



Quarterly Market Commentary

October 2024

During the third quarter, we saw significant developments in global markets, driven largely by central bank actions and key economic data. In this commentary, we will provide an overview of what we believe to be the most important events and what we see ahead for the markets.

Federal Reserve Begins Easing Cycle

After months of speculation, the U.S. Federal Reserve kicked off its long-anticipated easing cycle with a substantial move on September 18th, cutting its policy rate by 50 basis points, bringing the target range to 4.75%–5.00%. This decision marks a shift from the aggressive tightening that characterized much of 2022 and early 2023 and signals the Fed's intent to support a slowing economy.

Looking ahead, we believe there are five key factors to watch closely:

1. Employment – The health of the labor market will be critical, as robust employment can help cushion the economy from further downturns.
2. Consumer Spending – As a key driver of the U.S. economy, consumer spending will play a large role in determining whether the Fed continues to cut rates.
3. Credit Spreads – These are a vital indicator of financial stress in the economy. Widening spreads could signal trouble in the corporate sector.
4. Economic Activity – Interest-rate-sensitive sectors such as housing, durables, and business investment will directly reflect the impact of rate cuts.
5. U.S. Election – The 2024 U.S. Presidential Election is heating up, with polls showing a tight race. Current data points to Vice President Kamala Harris holding a small lead in the electoral college. Political uncertainty often creates volatility, so this will be a key event to monitor.

Closer to home, Canada's inflation picture is more stable. Headline inflation in Canada reached 2.0% in August, which is right at the Bank of Canada's target. While inflation has cooled, we continue to see the impact of high interest rates in the housing market, where activity has slowed. On the bright side, retail sales data reflected a strong rebound during the summer months, suggesting that consumer confidence remains intact.

Globally, economic data continues to be mixed. In Europe, the economy is performing below expectations, with growth still subdued amid lingering inflation concerns. China, on the other hand, continues to wrestle with structural challenges, including a slowing property market and weak domestic consumption. Both regions present ongoing risks to the global economy, though their direct impact on North America remains limited at present.



The reaction of equity markets to the U.S. rate cut was broadly positive, with U.S. stock markets rallying across sectors. While growth has been concentrated in large-cap technology stocks for much of the year, the recent broadening of market strength into other sectors is a promising sign. Investors are now looking beyond a handful of high-growth names, finding opportunities in sectors such as industrials and consumer staples.

In the fixed income markets, we saw a significant rally in August following weaker-than-expected payroll data. As a result, the market response to the Fed's rate cut in September was somewhat muted, given that the cut was already priced in. Moving forward, we expect bond markets to remain relatively rangebound, with future direction likely dictated by incoming economic data, particularly inflation and employment figures.

As we move into the final quarter of 2024, our focus remains on navigating the uncertainty that lies ahead, whether it's the Federal Reserve's continued rate cuts, upcoming U.S. elections, or global economic risks. The key takeaway is to stay disciplined, stick to your long-term investment strategy, and maintain diversification.

This current environment supports our dividend investing approach. They have tax advantages; they tend to hold up well in market selloffs and they tend to grow over time faster than inflation. Between 1977 and 2023, an investment in high-yielding Canadian equities would have grown at more than four times the pace of the same amount of money parked in the broader Canadian stock market (Norman Rothery, founder of StingInvestor.com)

We made some changes to the portfolio in the second quarter. We trimmed up our weightings in Cogeco Inc. trimmed up TD Bank (TD CA) and trimmed up Veren Inc. In addition, we trimmed down our weightings in National Bank due to strong performance.

We also added Cenovus Energy Inc. to the portfolio.

Cenovus Energy Inc.

Cenovus' Q2/24 print was quite mixed with major positive developments like achievement of its US\$4bln net debt target and several positive 2024 estimate guidance revisions overshadowed by a material funds from operation miss on weak downstream margins (utilization came in higher-than-forecast). We consider the market's interpretation of Q2/24 results somewhat too narrow and shortsighted, and the market reaction overblown. The bottom-line is that Cenovus now immediately transitions to 100% return of fiscal cash flow (all through buybacks at current share price, in our view) and should post best-in-class per share growth over the next 24-30 months as growth projects come online (even if we discount Cenovus' stated growth/capex trajectories). When combined with a discounted valuation, Cenovus remains a favoured name. We envision further relative multiple compression into 2026, which should become more apparent as the street introduces 2026 estimates towards year-end.

Apple Inc.

On September 9th, Apple introduced the new iPhone 16 family at its 'Glowtime' event. The event also featured other product launches and upgrades, with Apple as always saving the main event (iPhone) for last. Amid speculation that Apple might raise prices for its first AI-enabled phones, pricing was unchanged for all iPhone 16 models compared with 2023's iPhone 15 family.

