Insights & Strategies

PRIVATE CLIENT SOLUTIONS

May 9, 2018

Inside this Issue

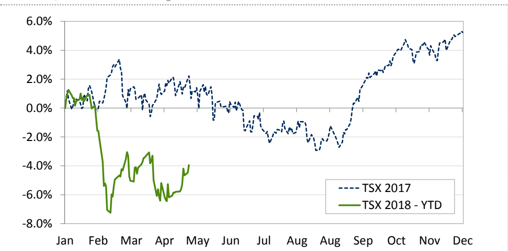
Catalysts for Canada

In 2017, the S&P/TSX hibernated for most of the spring and summer months, but by mid-summer, investors 'awoke' and pushed the index up 1,400 points in just four months. The year-end rally occurred as concerns faded about weak oil prices and the impact of a slowing Canadian housing market on the banks. Five months into 2018, we're dealing with a new set of headwinds that are holding back the S&P/TSX, most notably trade and pipelines.

The ongoing NAFTA talks are arguably one of the largest near-term overhangs on our market and the occasional midnight tweet has only served to intensify this level of uncertainty. We know investors loath uncertainty, which helps to explain why foreign investment in Canada has slumped to a 7 year low. Nonetheless, we strongly believe a NAFTA deal can be achieved this year. There will be some winners and losers, but the new rules of engagement will be a net positive for our market, allowing investors to properly assess the risks and allow capital to flow.

While capital may begin to flow, one thing that is not flowing is oil. The inability to push through the Trans Mountain pipeline expansion project is a clear message to foreign investors there are political risks in doing business in Canada. It must be fascinating for outsiders to watch as our government stymies growth of its single largest export and significant contributor to GDP. The lack of progress on building out new pipeline capacity has both long-term and immediate impacts for Canada. Due to existing pipeline constraints, this further depresses Canadian Western Select (WCS) oil prices. The heavy oil contract typically trades at a discount to its lighter oil peer (WTI); however, the discount has widened significantly over the past year as producers are unable to bring oil to market. Depressed WCS prices negatively impact Canadian energy producers, decrease employment opportunities, lessen demand for manufacturers supporting the energy sector, and also cut into government coffers. Surely the economic interests of the nation will prevail and the second largest overhang on our market will be removed. In our view, clearing these two issues will lead to a rally for the S&P/TSX similar to what was experienced in Q4/17, particularly in light of the market's more attractive valuation levels and significant rally in commodity price which has not yet been reflected in the equity market.

S&P/TSX Rally in the Cards...



...Valuation Looking More Attractive

Source: Bloomberg, Raymond James Ltd.

Please read domestic and foreign disclosure/risk information beginning on page 8.

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Digging into Canadian Sectors and Companies

Given Canada's improved valuation, particularly relative to the US, we dig into the sectors and individual companies that may present a value opportunity. In order to compare apples-to-apples, we use different valuation multiples for each sector: forward price-to-cash flow (P/CF) for commodity sectors, forward price-to-earnings (P/E) for financials, price-to-book (P/B) for real estate, and forward EV/EBITDA for the remaining sectors. Not surprisingly, the commodity sectors were both cheap relative to historical levels and to the S&P/TSX Composite Index (S&P/TSX), and financials also exhibit signs of value.

Canadian Value Sectors in Green

Multiple used	Sector	Discount/Premium Historical Valuation	Market Relative
EV/EBITDA	Discretionary	19%	-9%
EV/EBITDA	Staples	11%	-5%
P/CF	Energy	-5%	-20%
P/E	Financials	-6%	-24%
EV/EBITDA	Health Care	15%	42%
EV/EBITDA	Industrials	12%	-1%
EV/EBITDA	Info Tech	65%	52%
P/CF	Materials	-17%	-9%
P/B	Real Estate	*N/A*	-41%
EV/EBITDA	Telecom	16%	-23%
EV/EBITDA	Utilities	18%	13%

Source: Bloomberg, Raymond James Ltd.

Next we look at companies that trade both at a discount to their sector and to the market. In the table below, we highlight our highest conviction names.

