangle loyalty program, position Canadian Tire Corporation to drive revenue growth and market share gains. Forecast growth along with declining temporary expenses within Selling, General & Administration should drive operating leverage. This should be complemented by an aggressive Normal Course Issuer Bid. While investors may require evidence of this financial progression in 2023/2024, we view the valuation and dividend yield as attractive.

Cogeco Inc.

CCA's shares continue to be heavily depressed due to the Rogers share ownership overhang and the risk provided by wireless capex. We believe that we will receive additional clarity on these two risks, which should bode well for Cogeco Cable Inc. shares and, subsequently, Cogeco Inc. shares. Although the holdco discount for Cogeco Inc. has decreased, we continue to believe that the meaningful discount to Cogeco Cable Inc. shares is unwarranted. As a result of the undervalued nature of Cogeco Cable Inc. shares and this meaningful discount, we are maintaining our buy rating.

Crescent Point Energy Corp.

We believe the company has materially de-risked its Duvernay asset since the transformative acquisition announced in Q1/21, while layering-in more scalable resource-style assets with the recent Montney acquisition. We believe additional well data in both plays could serve as near term catalyst. Furthermore, we see potential for near term asset sales. This would increase exposure to its core scalable resource-plays (Montney & Duvernay) and reduce debt. In our view, this could be a catalyst for continued multiple expansion given the current valuation remains below its closest Canadian peer Whitecap and also below Enerplus.

We continue to expect Crescent Point to provide an outsized return of capital to shareholders through our forecast period. We estimate total 2024E cash return to shareholders of 12% of the current market capitalization, which is top quartile in our coverage universe (8% from base dividends and 4% from Normal Course Issuer Bid), all while reducing net debt by ~$500mm from current levels.

Crescent Point has a near term cash tax advantage relative to many of its peers. The company has $8.7B of total tax pools (including $1.4B of Canadian NCLs and $2.3B of U.S. NOLs) and we do not expect the company to pay material cash tax through our forecast period. As many peers now begin to pay cash tax, we believe Crescent Point's margins will be competitively advantaged by these tax pools for several years.

Definity Financial Corp.

We envision one of two scenarios playing out over the next few years. The most likely, in our view, is that the company continues to make acquisitions given the fragmented industry the company operates in (announced several small acquisitions over the past 12 months) and the increased leverage capacity that will be unlocked upon conversion to a CBCA company (expected later this summer). Definity's scalable systems, unleveraged balance sheet, experienced management team, and access to capital position the company well to complete a deal, in our view. We believe the alternative scenario is the company remaining largely as is with a sub 10% operating ROE (limited improvement in profitability and ROE). We believe an investment in Definity continues to offer exposure to a stable business model with good upside potential, if the company can grow through acquisitions.

Enbridge Inc.

We believe Enbridge's solid start to the year demonstrates the strength of its geographically diverse business model, as well as highly contracted and regulated assets. In our view, the company's resilient business model, long-life assets, and ability to pivot to meet continued industry changes, including a transition to a lower carbon future, 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, and we believe that 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

We believe that First Capital has one of the largest valuation upsides within our retail REIT coverage universe and is well positioned to navigate any economic headwinds. First Capital has a significantly higher concentration in necessity-based tenants (~85% of rents) versus its two closest retail REIT peers (RioCan at ~61% and SmartCentres at ~61%). While smaller-business tenancies can pose some risk during a recession, First Capital has the lowest exposure to other potentially vulnerable sectors such as department stores and fashion. First Capital continues to make progress on its target of $1bln of asset monetization by year-end 2024 ($363mm completed or committed thus far), which we believe will help drive Funds From Operation/unit growth and reduce leverage, while also at the cost of reducing exposure to some top-tier assets. We also note that First Capital's recent dispositions were sold at a 16% premium to IFRS, which, in our view, reflects solid results in a period affected by the pandemic and elevated interest rates. This disposition progress is noteworthy, in our view, given the overall slower transaction market. First Capital continues to trade at a valuation discount vs prepandemic levels, and to its Canadian retail peers.

Imperial Oil Ltd.

