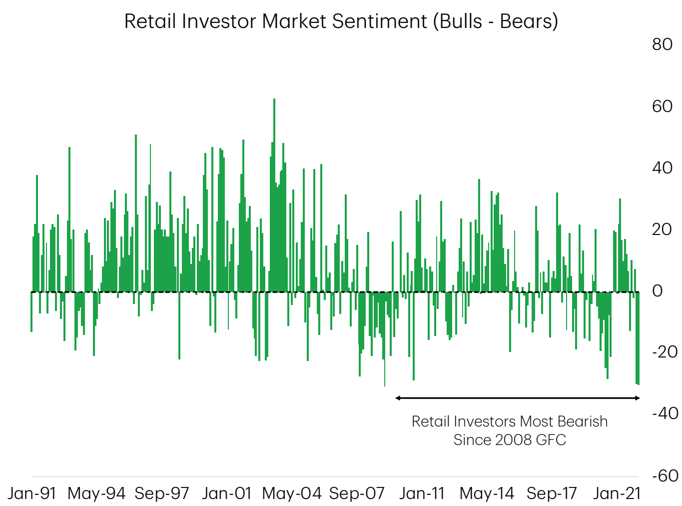
Quarterly Market Commentary

April 2022

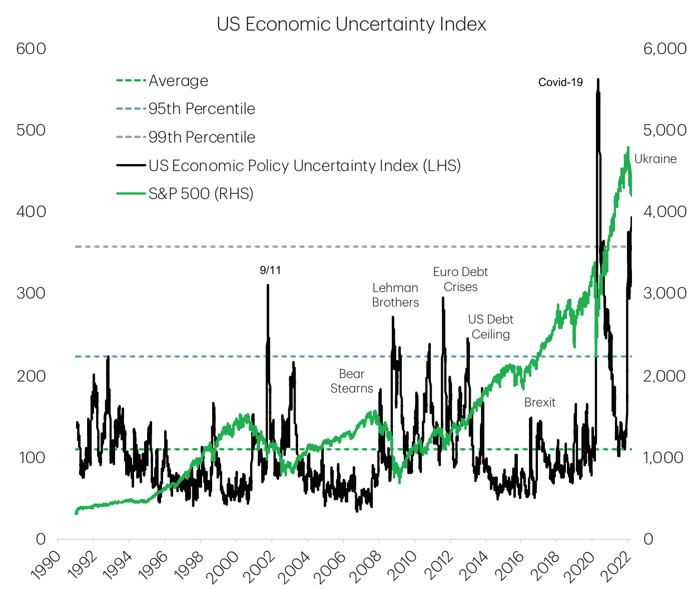
With all that is going on – the Russia-Ukraine conflict, market volatility, inflation and rising rates – it is little wonder that individual investors are feeling nervous. In fact, investors today are as bearish as they have been since 2008, a 30-year low (Figure 1). Volatility is also the through the roof, rising into the 90th percentile over the past five years.

Figure 1: Bears clawing at sentiment



Source: Bloomberg Finance L.P., as of March 7, 2022

Figure 2: Market bottoms on uncertainty



Source: Bloomberg, TD Wealth as of March 4, 2022

History has shown that periods of extreme uncertainty actually tend to be closer to a bottom of a market correction than the beginning (Figure 2). Let's not forget how we all felt in March of 2020 when the World Health Organization declared the official start of the pandemic. The uncertainty devastated markets long before the effects of any lockdown could be felt or any data on the economy could be assessed. As it happens, our worst fears about the economic impact of Covid proved unduly pessimistic, and the economy and markets experienced a powerful recovery.

So, in other words, the uncertainty that dominates before a major policy decision, or even an act of war, is more likely to impact valuations than the implications of the policy decision itself. We see this time and again in the lead-up to major Fed announcements and government proclamations.

The core strategy remains the same. This remains true in the midst of economic upheaval, pandemics, wars and even the threat of recession. The more formidable enemy is fear itself. Fear and uncertainty are what drive investors to make poor decisions. Where there is a lack of knowledge, we will fill it, at times, with our worst fears.

Where do we go from here?

The good news first. Bear markets precipitated by unexpected events, like the one we're experiencing, tend to be shorter-lived and less painful than structural or cyclical bear markets. The bad news is that they're also less predictable.

Let's consider a bull and bear case of how the macro landscape could evolve. In the bull case, normalization of the global supply chain leads to a peak in core inflation, although energy and food inflation could remain elevated. In this scenario, the Fed backs off from its aggressive tightening stance, allowing 10-year Treasury yields to come down. This is a well-supported scenario given that, historically, the market has tended to be too aggressive in pricing short-term interest rates. In China, meanwhile, reflation efforts could start to lift growth, fuelling demand for commodities and bolstering the global manufacturing cycle. This scenario would be a green light for risk assets, with growth stocks resuming their rally and the dollar weakening.

