Quarterly Market Commentary

December 2020

Bear market lows are typically set during a recession when an economic, financial or medical crisis causes a collapse of risk appetite while the economic recession reduces earnings expectations: a double driver for lower stock prices. New cyclical bull markets begin when monetary and fiscal stimulus encourages investors to anticipate economic recovery resulting in an increase in earnings expectations and an increase in risk tolerance: a double driver for stock market gains. Investment returns in these new bull markets tend to be front-end loaded as risk tolerance eventually normalizes and cyclical earnings gains tend to be paid for in advance. As a result, the first 12 months of new cyclical bull markets usually see terrific returns with relatively minor corrections while the second year of new bull markets tends to see significantly lower returns and the first substantial correction. For example, a correction of over 12% was recorded in 2010. We expect 2021 will see continued stock market strength for the next three or four months followed by a correction that should see stock prices decline over 12% before recovering to new highs at year-end. To put some numbers on it, we expect the S&P 500 will reach 4000 by April (6.5% price gain from December close), then decline about 12% to a mid-year low of 3500 before recovering to 4100 at year-end for a net price gain of 9.1% in 2021.

While there are many differences between 2010 and 2021 (European debt crisis then, pandemic now), we believe the stock market price action will be surprisingly similar to 2010 when the S&P 500 initially rose 7% to an April peak, then declined 17% to an early July low before recovering to set new highs by year-end for a net price gain of 12.8% in 2010. Our expectation of a mid-year correction will likely prompt us to recommend some modest profit taking in a few months' time, with the goal of returning to an aggressive stance at the lower mid-year prices we anticipate. Long-term investors could comfortably ignore the coming volatility, recognizing that a buy and hold strategy often outperforms those who attempt to time the corrections that will remain a regular feature of a bull market that has years to run.

One of the reasons prices of risk assets tend to correct in the second year of economic recovery is the fact that quarterly and monthly measures of economic growth almost always peak about 12 months after the recession low. This is partly a base effect as the year/year comparisons are easiest twelve months after the low. The goods sector generally contributes disproportionately to the initial 12-month surge of economic growth coming out of recession, as the need to rebuild inventories forces production growth higher than rapid sales growth. The pandemic related switch from service consumption to goods consumption has magnified this production boost.[i] After 12 months of strength in the goods economy, pent-up demand is usually partly satisfied and sales may start to slow. Inventories that were so difficult to build in the first 12 months would start to accumulate rapidly and production would need to be cut. As in 2010, we expect some degree of an inventory correction should begin around mid-year 2021 partially offset by a gradual recovery in the service sector as vaccinations continue to roll out. We anticipate that after peaking in April or May, U.S. and global industrial production growth will slow significantly, driving a correction in the more cyclical areas of the stock market regardless of whether a recovering service economy allows for continued job gains.

While we see problems mid-year, we do expect recent bullish trends will continue for a few more months (rising equities, slowly rising bond yields, declining U.S. dollar, rising commodity prices). Factors contributing to a continued risk-on environment include the ongoing earnings recovery as well as the prospect of more fiscal stimulus, an accelerated vaccination rollout and an associated decline of COVID 19 related mortality.

Our expectation for a continued economic and earnings recovery suggests the cyclical case for stocks remains strong, at least through the spring when the potential service sector recovery will no longer be enough to offset growing fears of a goods sector slowdown.

The economy continued to see improvement in the fourth quarter and the market resumes its rebound from the March lows. We experienced strong upward movement in the quarter and took advantage of the higher prices and slightly trimmed down our position in Canadian Tire while adding to Suncor, TC Energy and Restaurant Brands due to the value we continue to see in the stocks.

We are optimistic that our value approach to investing will continue to reward our clients in 2021 and below are highlights on some of our positions that we continue to favour:

BROOKFIELD PROPERTY PARTNERS

As we prepare this commentary, we learned that Brookfield Asset management (BAM) and a group of investors have made a proposal to Brookfield Property Partners (BPY) to take the company private.

We don't think this offer will come as a total surprise to investors given 1) BAM funded a BPY substantial issuer bid this past summer at US$12.00 per share 2) in the Q1 shareholder letter, BAM said "We will continue to purchase shares of these entities during these periods. Furthermore, where these discounts persist, we will also always consider more meaningful changes to these entities in order to maximize value." and 3) BAM has continued to highlight the resiliency and value of their real estate portfolio.

We have not made any decisions as to how we will move forward, but we are happy that we trimmed up the stock several times during the year, capitalizing on the weaker stock price due to the pandemic meltdown.

AECON GROUP INC.

Aecon Group was added to the portfolio earlier in the year and we are happy thus far with the performance of the stock. We feel that the company will continue to benefit from an anticipated increase in federal and provincial government infrastructure spending and we are comfortable continuing to hold our position.

