TD Wealth

Quarterly Market Commentary

June 2018

Over the past quarter, the global economy continued to fire on all cylinders. Governments are spending after years of austerity and private sector consumption remains strong against the backdrop of historically low unemployment rates. Despite the tightening economic cycle in the United States, and various headwinds, the global economy remains poised for growth.

Expectations of rising inflation caused the yield on 10-year U.S. Treasuries to hit a level of 3% for the first time since January 2014. While crossing 3% is noteworthy, we continue to believe that the increase in rates will be gradual and subdued. This is due in part to the fact that inflation remains on target but also due to the low level of yields on a global basis.

Rising bond yields create headwinds for equity markets. However, equity valuations have come down to more reasonable levels in recent months and continued earnings growth – backed by a fundamentally strong economy – is expected to remain a key driver for equity returns. Our expectation is that rising earnings and falling price/earnings multiples will combine to deliver positive returns in 2018, but lower than what we have seen in recent years.

While economic fundamentals and corporate earnings remain strong, we believe that the themes of rising yields, central bank tightening, and fears over heightened trade frictions are likely to persist, potentially leading to greater volatility in the coming months. Our prediction of “lower-for-longer” remains in effect for interest rates, and low to mid-single digit returns continues to be our base case for equities.

We are pleased with how our portfolios performed in the second quarter. We continued to take advantage of the market volatility with our trim function. Our active portfolio monitoring and rebalancing services ensures that your portfolio remains aligned with your investment objectives, even in volatile markets. During the second quarter, we trimmed up Enercare, Cogeco, AltaGas, and Alimentation Couche Tard. In addition, we trimmed down Suncor and Magna. Magna has worked out very well for us and we trimmed it down due to strong performance. We initially purchased this position on March 3, 2016 at $54.31 per share. On June 5th, we trimmed it down at $84.54 and it's worth noting that it closed the quarter at $76.46. These rules allow us to maintain a highly structured approach to investment selection, removing all emotion and ensuring that volatility is minimized.

Last quarter, we experienced an unprecedented number of our holdings increase their dividend. It is not uncommon to see two to three names increase their dividend, but we saw thirteen names increase their dividend. 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 quarter, we saw these holdings increase their dividend: NFI Group Inc (+15.4%), National Bank (+3.3%), and TELUS (+4%).

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

Enercare

Enercare's share price has come off materially this year (down 12% YTD), which we believe offers investors a good opportunity to buy a high-quality company with favourable near-term and long-term fundamentals.

We believe that Enercare is capable of growing by mid-single-digits organically and by low-double-digits including tuck-in acquisitions, while maintaining a comfortable amount of leverage and sustaining an attractive dividend yield (Enercare is a serial dividend raiser). The business is anchored by, in our view, a fixed-income-like Home Services business that has long-term recurring revenue, very low attrition (~2.5% per year), net unit growth, and annual price increases.

We see an opportunity for Enercare's EBITDA (Earnings before interest, taxes, depreciation, and amortization) from its sub-metering business to more than double over the next five years, with only half of currently contracted units billing and historical growth in contracted units over the past five years of 11% per year. At Enercare's sub-metering business, we see significant growth opportunities including expansion within existing markets, geographic expansion, and margin improvement. Management has been rolling out its rental model across the U.S., which we believe will result in incremental shareholder value creation (rentals are worth approximately 2.5x sales on a discounted cash flow basis), while the fragmented market (roughly 1,000-1,500 acquisition targets) offers additional growth upside.

Enercare currently trades at 9.5x F2018E EBITDA and 8.6x F2019E EBITDA. This valuation is a material discount to precedent transactions, which have been completed at multiples ranging from ~11-14x EBITDA (most recently the sale of Enercare' primary Ontario competitor, Reliance Home Comfort, for 14.3x LTM EBITDA).[1]

Canadian National Railway

We view CN as a relatively low-risk, high-quality industrial company, which should be a core holding. We expect the company to enter 2019 with renewed momentum and the capacity necessary to cost-effectively leverage a highly visible and well-diversified growth pipeline. [2]

NFI Group Inc.

Q1 was a somewhat disappointing start to the year after three consecutive quarters of record-high margins. However, we would emphasize that the fundamentals of the business and the industry remain solid and that the drivers of the miss appear to be transitory in nature, reflecting sales mix and reduced operating leverage during the seasonally weaker Q1. We expect margins to rebound going forward, alongside the seasonally stronger sales periods (Q2/Q4) and as the benefits of plant upgrades and the in-sourcing of fiberglass manufacturing come through. Furthermore, we would highlight that Q1/18 margins were an improvement

[1] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=C5FF53E62D0F29A6852582830044D812
[2] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=E6DCFD3114A2B36B8525828D005DFE74

over Q1/17 — on an LTM basis, margins are improving. Despite this, we have taken a slightly more conservative approach and trimmed our bus manufacturing margin estimates.

Management reiterated that the outlook for the transit business continues to be robust, with funding readily available. Furthermore, the company is making solid headway on its new product developments, which we expect will translate into further market-share gains.