Highest conviction value names

Ticker	Name	Sector	Valuation	Sector Discount	Market Discount
HBM	Hudbay Minerals Inc	Materials	3.7x	-54%	-59%
DGC	Detour Gold Corp	Materials	4.8x	-41%	-47%
ITP	Intertape Polymer Group Inc	Materials	6.9x	-16%	-25%
PEY	Peyto Exploration & Dev Corp	Energy	3.7x	-48%	-59%
WCP	Whitecap Resources Inc	Energy	5.3x	-27%	-42%
CNQ	Canadian Natural Resources	Energy	5.5x	-23%	-39%
TCW	Trican Well Service Ltd	Energy	7.0x	-4%	-24%
ERF	Enerplus Corp	Energy	5.7x	-21%	-37%
MFC	Manulife Financial Corp	Financials	9.3x	-22%	-40%
CIX	Ci Financial Corp	Financials	10.8x	-9%	-31%
SLF	Sun Life Financial Inc	Financials	11.5x	-4%	-27%
TD	Toronto-Dominion Bank	Financials	11.8x	-1%	-24%
RY	Royal Bank Of Canada	Financials	11.7x	-1%	-25%

Source: Bloomberg, Raymond James Ltd. Note: We use P/CF for energy and materials and P/E for financials.

Within materials, **Hudbay Minerals (HBM-T)** is our top value pick. HBM is a mining company engaged in the production of copper (60% of revenue), zinc (22%) and precious metals (11%), along with treatment and refining services (7%). We remain constructive on HBM given its exposure to copper and zinc, two attractive commodities with a solid supply and demand environment supporting current prices. Copper and zinc prices were up 32% and 30%, respectively, in 2017 following increased demand from China and the absence of investment in mine development and exploration. The company's assets are also well diversified with units in Peru, Manitoba and Arizona. HBM currently trades at a 53% discount to the materials sector on a forward price-to-cash flow (P/CF) basis and 57% discount to the S&P/TSX.

Within energy, we remain constructive on **Peyto Exploration & Development (PEY-T)**, which is engaged in the acquisition, exploration, development, and production of oil (9% of production) and natural gas (91%). With western Canadian spot natural gas prices (AECO) declining in 2017, PEY's share price followed along. PEY's share price came under more pressure due to the fact that it pays a generous dividend. We believe a dividend cut (we estimate a 50% probability) would likely be seen as a net positive by investors as it would remove the biggest question mark around the stock and be supportive of maintaining a strong balance sheet. We also believe that with a less volatile AECO price, yield, value and growth investors alike could come back to PEY with the share price recovering closer to fair value, which we believe corresponds to our analyst's target price of $16.00. The company trades at a 50% discount to the energy sector on a forward P/CF basis and 60% discount relative to the market.

As for financials, we like **Manulife Financial (MFC-T)**, one of Canada's largest insurance providers. MFC provides financial advice, insurance, and wealth/asset management services to its clients in the US (41% of revenue), Asia (37%) and Canada (22%). Since insurance companies perform well during a rising interest rate environment, we believe MFC could also be a contender as rates continue on their uptrend in the US and Canada. Additionally, the company has a new CEO (Roy Gori) set to make changes, with focus on improving the legacy business and balance sheet. The company trades at a 20% discount to the financials sector on a forward PE basis and 40% discount to the S&P/TSX.

Larbi Moumni, CFA
Equity Specialist

Jason Castelli, CFA
VP, Portfolio Manager

Investing at Home

While it feels comfortable to invest in your own back yard, finding the right investment should be process-based, and include taking a critical look at the market's overall efficiency, depth and breath. While Canada has a robust economy and provides one of the highest standards of living in the world, our economy is amazingly concentrated in a few sectors which can give passive investors a bumpy ride compared to some of its international peers. To this point, we feel Canada is an excellent market to utilize skilled active management to help smooth out the ride.

What are Canadian Equity Managers Thinking Right now?

This month we wanted to hear from some leading Canadian equity managers including the managers of some of our focus list funds to get their opinions on the Canadian marketplace and current opportunities. We asked each manager questions relating to the state of Canada's economy; below we share their paraphrased insights.

Alan Wicks - Manulife Dividend Income

Alan Wicks is a senior managing director and senior portfolio manager for Manulife Assent Management. Alan is the founder and team leader for the value equity team at Manulife which includes our focus list fund, the Dividend Income Fund.

- ***What is your strategic outlook for the Canadian economy in the next 6-12 months?***

The biggest driver of the Canadian economy at the moment is the sharp increase we've seen in bond yields which has led to a broad based correction in interest rate sensitive stocks. Overall, the Canadian economy is growing at about 2% a year with long-term inflation trends in line with expectations. In commodities, oil appears to be holding around $70 a barrel which will continue to be a positive driver for the Canadian economy. However, the rise in oil prices has not been accompanied by a traditionally strengthening loonie. A breakdown in this relationship is due in part to the expectation that the US will raise interest rates faster than here in Canada. That said, a slightly weaker Canadian dollar combined with sustained higher oil prices could provide an overall benefit to our economy.