Although COVID-19 uncertainties persist, we are encouraged that Aecon has witnessed a stabilization in its operating environment. Aecon's diverse end-market exposure, healthy backlog, and new-award prospects support our positive view on the company.

ALGONQUIN POWER & UTILITIES CORP.

Algonquin's expected 2021 adjusted EPS (Earnings per Share) range of $0.71 to $0.76 is consistent with our estimate and consensus. The midpoint of 2021 adjusted EPS guidance implies 13% y/y growth from our 2020 estimate. We have updated our estimates to reflect the details of Algonquin's capital plan, including newly announced initiatives within its unregulated power generation segment.

Algonquin targets a long-term adjusted dividend payout ratio of 80-90% (using EPS as a reference point). The company reaffirmed 10% dividend growth guidance for 2021, which implies a payout ratio at the top end of the range next year. If the company can attain the midpoint of the five-year payout ratio and EPS growth targets, this would translate into a 6% dividend Compound Annual Growth Rate (CAGR). We anticipate that Algonquin will lower its payout ratio gradually and continue to view dividend growth as an important component of the company's total return proposition.

BCE INC.

We continue to believe that the odds are high that BCE will allow the payout ratio to stay above 75% temporarily, so that 5% dividend growth is still possible when it reports Q4/20 results in early-February. As such, we believe that BCE shares remain the go-to name for investors looking for stability and income in the telecom sector. The growth profile might be better for other cable/telco names, but BCE still has good exposure to either long-term growth from 5G and broadband, and/or an upward rerating for the whole sector if investors start appreciating the long-life infrastructure characteristics.

BROOKFIELD BUSINESS PARTNERS

Brookfield Business Partners has an active Normal Course Issuer Bid in place to repurchase up to 4.0 million units (5% of outstanding), including up to 20k per day on the TSX. During Q3/2020 and YTD, Brookfield Business Partners has repurchased 417k units and 977k units, respectively

We would like to highlight Brookfield's strong liquidity position and funding options to support its near- and longer-term strategic growth initiatives (Brookfield does NOT need equity). The private equity firm has approximately $2.2 billion of current liquidity, including $0.3 billion of cash and liquid securities and $1.9 billion of availability on its corporate credit facilities ($2.6 billion cap). Brookfield is well-positioned to capitalize on new opportunities despite the pandemic, with local teams in place across the globe. In addition to new investments, Brookfield is evaluating several opportunities to grow and expand its existing businesses.

We believe that Brookfield Business Partners is an exciting opportunity for retail investors to participate in a Private Equity Portfolio. Their proven management team provides our portfolio greater diversification and potential for significant long-term upside.

CANADIAN IMPERIAL BANK OF COMMERCE

CIBC has very compelling valuations - on our 2021E and 2022E EPS, CIBC trades at 10.2x and 9.2x, respectively, compared to the five-year average (two-years forward) of 9.4x. On a relative basis, CIBC currently trades at a 9% discount to the group P/E (2021E EPS). The bank has traded at a 12% discount over the past five years.[ii]

We continue to favour CIBC largely based on relative valuation, potential upside to our target price, and expected dividend yield. In addition, we believe that the bank's lower risk exposure, most notably the bank's overweight position in domestic mortgages, continues to support our positive outlook.

COGECO INC.

We are somewhat surprised by the share price trading in the low 80s versus the Altice/Rogers offer of $123. Although we understand that the Audet family has rejected the offer, it does not mean that CGO shares should be trading at these levels, in our view. We wanted to point out, as we have in previous commentaries, that we believe ~90% of the Net Asset Value for Cogeco Inc. (CGO-T) is derived from CGO's investment in CCA. We believe that the share-price movement does not reflect the solid beat in CCA's core communications segment results, and positively, both CGO and CCA announced dividend increases of 10% and 15%, respectively. With the fundamentals of the business still intact, the current 15.1% discount to Net Asset Value is a good entry point in our view, and a good reason why we continue to hold our position.

CANADIAN TIRE CORPORATION, LTD.

Canadian Tire shares continued their late year rally and we took this opportunity to trim down our position slightly. After several trim ups over the year, we felt it was responsible to take some money off the table. We are very confident in the stock going forward and their most recent earnings report justifies our views.

The Q3/20 earnings beat was largely attributable to the very strong retail sales performance and inventory dealer replenishment at Canadian Tire, that continues to benefit from trends we have identified during the pandemic. This along with cost mitigation across its Retail portfolio drove the majority of the material earnings beat. This performance/trend in combination with stable credit metrics within the Financial Services segment, bodes well for a strong earnings recovery continuing in Q4/20 and accelerating in 2021 in our opinion. The outlook is further supported by the unexpected dividend increase in the last quarter.

