Quarterly Market Commentary

October 2023

A simple extrapolation of the decelerating trend in U.S. job growth suggests declining payrolls should be expected by early next year. Personal disposable income has already begun to decline in real terms after peaking in May. With real incomes declining, the U.S. consumer dipped into their shrinking pool of savings to finance the unsustainable burst of spending seen most clearly in July. Consumer spending slowed in August with anecdotal reports of further weakness in September.

We are at the halfway point in the U.S. inventory correction which should progress to a broad-based destocking in 2024. The U.S. retail sector has made good progress lowering inventories to be more in line with current sales, but retail sales will likely decline if we are correct that employment will begin to decline by early next year. Declining sales will necessitate further destocking in the retail sector to maintain appropriate inventory-to-sales (IS) ratios.

The retail sector is in much better shape from an inventory perspective than are the manufacturing and wholesale trade sectors. Unlike retail, IS ratios remain elevated relative to the pre-pandemic period in these sectors. Pre-pandemic IS ratios were elevated compared to the pre-Great Financial Crisis (GFC) period as companies took advantage of the Federal Reserve's low interest rate policy to build more inventories in the post-GFC period. With the Fed sticking to its plan of 'higher for longer' interest rates, companies must adapt to the higher cost of capital and we believe that will surely include a return to the leaner inventories seen when interest rates were last this high.

The greatest drag on GDP growth during recessions is almost always inventory destocking. The speed and degree to which companies destock in the year ahead will determine the degree of economic weakness. We expect the recession will be mild, partly because retail has already done much of their destocking and partly because we expect the return to pre-GFC IS ratios will be spread over a multi-year period.

During the past quarter, we realized some further dividend increases. Bank of Montreal raised their dividend by 3%, Whitecap Resources by 26%, Microsoft by 10%, and Royal Bank by 2.2%. In an inflation environment, a rising dividend is always a good asset.

Apple Inc.

On September 12th, Apple hosted its 'Wonderlust' event to introduce the new iPhone 15 family. The event also featured other product launches and upgrades (though not as many as in past), leading to the main event. Amid speculation about how Apple would approach product pricing,

the flagship iPhone 15 Pro is unchanged compared with last year's iPhone 14 Pro. The new phones come with a USB-C charging port, marking the end of the lightning port. Investors have fretted that the technology war between China and U.S. has taken a nasty turn, with some Chinese bureaucrats no longer able to own iPhones. Amid weakness and even pushback in China, Apple is looking to cultivate underserved foreign markets. Inclusion of the USB-C charging port, even if Apple was reluctant to do so, may aid in that push.

Apple announced its new Series 9 Watch, including an upgraded Ultra 2 premium smartwatch. The company has stopped using leather in its watch straps and phone cases as it seeks to strengthen ESG efforts and cut carbon emissions.

At its annual worldwide developer conference (WWDC) in June, Apple launched the Apple Vision Pro, the company's mixed-reality (MR) headset. As it has shown with iPhone, Apple is a product perfecter rather than a first-to-market company. Apple's perpetually refreshed roster of highly desirable products provides a unique advantage over industry rivals.

Despite concerns about Chinese politics, Apple is ahead of the market in 2023 and relatively outperformed peers during the 2022 tech sector selloff. As macro-economic softening and high costs displace supply-chain challenges, Apple continues to relatively outperform in most hardware and services businesses. Even with Apple shares off to a solid start in 2023, the current environment represents an opportunity to establish or dollar-average into positions in Apple.

Brookfield Renewable Partners L.P.

We believe that Brookfield Renewable deserves a valuation premium based on several factors: scale, broad investment opportunity-set, consistent value-accretive track record, ability to act on large/complex transactions, operating/procurement expertise, management depth, and a strong funding platform. With Brookfield-sponsored energy transition and infrastructure funds having raised substantial capital, we believe that opportunities to co-invest on large scale opportunities are expanding rapidly.

Bank of Montreal

The bank reported Q3/23 adjusted earnings per share (EPS) of $2.78 (down 10% y/y) versus our estimate of $3.05 and consensus of $3.14. Severance and legal provisions removed $0.34 from adjusted earnings per share. Higher provision for credit losses reduced EPS by $0.12 relative our estimate. Pre-tax, pre-provision (PTPP) earnings was up 7% y/y; 4% lower-than-expected, reflecting higher expenses (severance) offset by higher fee income (cards, insurance). Operating leverage (OP) was -11.5% versus our forecast of -5.6%.

Our positive outlook on Bank of Montreal is supported by our expectation that the Bank Of The West (BOTW) deal will support industry-leading PTPP growth in the medium term and particularly in 2024 as the expense synergies play-out. In our view, relative valuation does not reflect the bank's improving performance, the benefits of the BOTW deal, and business mix.

Cogeco Inc.

Cogeco Cable Inc. shares continue to face headwinds relating to the risk provided by wireless capex for its planned wireless expansion, along with an overhang from Rogers share ownership. When we have additional clarity on these two items, we believe that we could see a material upward move in Cogeco Cable Inc. shares and, subsequently, Cogeco Inc. shares. Although we acknowledge that liquidity is low for Cogeco Inc., we would be remiss not to mention that Cogeco Inc. 's holding-company discount has widened substantially since the reporting on Q2/23 results

in April. Given the undervalued nature of the Cogeco Cable Inc. shares, along with the meaningful holding company discount, we are maintaining our BUY rating.