Imperial Oil remains our #2 overall pick after Canadian Natural Resources. We believe the market's negative reaction to no announcement of a third substantial issuer bid with the quarter was overdone. Note that we had pushed our $1 billion substantial issuer bid assumption to Q4/23 from Q2/23 following the Investor Day. We continue to like Imperial Oil for its best-in-class balance sheet, a relatively flat upstream growth/capex profile through 2027, a commitment to returning the vast majority of fiscal cash flow generated (although less clearly defined than some of its peers), and an attractive valuation for a top-tier operator.

Rogers Communication Inc.

Rogers continues to fire on all cylinders in its wireless business and its execution starting from Q3/21 to the present day has been best-in-class in our view. When Rogers reports Q2/23 earnings on July 26, we anticipate that it will have led the industry on postpaid sub additions for the quarter. Rogers continues to perform well in the new to Canada market and is benefitting as consumer behaviour continues to normalize in the post-pandemic environment. While Rogers maintains higher leverage relative to Canadian peers, its leverage relative to U.S. based telecoms shows nothing unusual or scary. Its largely predictable and recession resistant cashflows provide us comfort in its temporary move to ~5x leverage. Should management continue to execute the Shaw merger effectively, we believe that there is the potential for a guidance increase as the year progresses.

If you should have any questions, please do not hesitate to reach out.

MK Total Wealth Management Group
TD Wealth Private Investment Advice
5140 Yonge Street, Suite 1600,
North York, ON M2N 6L7
T: 416 279 1455
TDMKGRP@td.com

TD Wealth

Sources:
June 6th, 2023 – AAPL Argus Analyst Report
May 4th, 2023 - (BCE-T) Largely In-line Q1 Results
May 24th, 2023 - (BMO-T) Q2/23: Ests. Need to Come Down, But '24 Outlook Remains Positive
May 4th, 2023 - (CNQ-T) Q1/23 Conference Call Highlights and Updated Estimates
May 11th, 2023 - (CTC.A-T) Q1/23 Results: A Soft and Somewhat Complex Quarter
April 17th, 2023 - (CGO-T) Q2/23 Results
May 12th, 2023 - (CPG-T) In Line Q1. New High Impact Plays Outperforming Expectations
May 12th, 2023 - (DFY-T) Q1/23: Strong Top Line; Pressure in Personal Auto
May 8th, 2023 - (ENB-T) Q1/23 Results
May 4th, 2023 - (FCR.UN-T) Deleveraging Paused in Q1/23, While SPNOI Growth Accelerated
May 3rd, 2023 - (IMO-T) Q1/23 Conference Call Highlights and Updated Estimates
May 12th, 2023 - (MFI-T) Now Past the Bottom; Margins Expected to Expand Sequentially
April 27th, 2023 – MSFT Argus Analyst Report
May 31st, 2023 - (NA-T) Q2/23: Business Mix Does Not Support Premium Multiple
June 6th, 2023 – QSR Argus Analyst Report
April 27th, 2023 - (RCI.B-T) Strong Execution No Longer Justifies a Valuation Discount
May 25, 2023 - (RY-T) Q2/23: Expenses Remain a Problem for RY
May 1st, 2023 - (TRP-T) Q1/23 Results
June 14th, 2023 – TD Argus Analyst Report
https://tdsecurities.bluematrix.com/links2/doc/pdf/344720ab-98b1-41c9-9e0a-7be621f46ce1?id=ZGFuaWVsYS5wb3JyZXR0YUB0ZC5jb206Ng==

The information contained herein has been provided by MK Total Wealth Management Group and is for information purposes only. The information has been drawn from sources believed to be reliable. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance.

Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS.

Index returns are shown for comparative purposes only. Indexes are unmanaged and their returns do not include any sales charges or fees as such costs would lower performance. It is not possible to invest directly in an index.

Links to other websites from this document are for convenience only. No endorsement of any third party products, services or information is expressed or implied by any information, material or content referred to or included on, or linked from or to this Website.

MK Total Wealth Management Group is part of TD Wealth Private Investment Advice, a division of TD Waterhouse Canada Inc. which is a subsidiary of The Toronto-Dominion Bank. All trademarks are the property of their respective owners. ®The TD logo and other TD trademarks are the property of The Toronto-Dominion Bank or its subsidiaries.