- ***What do you think is the biggest headwind for the Canadian economy in the next 6-12 months?***

One of the biggest risks going forward is that interest rates continue to go up rapidly. Stephen Poloz, Governor of the Bank of Canada, has indicated the possibility of two further rate increases this year. Given that debt to disposable income ratios are at historically high levels, further rate increases this year would take more money out of Canadians' pockets to service their debt. Higher debt service levels would also translate into slower than expected economic growth as consumers would reduce their spending accordingly. There are also exogenous risks to the Canadian economy which include the constant threat of global trade wars (the United States and China) and the renegotiation of NAFTA.

- ***What are the biggest catalysts for the Canadian economy in the next 6-12 months and what opportunities do they provide?***

A major catalyst for the Canadian market place would be a combination of interest rates stabilizing at current levels, coupled with a reduction in the seemingly constant threat of global trade wars. Concerning NAFTA, a positive outcome for this agreement is looking more likely than even just 3 months ago. A positive outcome for NAFTA would provide the Canadian economy with positive stability going forward.

Opportunities within the Canadian market have been created as a result of the rapid pullback in interest rate sensitive companies, which has made their valuations more attractive. The fund has built up cash in the past year given the team's disciplined process of deploying cash when the risk/reward of stocks is attractive based upon their buy/sell targets. With recent market volatility, the fund has been able to strategically deploy some of this cash where they feel the risk/reward relationship for some of these companies has improved significantly.

Max Lemieux – Fidelity True North

Maxime Lemieux is the portfolio manager of Fidelity True North (the fund), a focus list member. Maxime joined Fidelity in 1996 as a research associate. He was promoted to analyst in 1998, and became PM of the fund in 2009.

- ***What is your strategic outlook for Canada in the next 6-12 months?***

Fidelity True North Fund focuses on bottom-up fundamental analysis and seeks to generate excess returns over full market cycles. As fundamentals take time to play out, the time horizon for investments is generally in the 3-5 year range. However, in the near term, investment opportunities can often present themselves, especially during periods of market dislocation. During the last quarter, markets faced geopolitical risks (e.g. trade discussions between the U.S. and China) which brought heightened volatility in the markets. These episodes of volatility tend to present buying opportunities in fundamentally-sound companies that have been discounted by the broad market sell-off. Fidelity True North Fund will generally capitalize on these events to increase existing holdings at cheaper valuations or, in some cases, initiate positions in companies that were previously too expensive.

- ***What do you think is the biggest headwind for the Canadian economy (6-12 months)?***

Not necessarily in the next 6-12 months, but we're beginning to see risk coming back to markets, as evidenced by the heightened volatility in the last quarter. With interest rates continuing to trend higher and spreads on corporate bonds increasing, this may be an indication of the start of the late-cycle. As with all market events, the timing can't be predicted but the indications are enough to warrant caution and to focus on companies with more resilient balance sheets and that have not undertaken too much leverage. With elevated housing prices, a stretched credit cycle and overleveraged consumers, Canadian banks may face challenges in a recession. Fidelity True North Fund's largest underweight position is in banks.

- ***What do you think is the best opportunity within the Canadian market right now?***

Fidelity True North Fund is currently favouring food & staples retailers and software & services firms. Top holdings among food & staples retailers include Alimentation Couche-Tard, Loblaw and Metro. In general, the Canadian grocers are well-managed and generate consistent cash flows. In addition, these businesses tend to be less cyclical, meaning they generate steady revenues regardless of the economic conditions. Top holdings in software & services include CGI and Constellation Software. These companies are favoured for their robust fundamentals and positive earnings growth trajectories.

Tim Caulfield - Franklin Bissett Canadian Equity Fund

Tim Caulfield is the director of equity research at Franklin Bissett Investment Management and is co-lead manager of the Franklin Bissett Canadian Equity program, Franklin Bissett Canadian Equity Fund and Franklin Bissett Monthly Income and Growth Fund. Mr. Caulfield's analyst responsibilities include coverage of the financial sector.

- ***What is your strategic outlook for Canada in the next 6-12 months?***

The outlook over the short term is fairly unpredictable with a myriad of factors that could have significant impacts on Canadian equity markets, including geopolitical tensions, trade wars and NAFTA outcomes. Despite being in the 10th year of the current bull market, the key here is to focus on valuations which aren't where they were in 2009. It's important to also consider the solid economic backdrop, with global synchronized growth. Looking closer at company specific conditions, investors have raised their expectations for underlying business fundamentals on the back of recent strength, making it more difficult for businesses to meet those expectations.