Apple has lauded its version of AI as 'Apple Intelligence,' and the technology was on display during the company's annual Worldwide Developers Conference (WWDC) in June 2024. Apple Intelligence builds personalized intelligence into iPhone, iPad, Watch, Mac and more. Some of the features of Apple Intelligence on the iPhone were previewed at WWDC, but all products introduced at the Glowtime event featured upgrades and new features.

The new Apple Watch Series 10 has a four-core neural 'chiplet' to accelerate AI features including real-time translation, fall detection, and sound enhancement. Perhaps reflective of the company's aging first demographic, AirPods Pro 2 can act as a hearing aid. The iPhone 16 Pro and Pro Max models have multiple differentiating features from iPhone 16 and iPhone 16 Max, including the new A18 Pro processor, titanium casing (vs. aluminum for iPhone 16), and a new 48-megapixel camera. All the phones feature USB-C charging ports, and the last phones using the 'lightning cable' will soon be out of production.

With the launch of the new iPhones, Apple has entered the generative AI space after being on the sidelines for nearly two years following ChatGPT's launch in November 2022. By mainly positioning these new enhancements on its highest end 'Pro' series iPhones, the company seeks to drive a robust new upgrade cycle in 2025 and beyond. Although some view these products as 'AI-Lite,' the market believes product perfecter Apple will continue to enhance on-device generative AI in future models.

After lagging the peer group through mid-2024, Apple shares have rallied lately on prospects for its first AI phone. We believe the current environment represents an opportunity to establish or dollar-average into positions in Apple.

BCE Inc.

BCE has agreed to sell its 37.5% stake in MLSE to Rogers for \$4.7 billion. The transaction is expected to close in mid-2025.

We view this transaction as a positive for both Rogers and BCE. Rogers can consolidate the various sports teams/assets, and this should help their ability to raise third party funding for the assets. Meanwhile, BCE is set to benefit from the proceeds of the divestment being used to pay down leverage. They have also secured content for the Toronto Maple Leafs and Toronto Raptors on their TSN owned asset for the next twenty years, which gives us renewed confidence around their media assets being able to leverage those assets when selling advertising. The transaction also gives us additional confidence surrounding BCE's ability to continue to raise its dividend.

Brookfield Renewable Partners L.P.

On September 24th, Brookfield Renewable Partners management provided its annual strategic update to investors and analysts. The five-year target for total equity deployment towards growth (organic plus acquisitions) increased to a range of \$8 billion to \$9 billion, versus \$7 billion to \$8 billion last year.

Management expects funds from operation per unit compound annual growth rate of 10% plus through 2029, which is consistent with last year's guidance. We believe the company's robust funding platform, with a diverse set of levers, differentiates the company from most competitors. In our view, the company offers the deepest transparent growth pipeline in our coverage universe, with a strong funding position than others in our coverage universe.

Cogeco Inc.

We continue to believe that Cogeco Inc. remains undervalued when compared with Cogeco Cable, while Cogeco Cable itself has asymmetrical upside for investors relative to downside risk. A lot of negativities from U.S. broadband trends and a potentially expensive multi-year wireless network build in Canada are priced into Cogeco Cable and, subsequently, Cogeco Inc. We also continue to believe that a potential collapse in the Cogeco holdco could be a catalyst both for Cogeco Inc. and Cogeco Cable shares to break away from very low valuation levels.

Canadian Natural Resources Ltd.

The company hosted a conference call following the Q2 earnings. In our view, the call highlighted the sustainability and flexibility of Canadian Natural Resources' business model as natural gas weighted drilling scales back and synthetic crude oil production ramps up into year-end and beyond.

The company boasts the most sustainable business model within our coverage, in our view, and we continue to view it as a core energy holding. We highlight 100% return of fiscal cash flow through buybacks plus ratable dividend increases, best-in-class capital flexibility given significant portfolio diversity, and infrastructure dominance (i.e., cost structure advantage and an abundance of drill-to-fill opportunities) as key tenets of our investment thesis.

Canadian Tire Corporation, Ltd.

We have been evaluating potential catalysts for Canadian Tire and believe we are seeing early signs of several taking hold. We acknowledge the Canadian consumer remains challenged but inventory management/cost control in Retail and stabilizing provisions within Canadian Tire Financial Services are encouraging. This gives us increased confidence in our outlook for Canadian Tire to reach an earnings per share inflection point in the second half of 2024. While we may be early with our recommendation, given the risk from a potential prolonged consumer slowdown, we see early signals taking hold that should drive 2025 earnings per share growth leading us to increase our target multiple.

Definity Financial Corp.

Definity has delivered on all its growth, profitability, and business mix targets. This gives us confidence that Definity will successfully lift return on equity by another 200 to 300 basis points (~12.5%) organically in the midterm.