The bear case involves a prolonged war in Eastern Europe, wherein a broad risk-off sentiment would raise the risk premium, lower consumer spending and weaken corporate earnings. The risk of energy and food inflation would intensify as oil holds above US$100 per barrel and the prices of wheat, soybeans, and other agricultural commodities continue to rise. These inflationary pressures may also feed into the prices of other goods and services, forcing central banks to tighten to prevent a price-wage spiral in a weakening economy. In this case, the dollar would strengthen while risk assets sold off.

At this point, we would assign a 70% odds to the bullish scenario and 30% to the bearish scenario.

CRESCENT POINT ENERGY

We added Crescent Point Energy to the portfolio last month. We now believe Crescent Point should be firmly in the minds of investors for a core oil-weighted holding. Since the significant strategy pivot in 2018 the company has reduced leverage significantly (by over $2 billion since YE2018), while optimizing the asset portfolio and entering a new play through the acquisition of Shell's Kaybob Duvernay position early in 2021. Now that the balance sheet has been solidified, we believe a more formal return of capital strategy (similar to the frameworks that many other Exploration & Productions have put forth recently) should be forthcoming in the near term. The current dividend of only $102 million per year represents only 5% of 2022E cash flow (and 8% of Fiscal Cash Flow (FCF)) which leaves significant unallocated FCF for incremental return of capital announcements, in our view. For example, if Crescent Point were to return 50% of FCF to shareholder return initiatives, we estimate this would equate to 12% of the current market cap —while still allowing for $659 million of debt reduction throughout the year.

In addition, Crescent Point recently reported successful results on the newly acquired Duvernay asset, with capital costs improving significantly from prior estimates and strong well rates on the company's first drills in the area.

ALGONQUIN POWER & UTILIITES CORP

The company reported Q4 results on March 3rd. Earnings were consistent with expectations, and 2022 guidance is unchanged. We believe that Algonquin offers a compelling valuation in the context of an extensive growth pipeline that includes organic development activity, acquisitions, and utility rate-base investments. As the company has a diverse/transparent growth opportunity-set, a manageable payout ratio, and comfortable leverage, we believe that above-sector-average dividend growth is realistic.

APPLE INC

Apple announced record results for fiscal 1Q22, revenue and earnings per share grew in double-digits year-over-year while exceeding lofty consensus expectations. Supply chain constraints in calendar 4Q21 were more significant than those in the calendar third quarter, according to the company. Despite these issues, Apple's massive volume leverage resulted in record net income of $34.6 billion for 1Q22. Apple has long had its main product launch event in September, along with its software event, WWDC, typically held in summer. After the iPhone 13 rollout in September 2021, Apple in October previewed its lightning-fast MacBook Pro line, and in late fall introduced new wearables including next-generation Air Pods and watches. Given the steady and accelerating flow of Apple products, the company could add more new product launch days in future years.

BCE INC.

BCE raised the dividend by 5% when they reported fourth quarter earnings on February 3rd. We view BCE as a stable and attractive investment for investors seeking safety and income (the current dividend yield of 5.5% is still the highest dividend yield among Canadian telco/cable names). Execution by management has been strong, and the company has impressive long life infrastructure assets.

BROOKFIELD RENEWABLE PARTNERS L.P.

Brookfield Renewable raised the dividend by 5% this quarter. The company reported fourth quarter results on February 4th that matched both our estimate and the consensus forecast. We believe that Brookfield Renewable deserves a valuation premium based on several factors: scale/track record; broad investment opportunity-set; consistent value-accretive initiatives; ability to act on large/complex transactions; operating/procurement expertise; management depth; and a strong funding platform. We believe that Brookfield Renewable is well positioned for further growth tied to decarbonization and electrification trends.

COGECO INC.

The holdco discount for Cogeco Inc. shares, currently at 21%, remains at elevated levels relative to history. We do not incorporate a holdco discount/premium in our target price. That being said, we believe our BUY rating is supported even if one were to incorporate a 5% holdco discount (translates into ~$123).

CANADIAN IMPERIAL BANK OF COMMERCE

CIBC announced a two-for-one share split this quarter. The bank reported fourth quarter earnings on February 25th. Adjusted cash earnings per share were $4.08 (up 14% year over year) versus our estimate and consensus of $3.67. CIBC's strong performance reflects exceptionally strong commercial/wholesale loan growth in the last 12 months. In the next 12 months, the bank's industry-leading Net Interest Income growth should support strong Pre-Tax, Pre-Provision earnings despite higher expense growth. While the next credit cycle could lead to greater stress on these recently added loans, we do not expect investors to focus on the downside risk until there is convincing evidence of a turn in the credit environment. For now, the bank's leading top line growth and reasonable valuation support our positive outlook on the stock.

CANADIAN TIRE CORPORATION, LTD.

On March 11th, Canadian Tire hosted its 2022 investor day that laid out its long financial aspirations, inclusive of its key growth drivers, and a major investment of $3.4 billion through 2025 to support these initiatives. We believe Canadian Tire's investor day outlined the powerful assets at its disposal. This includes the critical mass of loyalty/credit card members and the wealth of data this provides. Further investment and integration in its digital capabilities, owned product offering, data analytics, and store base should, in our view, drive market-share gains. We believe this should improve investor confidence in Canadian Tire's ability to grow its Retail segment as the pandemic eases.