As mentioned earlier, NFI Group raised the dividend 15.4% this quarter. We believe that the company is continuing to strike a balance between growth and yield, with future acquisitions likely. However, management also indicated that it is actively considering alternative uses of capital such as implementing a normal course issuer bid.[3]

CIBC

Our positive outlook on the stock reflects relative valuation in the context of the bank's improving top line growth, efficiency, and more diversified platform. 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. While mortgage growth did not slow abruptly this quarter, stronger margins, and expense discipline drove a solid result. [4]

Telus Corporation

We believe that it is a well-positioned and well-managed company trading at a reasonable valuation relative to its growth prospects. We expect the continuation of mid-single digit EBITDA growth and 7-10% dividend growth going forward, supported by heavy exposure to a healthy Canadian wireless market and industry leadership on fiber to the home (FTTH) deployment in its wireline segment. TELUS has now surpassed 50% of its urban households with FTTH, such that capex is starting to decline and fiscal cash flow (FCF) is finally improving. Even if wireless growth decelerates over the next couple of years (owing to sector maturity and new competition), we believe that TELUS will be able to sustain attractive consolidated FCF growth by reaping the cost and average retail price per unit (ARPU) benefits of more FTTH coverage, while concurrently seeing a decline in FTTH capex (starting in 2020). We see low odds of price-war disruption at TELUS Mobility, and the risks of rising interest rates are arguably much better reflected in Canadian telco valuations today than they were at the start of 2018. [5]

Magna International

As mentioned earlier, we trimmed down our weighting in Magna due to strong performance. We remain positive on Magna but we remain cautious on the multiples currently applied to auto suppliers at this point in the auto cycle. This is magnified by the uncertainty posed by NAFTA negotiations and the threat of tariffs potentially being imposed by the U.S. upon auto and auto part imports. In the absence of a near-term NAFTA resolution, our concern is that uncertainty regarding trade could weigh upon near-term auto supplier valuations and potentially leading up to U.S. mid-term elections in November. [6]

Emera

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

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[3] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=3F208F605B7308988525828D003C7D42
[4] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=1C572D4B5706A53D8525829600557FB5
[5] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=983628876D7E677D8525828A003C7E57
[6] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=96724E682EB9F669852582BA004A36BE

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. [7]

Canadian Tire

The company announced the acquisition of Helly Hansen ("HH") for $1.035-billion from Ontario Teacher's Pension Plan. Once investors digest the up-front sticker shock of the HH transaction, we believe it should be viewed positively and seen as an improvement in enhancing the brand that creates shareholder value over the mid-term. We view Canadian Tire performing better in the second half and view the current risk/reward profile as attractive.[8]

Cogeco Inc.

We believe that Cogeco Inc.'s current discount to net asset value (NAV) 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 NAV. 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. [9]

Alimentation Couche Tard

Couche-Tard shares have fallen 16% so far this year, and are now trading at 12.5x our forward EPS, well below its international c-store peers and even below the grocers, despite a strong earnings outlook led by recent acquisitions and related synergies. Investor confidence in the organic growth outlook (particularly the U.S.) has been shaken, although we do see a re-acceleration same-store sales, albeit gradually, over the coming year as it turns around CST's fortunes, adds the Holiday acquisition, implements national marketing/promotional campaigns, and weather comps get easier. A greater fresh food rollout should contribute more materially to organic growth by F2020. Although patience is required, we recommend buying now while the shares remain severely depressed.[10]

Suncor Energy Inc.

We continue to believe 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. [11]

TransCanada Corp.

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 km 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

[7] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=F5570D195CF07AAE852582B7004D2B35
[8] tdsresearch.cibg.tdbank.ca/equities/equity/goToCompany.action?symbol=CTC.A-T&saveAsName
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[11] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=92A918817CE05D08852582A6003C8314

business model, and financial strength are competitive advantages when pursuing new assets.[12]

Premium Brand Holdings Corp

We expect strong organic revenue growth – driven by a long runway in sandwich manufacturing, a scalable North American meat snacking platform, and new eastern Canadian distribution capabilities coming soon, to name a few – combined with modes margin expansion, and contributions from acquisitions to drive strong EBITDA growth through our forecast period. [13]

Transcontinental Inc.

We believe that Transcontinental shares remain attractive at current levels, primarily due to: (1) its resilient legacy business, which we believe should remain stable in the near term, given its emphasis on retailer-related print and plant consolidation; (2) its significant entry into flexible packaging, which adds a platform for future growth; (3) the company's strong free cash flow generation, which should allow for steady deleveraging, periodic dividend hikes, and additional acquisition activity down the road; and (4) its current valuation, which we believe will expand over time as flexible packaging becomes a more significant contributor to earnings.

MK Total Wealth Management Group
TD Wealth Private Investment Advice
4950 Yonge Street, Suite 1600
North York, ON M2N 6K1
T 416 279 1455
mktotalwealth@td.com

www.mktotalwealth.com

[12] tdsresearch.cibg.tdbank.ca/equities/equity/openReportFile.action?reportId=B89E8CCDA70C2CB3852582970044ED7F
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