- ***What do you think is the biggest headwind for the Canadian economy in the next 6-12 months?***

The outcome of NAFTA negotiations will either serve as the largest catalyst or headwind for the Canadian economy. Ultimately it will be critical to have positive trade resolutions to ensure we keep the Canadian economy healthy. Should NAFTA become a headwind for Canada, it could weaken the Canadian dollar, which would have an offsetting impact on the domestic economy and equities.

- ***What are the biggest catalysts for the Canadian economy in the next 6-12 months and what opportunities do they provide?***

We're seeing dislocations in energy space dynamics with the underlying commodities trending higher while political issues (related to pipelines) weigh on the sector. We view the political influence as being transitory which is leading to some excellent opportunities within the space.

Spencer Barnes, MSc.
Mutual Fund & ETF Specialist

Is It Time to Tap the Maple Tree?

Years ago, US corporations decided to "tap" into the Canadian fixed income market by issuing a variety of corporate bonds trading in Canadian dollars. Fondly called Maples, these issuances allow Canadians to invest in foreign companies without having to worry about exchange rates when receiving coupons or the final maturity payment.

In the past, this was primarily done by American financial names, but when things went bad for these companies (specifically during the financial crisis), they abruptly stopped issuing debt in Canada because there was no real appetite. That was years ago and US corporations are now slowly creeping back into our market and are having a lot of success. These include big US companies like Mondelez which brought a new issue in March of this year, and Walt Disney which issued in October of last year. Just a few weeks ago, Bank of America brought two new issues which totaled $1.5 billion. This is the largest new issue Maple deal since last year when Apple entered the Canadian market. If you prefer to invest in a Canadian-domiciled company but want international exposure, you could buy a name like Molson Coors. It's a well-known name in Canada and receives a lot of revenue from the US market and abroad. If you would like fixed income exposure to US companies but want to avoid exchange rate hassles by being paid in Canadian dollars, then you may want to look at the Maple market. We have provided a list of Maple bonds below.

U.S Companies with Canadian Pay Issues (Maples)

Issuer	Coupon Rate	Maturity Date	Offering Price	Semi-Annual	Annual Equiv.	Debt Rating
AT&T Inc.	3.825%	25-Nov-2020	$103.20	2.530%	2.540%	BBB+
Citigroup Inc.	3.390%	18-Nov-2021	$102.10	2.760%	2.780%	BBB+
McDonald's Corp.	3.125%	04-Mar-2025	$99.80	3.160%	3.180%	BBB+
Mondelez Int'l Inc.	3.250%	07-Mar-2025	$99.50	3.330%	3.360%	BBB
Morgan Stanley	3.125%	05-Aug-2021	$101.15	2.750%	2.770%	BBB+
Penske Truck Leas	2.950%	12-Jun-2020	$100.95	2.480%	2.500%	BBB
PepsiCo Inc.	2.150%	06-May-2024	$96.40	2.805%	2.820%	A+
UPS Inc.	2.125%	21-May-2024	$95.85	2.775%	2.790%	A+
Walt Disney Co.	2.758%	07-Oct-2024	$99.15	2.900%	2.920%	A+

Source: Bloomberg, Raymond James Ltd. Priced on May 1, 2018

Harvey Libby
Fixed Income & Foreign Exchange

Commodities & Structured Notes

Structured notes can be a great way to play commodities and potentially enhance returns. They can be fully customized to meet an investor's specific view on the direction of a chosen commodity while taking into account the investor's risk/return objectives.

An example of a note that could be designed to benefit from a neutral to bullish view on a commodity is the booster note. This note provides the opportunity for an investor to earn a 'boosted' return based on the performance of the chosen commodity, while having a pre-selected level of downside protection.

If looking at oil as the preferred commodity exposure, a possible proxy is The United States Oil Fund (symbol USO), an exchange traded fund (ETF) that attempts to track the price of West Texas Intermediate Light Sweet Crude Oil.