Canadian Natural Resources Ltd.

Canadian Natural Resources boasts the most sustainable business model within our coverage, in our view, and we continue to recommend it as a core energy holding. We highlight rapid deleveraging, an aggressive shareholder returns framework (line of sight to 100% return of fiscal cash flow (FCF) in Q1/24 on strip, per our estimates), ratable dividend growth, significant capital flexibility, and infrastructure dominance (meaning an abundant pipeline of drill-to-fill opportunities) as key tenets of our investment thesis.

Crescent Point Energy Corp.

Crescent Point has made significant progress repositioning its business since Craig Bryksa assumed the role of President/CEO. This transition has been especially pronounced over the past two years with the 2021/2022 acquisitions of Duvernay assets, the 2023 acquisition of Montney assets, and various divestitures. New scalable resource plays now account for approximately half of Crescent's production (growing to ~70% by 2028E) and 70% of the 2024 capital budget. In our view, the successful asset repositioning and demonstrated results in both the Duvernay and Montney are now more appreciated by the market.

Canadian Tire Corporation, Ltd.

We remain constructive on the initiatives being taken by Canadian Tire to connect its banners to drive future growth. We believe its investments in IT, its loyalty program, private-label offering, and data analysis will pay dividends in driving market share gains and mid-to-long-term growth. Unfortunately at this time, it appears that the combination of macro headwinds impacting consumer discretionary spend and elevated growth expenditures will weigh on near-term financial performance and cloud the positive future benefits of these initiatives. With a lack of visible near-term fundamental catalysts, we believe that the share price is likely to remain range bound until at least the back half of our target horizon.

Definity Financial Corp.

Definity Q2/23 operating EPS of $0.56 was up 27% y/y and above our estimate of $0.31 (consensus: $0.44), reflecting lower-than-expected catastrophe losses, release of COVID-related reserves (estimate added $0.07-$0.08 to EPS), and higher investment income (up 35% y/y). 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). 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.

On September 5, 2023, Enbridge announced it had entered into a definitive agreement with Dominion Energy to acquire three utilities for an aggregate transaction value of ~$19bln (~US$14bln). The purchase price consists of ~$6.2 billion of assumed debt, plus ~$12.8 billion cash consideration, which will be funded in part by proceeds from the equity offering.

We believe this transaction will be value accretive long-term, although it introduces some near-term financing uncertainty. We view the company's resilient business model, and long-life assets as

warranting a premium valuation. Over the long term, we expect Enbridge's incumbency, geographic footprint, scale, connectivity, and diversification to position it to play a role in decarbonizing energy infrastructure and North American energy security.

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. The company has a significantly higher concentration in necessity-based tenants (~85% of rents) versus its two closest retail REIT peers (RioCan at ~62% and SmartCentres at ~60%). While smaller-business tenancies can pose some elevated risk during a recession, to-date we have seen continued strong demand for space from these retailers. First Capital continues to make progress on its target of $1bln of asset monetization by year-end 2024, which we believe will help drive FFO/unit growth and reduce leverage, while also at the cost of reducing exposure to some top-tier assets. This disposition progress is noteworthy, in our view, given the overall slower transaction market. First Capital continues to trade at a valuation discount vs pre-pandemic levels and to its Canadian retail peers.

Maple Leaf Foods Inc.

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 are seen improving through H2/23 and into 2024, while attractive returns from the new poultry and bacon facilities should surface by year-end, leading to the company: 1) earning 15-16% run-rate EBITDA margins at some point in 2024E; and 2) generating an 8%/10% FCF yield by 2024E/2025E.

Microsoft Corp

Microsoft continues to pursue long-term growth through its AI and cloud investments. The company may just hold the premier position in business technology. Although obviously not immune from macroeconomic challenges, Microsoft has about as diversified and 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 just 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.

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

Restaurant Brands 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.

Rogers Communication Inc.

In our view, Rogers has been operationally best-in-class since Q3/21 and, when Q3 results are released for the Big Three, we anticipate that Rogers will continue with this performance. Rogers' management outlined meaningful market share gains in the West and Ontario during the quarter and stable underlying ARPU in its wireless segment. Its bundling strategy has also helped it gain wireline share in the West as it has spoken to the effectiveness of its revenue synergy strategy with the Shaw assets. Management has also noted that opex synergies, re-branding, customer management systems and product/bundling/ marketing are at or ahead of plan. Regarding costs, a significant portion of the duplicate headcount has been removed. It is likely ahead of plan on reaching a $600mm annualized run rate in synergies by the end of FY23 or very early in Q1/24 versus the original end of Q1/24 target. Rogers also noted that its first non-core asset sale announcement should come before year-end.

Royal Bank of Canada

Royal reported Q3/23 adjusted EPS of $2.84 (up 11% y/y) vs. our estimate of $2.65 (consensus: $2.70). PTPP was up 8% y/y and 2% lower than expected, reflecting much higher expenses, partially offset by higher trading revenue and other fees (cards, insurance). A lower-than-expected tax rate (earnings mix) added $0.19/ share.

Over the past 5-10 years, Royal has traded at a 6-8% premium to the group. Although Net Income Margins advantages have faded, we expect expense actions, the HSBC deal, and business mix (large, dominate positions in several business lines) to continue to drive superior PTPP growth and higher relative Return On Equity (ROE), and ultimately support Royal's premium valuation.

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