We have heightened conviction in the financial recovery at Canadian Tire and remain bullish on the share price over our investment horizon, as the company has adapted appropriately to the evolution of retail in recent years.

ENBRIDGE INC.

Over the long term, we expect Enbridge to continue to have a strong competitive incumbency due to its geographic footprint, scale, and diversification, and we believe that this positions it to play a role in North America's contracted and regulated energy infrastructure transitions.

The company expects to have annual investment capacity of $5bln-$6bln (post Line 3 Replacement Program), of which it expects to allocate $3bln-$4bln in low capital intensity growth and regulated utility or utility-like investments. A combination of share buybacks, other organic growth, paying down debt, or small asset acquisitions will compete for the balance of capacity. Together with 1-2% DCF/share Compounded Annual Growth Rate (CAGR) from enhanced returns from the existing business, management believes that 5-7% Discounted Cash Flow/share CAGR is sustainable in the long term.

FIRST CAPITAL REIT

We remain optimistic and confident on the recovery in value of First Capital, despite the impact of COVID-19 on both the economy and shopping behavior.

We believe the continued improvement in rent collections will lead to outperformance in terms of both growth and stability within First Capital's peer group. They collected 75% of rents at Q2/20, 79% in July, 82% in August, and 86% at Q3/20 (91% including government support). First Capital's primarily necessity-focused tenant and asset base in high-density locations helped sustain strong leasing activity in Q3/20, with over 1.3mmsf of leases signed since the onset of the pandemic, at a +9% average rental rate spread. Additionally, occupancy has remained resilient on a year-to-date basis, declining by just 90 basis points since Q4/19, and 30bps from Q2/20 to Q3/20. This highlights First Capital's ability to pro-actively lease vacant space during the pandemic with stronger, more stable tenants in many cases.

Versus its closest retail peers, First Capital has the highest concentration in tenants deemed 'essential' and those that cater to peoples' everyday needs. Nearly 75% of rents are derived from these tenants, including grocers (17%), medical offices (15%), pharmacies (9%), and banks (8%), among others. This is well ahead of First Capital's two closest peers, RioCan REIT (55%) and SmartCentres REIT (61%). First Capital also has virtually no exposure to retail's most challenged areas (e.g. department stores, fashion, theatres).

Compared to the two grocery-anchored retail REITs (Choice Properties and Crombie), First Capital has higher urban-concentration (>90%) and population density (301,000 average 5km-radius population density, +45% since 2016).

This past December, First Capital sold a 50% interest in a development land parcel (Panama Place, Montreal) and six grocery-anchored shopping centres (located in Quebec, Alberta and Ontario). Pricing appeared to us to be above IFRS values, indicating positive momentum in First Capital's disposition program during the pandemic.

We believe this uncertainty is fully discounted in the current unit price, offering investors an attractive entry-point. First Capital currently trades 38% below our current Net Asset Value (47% below our pre-COVID-19 NAV estimate of $25.60), versus the historical average of just a 3% discount.

We view First Capital as one of our most attractive plays on the reopening of the economy. First Capital's units outperformed during the two recent sector rallies: +14.7% versus +2.1% for the S&P/TSX Capped REIT index return between July 27 and mid-August, and +35% versus +18% between May 13 and June 8. As news of successful vaccine trials broke in early November, First Capital returned 34% over a period of just three weeks, giving some visibility to the level of returns we believe we may be able to expect once a larger portion of the population is vaccinated. However, we were quickly reminded of the risks associated with retail in December, as FCR units fell by ~15% on news of increased lockdown measures.

MAPLE LEAF FOODS

The shares led all other Consumer Staples under coverage in the first half of 2020 (+10%) but lost ground in the third quarter after news that COVID-19 surfaced in its primary processing plant (creating inefficiencies and causing exports to China to be temporarily suspended). November/December resulted in a 12% total return in 2020 for shareholders – not the substantial gains we anticipated (as valuation contracted) but much better than the 4% for Consumer Staples in general.

We still see the potential for shares to double over the next 2-3 years as demand growth, continued mix improvement and cost discipline combine to push Meat Protein Earnings Before Interest, Depreciation and Amortization (EBITDA) margins closer to the company's 14% target by 2022 (~16% by 2023), and investors better reflect Maple Leaf's Plant Based Protein (PBP) strategy in the valuation. At this point, PBP Selling, General and Administrative (SG&A) spending is expected to remain high in dollar terms, with rapid revenue growth and ~30% normalized gross margins allowing the segment to grow into these spending levels within 3-5 years; this would push segment EBITDA margins back into the double digits. So, we continue to believe that investors should take advantage of the market's myopia depending on their personal circumstances in order to benefit from several strong long-term value creation drivers that we expect should push margins and valuation meaningfully higher over the next 3 years.

PARKLAND CORP.