Below we look at the terms and indicative pricing of a short-term booster note tied to the USO:

Note Terms:

- Booster Note Term: 1 year
- Underlying: United States Oil Fund (USO)
- Note Currency: CAD
- Downside Protection: None (1 for 1 downside)
- Boost Level: 16% (capped)

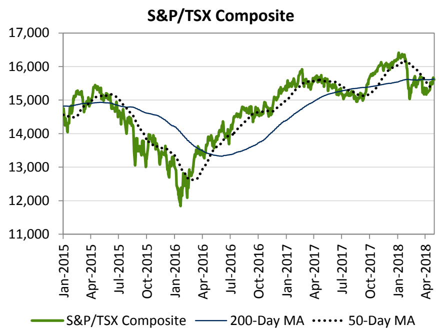
Potential Payoff Scenarios:

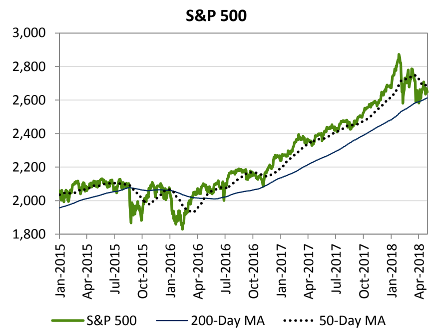
USO Performance Until Maturity	Investor Receives
+1%	Principal + 16% return
+10%	Principal + 16% return
+25%	Principal + 16% return
-10%	90% of invested Principal

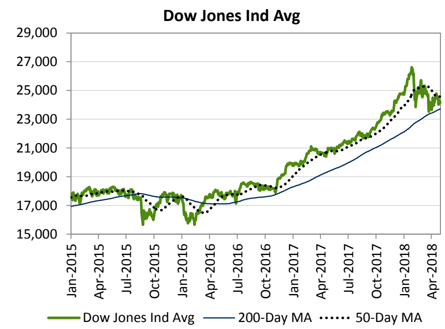
Christopher Cafley, MBA
Structured Notes & Solutions