We continue to believe that the most appropriate way to value the stock is to apply a probability-weighted valuation tied into several possible scenarios. We believe an investment in Definity continues to offer exposure to a stable business model experiencing solid fundamentals with upside if Definity grows through acquisitions.

Enbridge Inc.

In our view, Enbridge is better equipped than most energy infrastructure companies in this current energy environment, given its minimal commodity and volume exposure, diverse set of crude oil and natural gas pipelines, and growing utility business.

We see Enbridge as a leader in the midstream energy industry and expect it to benefit from its extensive infrastructure network for both crude oil and natural gas transportation. Enbridge should also benefit from plans to increase capacity on its main shipping line and from its 2017 merger with Spectra Energy.

Enbridge also generates stable cash flow and has the resources to buy back its stock. We also believe that the dividend is safe and sustainable. Enbridge has increased its dividend for 29 straight years, with average annual growth of nearly 12% over the past 20 years.

First Capital REIT

Near-record leasing spreads negotiated rent bumps reaching new highs, and a "deep and robust" leasing pipeline all demonstrate solid execution and full participation in today's strong market by FCR's necessity-based shopping center portfolio. The widening demand/supply imbalance bodes well for continued growth in market rents, in our view. First Capital REIT remains one of our best REIT ideas.

Maple Leaf Foods Inc.

Upside to earnings is significant following scale investments in plant automation, but market factors and consumer weakness have prevented much of this from showing up in results. There has been improvements and the EBITDA margin hit a seven-year high in Q2/24. We see reasons to believe that remaining headwinds will diminish gradually through 2025, resulting in much higher earnings and, when combined with more normal capex spending, significant fiscal cash flow generation and balance-sheet deleveraging. Although we believe investors will allocate a low multiple (~5x) to the more volatile hog production and slaughtering business once it is spun out, we would expect a much more reasonable (10x+) valuation to be awarded to the remaining protein-focused consumer packaged goods business, particularly once the company reaches its margin targets and displays greater consistency in results.

Microsoft Inc.

Microsoft continues to pursue long-term growth through its AI and cloud investments and may just hold the premier position in business technology. CEO Satya Nadella sees Gen AI as a rare change to a fundamental computing paradigm and Microsoft is moving to exploit the opportunities opened by Gen AI as quickly as possible, as demand currently outstrips the supply of its cloud services. Although not immune from macroeconomic challenges (such as declines in the PC OEM market and 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 seen as a haven by investors in uncertain times. The company is one of just a few with a complete, 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 selloffs, they recovered in 2023 and 2024 as the company has reassumed its rightful place as an industry leader, though this has also driven the valuation modestly higher. Microsoft is also one of the few Tech companies in our coverage group that pays a dividend that we consider safe.

Restaurant Brands Inc.

The company reported a solid quarter where overall revenue rose 17.2% to 2.08 billion from \$1.78 billion but missed the consensus estimate of \$2.10 billion.

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.

Rogers maintains best-in-class wireless operational execution, and industry-leading 2024 estimated EBITDA growth. The company has a clear path to debt reduction through fiscal cash flow generation and asset sales. However, Rogers trades at a discount of 14%/ 18% on fiscal year 2024 estimates/fiscal year 2025 estimates EBITDA relative to BCE/Telus. Additional debt leverage will provide torque for Rogers as telco sentiment keeps improving.

Toronto Dominion Bank

Bharat Masrani announced he will retire at the Annual Meeting of Shareholders in April of next year after 38 years with the Bank and nearly 10 years as Group President and CEO. Raymond Chun will be the next CEO of TD Bank Group.

Ray is a career TD banker, with a deep appreciation of the Bank's culture, brand and focus on customers and clients. Across his multiple leadership roles, he has shaped new strategies and elevated the customer experience to deliver competitive advantage and growth. He has served as President and CEO of TD Insurance, President of TD Direct Investing, Group Head of Wealth Management and Insurance, and currently serves as Group Head, Canadian Personal Banking.

Tourmaline Oil Corp.

The company again increased its base dividend by 3%. Tourmaline's decision to add an incremental rig for the next year is curious. Although the reaction of some will be that this could add incremental supply to an already saturated market, we suggest that this is a prudent and calculated decision by Canada's largest gas producer who is looking beyond 2024.

Tourmaline is one of the highest quality exploration and productions in the Canadian gas space, given its industry dominant position, large Montney growth potential, global-market exposure, near-term fiscal cash flow, and negligible debt.

Veren Inc.

Veren has successfully transitioned to a Montney/Duvernay high-impact producer, with growth supported by a low-decline legacy asset base in Saskatchewan. The company now has ample quality inventory to support 20 years of strong organic volume growth, and more importantly, fiscal cash flow per share growth. We expect Veren to reduce financial leverage close to its target by year end ahead of potential increases to return of capital.

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