Quarterly Market Commentary

April 2023

Fed officials have been quite consistently saying that they don't expect to cut rates in 2023, but the market has been equally consistent in the expectation that rates will be cut this year. At least three 25 bp cuts are currently priced in for later this year. It has been our view that we should believe the Fed and not expect rate cuts. The Fed says it has learned from the mistakes of the inflationary 1960s and 1970s when the Fed eased too soon on five occasions, and in each case inflation either didn't decline or came roaring back, forcing the Fed to reverse course and tighten again.

It is also important to note that the Fed now has only three 25 basis point cuts in its 2024 projection. Whether we get three or four cuts next year, the consistent message from the Fed is the plan to keep monetary policy restrictive in 2024 with a Fed funds rate remaining above inflation and above the neutral rate (which the Fed continues to believe is about 2.5%). The goal is to ensure the re-acceleration of growth in 2024 remains below trend to ensure inflation does not accelerate again.

While the negative news is that we continue to believe that an economic slowdown or recession is still ahead of us, the good news is the equally clear history that new bull markets begin in a recession. We continue to remain cautious now but look forward to any terrific buying opportunity that becomes available later this year.

As you know, all of our equities have to pay a dividend to be part of our portfolio. We favour dividends because they are often the sign of a financially healthy and stable business that is committed to rewarding shareholders. Last quarter, a number of our holdings increased their dividends:

- Crescent Point Energy declared a special cash dividend, based on its fourth quarter results, of 3.2 cents per share. The payment is in addition to the company's regular quarterly dividend of 10 cents per share.
- BCE announced a 5.2% increase
- TC Energy announced a 3.3% increase
- Restaurant Brands announced a 1.85% increase
- Maple Leaf Food announced a 4.8% increase
- Brookfield Renewable announced a 5.5% increase
- Canadian Natural Resources announced a 5.9% increase
- Definity Financial announced a 10% increase

We made some changes to the portfolio in the first quarter. We reduced our Financial Services weighting due to the sudden turmoil that brought down or threatened a handful of U.S. banks and one major European bank. We must stress that the Canadian banking system is far more secure, far more diversified, and far more regulated than those of the U.S. or Europe. Regardless, we wanted to exercise caution until the sector has further clarity. We also realized profits with Suncor after it crossed a SELL threshold in our Quantitative metrics. We moved these proceeds to Imperial Oil.

Imperial Oil Ltd.

We recently added Imperial Oil to the portfolio. Imperial Oil is a Canadian integrated producer with significant downstream and oil sands exposure. The majority shareholder is ExxonMobil Corporation, which owns 69.6% of the company. We like this company on the basis of a best-in-class balance sheet, aggressive shareholder capital returns, and relatively in-line valuation for a company that has historically attracted a multiple premium.

Apple Inc.

In 2022, Apple extended its dominance in global smartphone revenue share to 50% of total, from the mid-40% range for calendar 2021. Most investment theses around Apple are based on strength in up-and-coming categories such as Wearable and Services. iPhone has been around long enough to be almost forgotten. We believe iPhone is in the early innings of a dominant phase in which it becomes the global market leader in smartphone share. U.S. teenagers overwhelmingly own or want to own iPhone (87% of total, according to a study by BlueMatrix). As this cohort ages, U.S. Android ownership will continue to dwindle. To a lesser extent, the same pattern could play out in the world at large.

Bank of Montreal

BMO reported first quarter earnings of $3.22 versus TD’s estimate of $3.19 and consensus of $3.16. Our positive outlook on BMO is supported by our expectation that the Bank Of The West (BOTW) deal will support near industry-leading Pre-Tax, Pre-Provision Earnings growth in the near-and-medium term. Additionally, we believe BMO’s risk culture remains strong. In our view, relative valuation does not reflect the bank’s improving performance, the benefits of the BOTW deal, and business mix (commercial over residential mortgages).

Brookfield Renewable Partners L.P.

The unit price has outperformed most of its peers so far in 2023; its 24% year-to-date price increase is ahead of both the Canadian Renewables Independent Power Producer (IPP) average increase of 8% and the 4% rise in the S&P/TSX Composite. This follows an outsized decline from the recent sector peak in mid-August; Brookfield’s units are 22% below their August peak (vs. a sector average variance of -26%).

We believe that Brookfield 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. Brookfield’s annual equity investment target over the next five years is $1.2 billion-$1.4 billion. The company has continued to broaden its energy transition-focused investments, including its participation in the recently announced agreement to acquire Australian generator Origin Energy ($750 million expected equity investment for Brookfield) and its pending acquisition of a 51% interest in Westinghouse (nuclear services). We believe the Origin transaction provides Brookfield with entry to a new jurisdiction (Australia) at scale with significant opportunities for decarbonization investments, at what we view as a reasonable valuation. The company expects to grow normalized funds from operation/unit at a 10%+ CAGR over the next five years before prospective M&A. We believe many investors underestimate Brookfield’s earnings resiliency in a recession environment.

Cogeco Inc.

With Cogeco Cable Inc., and in turn Cogeco Inc., reducing their 2023 guidance as management is reducing its expectations on subscriber loading in its U.S. segment, we have reduced our Cogeco Cable Inc. target price to $110.00 from $115.00 previously. With the vast majority of our Cogeco Inc. net asset value being comprised of its Cogeco Cable Inc. share holdings, our Cogeco Inc. target price has come down to $110.00 as well from $115.00 previously. Please note that more than 90% of our net asset value for Cogeco Inc. is derived from Cogeco Inc. 's investment in Cogeco Cable Inc.