Charts of Interest

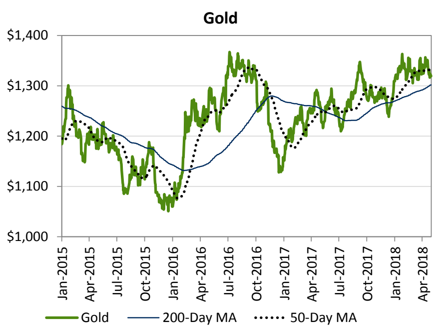
Markets

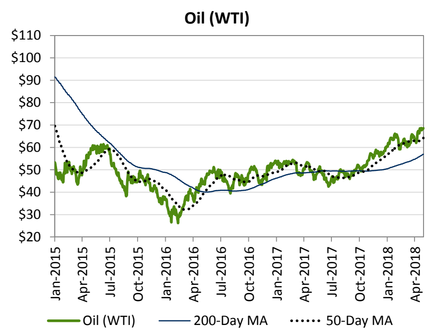


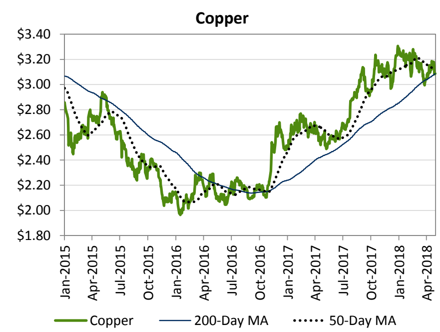




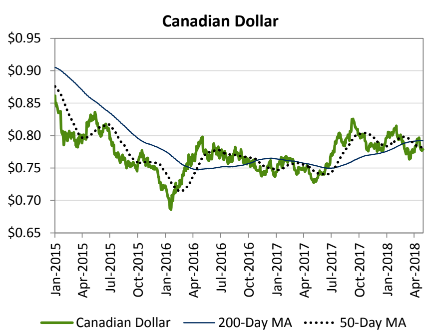
Commodities

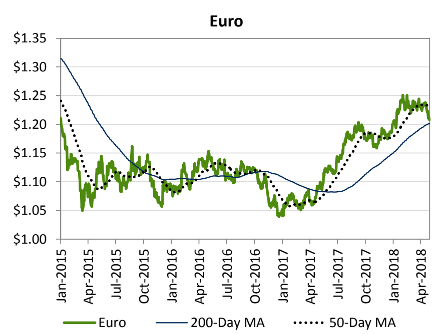


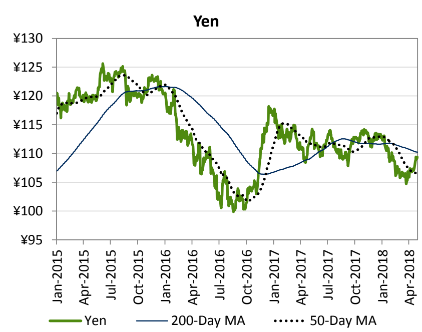




Currencies



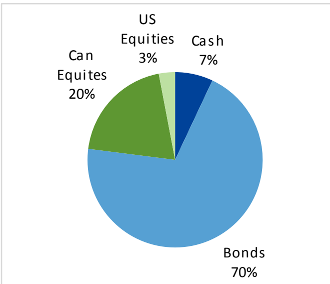


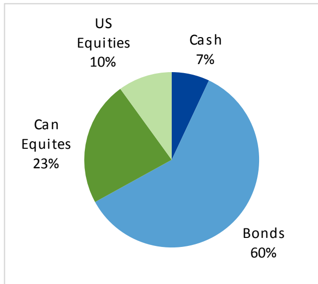


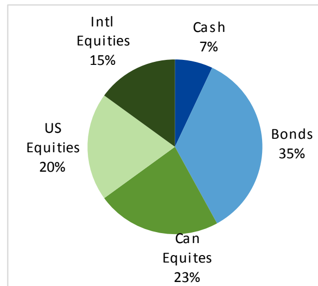
Source: Bloomberg, Raymond James Ltd. Performance as at April 30, 2018.

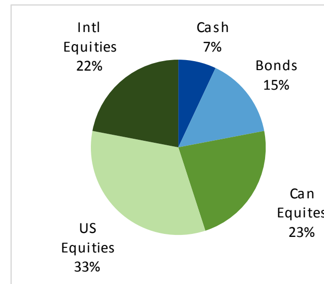
Investor Profiles and Asset Class Weightings

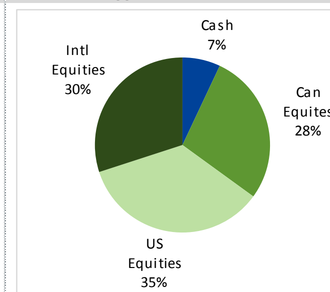
Recommended Asset Allocation











	Capital Preservation	Conservative	Moderate	Growth	Aggressive Growth
Cash	7%	7%	7%	7%	7%
Bonds	70%	60%	35%	15%	0%
Can Equities	20%	23%	23%	23%	28%
US Equities	3%	10%	20%	33%	35%
Intl Equities	0%	0%	15%	22%	30%
Tactical Asset Mix (Bonds include cash)					
Bonds | Equities	77 | 23	67 | 33	42 | 58	22 | 78	7 | 93
Strategic Asset Mix (Bonds include cash)					
Bonds | Equities	80 | 20	70 | 30	50 | 50	30 | 70	10 | 90
Asset Ranges					
Cash	0-20	0-20	0-20	0-20	0-20
Bonds	60-100	50-90	20-70	10-50	0-30
Equities	0-30	10-50	30-75	50-90	70-100
Description					
	May be appropriate for investors with long-term income distribution needs who are sensitive to short-term losses. The equity portion of this portfolio generates capital appreciation, which is appropriate for investors who are sensitive to the effects of market fluctuation but need to sustain purchasing power. This portfolio, which invests primarily in fixed-income securities, seeks to keep investors ahead of the effects of inflation with an eye toward maintaining principal stability.	May be appropriate for investors with intermediate-term time horizons who are sensitive to short-term losses yet want to participate in the long-term growth of financial markets. The portfolio, which fixed-income securities tend to make up the largest proportion of holdings, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. The portfolio has characteristics that may deliver returns lower than that of the broader market with lower levels of risk and volatility.	May be appropriate for investors seeking a balance between capital preservation and capital growth. This portfolio, which is a split between fixed-income securities and equities, seeks to keep investors well ahead of the effects of inflation with an eye toward maintaining principal stability. With roughly half of the portfolio invested in a diversified mix of Canadian and international equities, investors should be comfortable with moderate fluctuations in the portfolios.	May be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which has a higher weighting in equities, seeks to keep investors well ahead of the effects of inflation with principal stability as a secondary consideration.	May be appropriate for investors with long-term time horizons who are not sensitive to short-term losses and want to participate in the long-term growth of the financial markets. This portfolio, which is primarily invested in equities, seeks to keep investors well ahead of the effects of inflation with little regard for maintaining principal stability. The portfolio may deliver returns comparable to those of the broader equity market with similar levels of risk and volatility.

Important Investor Disclosures

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