DEFINITY FINANCIAL CORP.

We envision one of four 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. 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. The other three scenarios include: 1) the company itself gets acquired (unlikely until at least the end of the demutualization protection period 2 years post initial public offering); 2) the company grows its direct written premiums at an above-average rate and continues to refine its business model resulting in an ~250bps improvement in operating return on equity; or 3) the company largely remains as is (limited improvement in profitability and operating return on equity). With market conditions expected to remain firm over the next year and the company's stable business model, we believe the stock has good upside potential.

ENBRIDGE INC.

Enbridge increased their dividend by 3% this quarter. 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 that 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 and continued energy demand.

FIRST CAPITAL REIT

We view First Capital as representing one of the largest "re-opening trade" upside opportunities across our REIT coverage universe.

First Capital has the highest concentration in necessity-based tenants (at ~75% of rents) versus its two closest peers (RioCan REIT: 60%, and SmartCentres REIT: 61%), and also has by far the lowest exposure to retail's most challenged areas (e.g. department stores, fashion, theatres). Cap rates for grocery-anchored urban retail properties (First Capital's portfolio focus) have compressed during the pandemic.

Despite this, First Capital remains one of just a few REITs trading at meaningful valuation discounts versus pre-pandemic. We further note that First Capital's pre-pandemic valuations were already discounted to reflect the need to de-lever following its $742mm share buyback in 2019. First Capital's current Price / Net Asset Value valuation is materially below that of its two closest peers (averaging 99%).

MAPLE LEAF FOODS INC.

Maple Leaf Foods increased the dividend 11.1% this quarter. We believe Maple Leaf has a lot going for it as an industry leader in ESG (Environmental, Social, and Governance), 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). But Maple Leaf's 2021 returns were muted relative to the sector average based on what we believe are two investor impediments: 1) the substantial EBITDA losses in Plant Based Protein (PBP), and 2) the negative FCF stemming from extremely high levels of capital expenditures and PBP opex.

For 2022, we see the shares moving materially higher toward our $45 target. Despite some headwinds in Q1/22 — i.e., challenging labour markets (Omicron-related employee absenteeism), unfavourable poultry market conditions, and a spike in transportation/fuel costs — we remain confident in Maple Leaf's ability to boost run-rate Meat EBITDA margin (excluding duplicate-overhead and start-up costs in the new London poultry facility) to its target 14% run rate by YE2022 (and to 16% run rate by YE2023). This, coupled with a commitment to return the PBP business to breakeven in 18 months, and a substantial reduction in capex by mid-year (when new London poultry and Indiana tempeh facilities are expected to be commissioned), should lead to meaningful fiscal cash flow generation for the first time since 2017/18, in our view.

PARKLAND CORP

Investors have largely ignored Parkland shares over the past year, focusing on companies with greater leverage to the energy bull run elsewhere in the sector. But with management continuing to execute on plan and deliver solid growth, valuation has slid to trade more in line with the refiners despite refining accounting for only ~25% of EBITDA. We see Parkland offering very good value and growth in 2022, positioning it to move back up closer to historical average valuations once the energy bull run fades and/or investors widen their horizons.

ROYAL BANK OF CANADA

Last month RBC announced the acquisition of Brewin Dolphin, a discretionary U.K. & Ireland Wealth Management company for £1.6bn (C$2.62bn). The transaction values Brewin Dolphin at 2.8% of Assets Under Management. The transaction is expected to close by the end of September 2022. Brewin Dolphin has assets under management of £57bn, with a five-year compound annual growth rate of 10% and has consistently generated positive net flows.

Over the past 5-10 years, Royal 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. We believe that the bank is particularly well positioned for the themes we believe will favour bank stock performance in 2022. Consequently, we expect Royal Bank to be among the leaders in terms of Pre-Tax Pre-Provision earnings growth in 2022. Finally, return of capital also supports a positive outlook on the bank. Royal Bank repurchased ~9mm shares in the first quarter.

SUNCOR ENERGY INC.

Suncor's commitment to accelerated shareholder returns, combined with rapid deleveraging, demonstrates the resilience of its business model, in our view. We continue to see relative upside through a catchup trade (recall, it was a material underperformer in 2021, given multiple operational missteps).

TC ENERGY CORP.

The company increased the dividend 3.4% this quarter. We are updating our target price to primarily reflect industry tailwinds, improved cost of capital as well as access to capital, and the company's relatively unique position to support any accelerating exports to serve energy markets outside of North America, along with other factors. We also believe that the more constructive outlook should support sustained higher valuations than we had previously been using in our target valuation. As such, we have increased our target valuation to be more reflective of recent trading valuations and it results in our target price increasing by three dollars to $75.00.

TC Energy has a strong incumbency in prolific natural-gas-producing regions in North America, notably the Appalachian and Montney, combined with access to large markets, in our view. We believe that TC Energy's scale, energy infrastructure expertise, low-risk business model, and financial strength position the company well as societies transition to using lower-carbon energy sources over the long term.

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