Canadian Natural Resources Ltd.

The company continues to boast the most sustainable business model within TD's coverage — therefore, we continue to recommend it as a core energy holding. We highlight rapid deleveraging, an aggressive and evolving shareholder return framework, ratable/sustainable dividend growth, significant capital flexibility, and infrastructure dominance as key tenets of the investment thesis.

Canadian Tire Corporation, Ltd.

The company reported fourth quarter normalized earnings per share of $9.34, well above TD's forecast of $7.68 and consensus of $7.46. Retail demand remained resilient in the quarter, driven by its growth pillars, inclusive of its loyalty program and data analytic capabilities. This led to flattish year over year Retail sales, that we view as impressive as it lapped a strong comparable period in Q4/21. The majority of the beat, however, was attributable to the Retail gross margin that increased year over year in contrast to consensus that anticipated a notable decline. As such, the Retail segment accounted for ~$2.00 of the $1.66 earnings per share outperformance relative to our forecast, with the Financial Services segment slightly below our expectation accounting for the difference. We maintain our positive outlook.

Crescent Point Energy Corp.

The company declared a second special dividend (payable March 17) of $0.032 per share. Crescent Point Energy pays out 50% of fiscal cash flow (after base dividends) quarterly, anything up to that level that is not spent on buybacks could be returned to equity holders via a cash special dividend.

Crescent Point offers strong return of capital, low debt, growing exposure to a high-impact, liquids-rich play, and a relatively low valuation.

Definity Financial Corp.

We envision one of three scenarios playing out over the next few years. The most likely, in our view, is that the company makes an acquisition given the fragmented industry the company operates in (announced minority interest in Apollo in March 2022). 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 other scenarios include: a) the company grows its Direct Written Premium at an above-average rate and continues to refine its business model resulting in an ~200bps improvement in operating ROE; or b) the company largely remains as is (limited improvement in profitability and operating ROE). We believe an investment in Definity offers exposure to a stable business model with good upside potential if the company can grow through acquisitions.

Enbridge Inc.

Enbridge held an investor day on March 1, 2023. The company released its 2022-2025 financial guidance, as well as discussed the company's recent performance, long-term strategy and outlook, portfolio of secured projects, and funding plan.

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 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 First Capital has one of the largest valuation upsides within our retail 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 ~60% 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. The company remains committed to its target of $1bln of asset monetization by year-end 2024 ($179mm completed 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. Earlier in March, First Capital ended the proxy battle with Sandpiper Group and Artis REIT (also reached an agreement with Ewing Morris on March 3) and leading up to this we saw the addition of three new Board member trustees and the appointment of Paul Douglas into the Chair role. In our view, this ensures continuity and stability of governance and strategy, which has seen improvements and broad investor support in recent months.

Maple Leaf Foods Inc.

We believe Maple Leaf has a lot going for it as an industry leader in Environmental, Social, and Governance (ESG), well above average Meat revenue growth, the largest branded Canadian market shares in fresh and prepared meats, and dominant leadership positions in Raised Without Antibiotics (RWA) pork (North America) and RWA poultry (Canada). Despite strong brand performance, Maple Leaf Food's near term margin outlook is being negatively affected by unprecedented and unsustainable agricultural market conditions (including oversupply). Fundamentals are expected to start improving closer to mid-year, while the elimination of supply chain inefficiencies and attractive returns from the new poultry and bacon plants are expected to gradually emerge over 9-12 months. Combined, this should result in the company: 1) earning 15-16% run-rate EBITDA margins within 4-5 quarters, and 2) generating over 9% fiscal cash flow yield by 2024E. Should this scenario unfold as expected, we would expect valuation (currently 7.9x our next twelve months EBITDA) to return and eventually surpass its 10-year average of ~9.8x.

Microsoft Inc.

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. Although obviously not immune from macroeconomic factors (like the decline in the PC OEM market or the decline in digital advertising), 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 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 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.

While Rogers shares have started to close the valuation gap relative to BCE/TELUS, the shares continue to trade at a meaningful discount to BCE and T on an enterprise value/EBITDA basis. Starting in Q3/21, Rogers' execution in wireless has swung from being worst-in-class to industry-leading. We anticipate that Rogers will continue its industry leading pace when Q1/23 results are reported. As the focus for Rogers shares changes to synergies and scale/competitive positioning benefits after the acquisition of Shaw, we believe that Rogers will significantly outperform its peers. While we currently include $950 million in synergies by FY24, we believe that the total synergy guidance could soon be increased. Additionally, we believe that the company is well positioned versus the overall Canadian market if macroeconomic headwinds increase in the coming months. Rogers has minimal exposure to cyclical advertising revenues with its media assets while it maintains less exposure to business telecom services than its peers.

TC Energy Corp.

The company reported fourth quarter earnings of $1.11 that was above TD's estimate of $1.09 and consensus of $1.10. TC Energy declared a 3.3% dividend increase.

Over the next year, TC Energy's planned asset sales will be key in funding its capital program, and our forecasts assume $8 billion of proceeds, although we realize this could be higher. In addition, as TC Energy completes Phase One of Coastal GasLink (CGL), the company faces a relatively unique situation in that it will likely be impairing a substantial amount of the capital outlay as it is spent. Bigger picture, the challenges CGL faced on a number of fronts demonstrates the relatively high barriers to entry for large-scale pipeline franchises in North America, in our view, reinforcing TC Energy's incumbency. In the long term, we believe the company'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.

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