Parkland's share price has doubled from the March bottom. But the shares are still trading at only 7.8x/8.2x our consensus 2021E EBITDA, well below the ~8.7x five-year average. With higher fuel margins, proactive cost-savings initiatives ($50mm-$70mm/annum is sustainable in our view), and strong execution (delivering new business wins and strong Same Store Sales), we see further upside to our $46.00 target price in the following scenarios: 1) should valuation return to historical average of 8.7x following COVID-19, it would boost our target price to $52.00; 2) if one or several acquisitions at reasonable valuations combined to add meaningfully to earnings; and/or 3) crack spreads return to 2018-2019 levels, which alone could push our target price to $53.00.

Parkland is trading at 7.8x next-12-month EBITDA, which is below its five-year average of 8.7x and the weighted-average of its peers.

ROYAL BANK OF CANADA

Royal Bank of Canada (RY) reported Q4/20 adjusted Earnings Per Share of $2.27 (up 2% year over year) vs. our estimate of $2.06 (consensus: $2.05). Relative to our estimate, PCLs and expenses were lower than expected and trading revenue was significantly lower. Pre-Tax Pre-Provision Profit (PTPP) was up 4% y/y (slightly better-than-expected).

Over the past 5-10 years, Royal Bank Stock has traded at an ~5% premium to the group. In our view, the bank's structural advantages and track-record continue to support a healthy premium. Specifically, we believe that RY's three large domestic businesses (banking, wealth, and capital markets) will continue to provide balanced earnings growth. Additionally, the bank's ongoing cost management initiatives (not treated as items of note), as well as strong capital levels, point to better medium- and long-term performance from RY, in our view.

NATIONAL BANK

National Bank's (NA) solid 2020 results reflect strong execution as well as an advantageous business mix relative to the group. While NA has very modestly under-performed over the last six months, the stock continues to trade at 1.8x Book Value/share (consistent with RY), reflecting the industry's highest Return on Equity (ROE). Looking out to 2021, we expect normalizing conditions in capital markets, cards, service fees, and other non-Committed Monthly Recurring Revenue fees to favour several of NA's larger peers.

On our 2021E and 2022E EPS, NA is trading at 10.5x and 9.5x, respectively, compared with the five-year average (two-years forward) of 9.9x. On a relative basis, NA is currently trading at a 6% discount to the group P/E (2021E EPS).

SUNCOR ENERGY INC.

Suncor materially underperformed its Canadian Integrated peers in 2020. While it has made up some ground in recent months, we believe it has more room to run on a catch-up trade. It is also catalyst rich.

The first and obvious catalyst is a potential mid-term refinery crack spread recovery. The second is its 2023 target of $1 billion of additional free funds flow generation (independent of production and oil prices). This target is looking very achievable (and might even get accelerated) because it recently completed two key projects that should help drive this target (the Suncor Syncrude bidirectional pipeline; deployment of driverless trucks at Fort Hills). While other work still needs to be completed (supply chain management, business process improvements and tailings management), we believe we can start to think about banking this $1 billion target in the first half of 2022 timeframe. In addition, Syncrude operatorship is to be transferred to Suncor by year end 2021. The synergies estimates here is also material at $300 million per annum, most of which could be achieved within one year of transfer in our view. If we hypothetically build in only the $1 billion of upside, Suncor screens the most attractive on relative value at strip Fiscal Cash Flow yield of 15.6% vs. the peer average of 12.2%. In addition, its balance sheet is back to a point where Suncor recently had the confidence to announce the following 2021 targets: 1) a $500 million share buyback, 2) a $250 million growth capital wedge for projects driving its $1 billion target, and 3) another $500 million to $1 billion of debt repayment.

TC ENERGY CORP.

In terms of the EBITDA outlook, TC Energy (TRP) is guiding to $12 billion + for 2024E, representing a 7% CAGR from the expected 2020E comparable Earnings Before Interest, Depreciation and Amortization (EBITDA). The company continues to advance a $37 billion secure capital program, evaluating a need of ~$5 billion in projects annually to maintain its growth expectations of 5-7%. Highlighting the required maintenance capital of the core business, opportunities for investment at Bruce Power, in-corridor expansion, and other opportunities associated with the energy transition, management feels confident in finding more than enough opportunities to fulfill this need.

TC Energy reaffirmed their Dividend Growth Guidance. TRP's common share dividend growth guidance of an annual rate of 8-10% in 2021 and 5-7% thereafter was reaffirmed in November. The company cited the expected future growth in earnings and cash flow per share, driven by the secured capital program and other under-development projects.

We feel that TC Energy has more upside from these levels and were comfortable holding this position.

If you should have any questions or comments, please do not hesitate to ask.

MK MacDonald Konidis
Total Wealth Management Group

TD Wealth

[i] TD Securities Inc. – January 2021

[ii] TD Securities Inc. – January 2021