Weekly Trends

PRIVATE CLIENT SOLUTIONS

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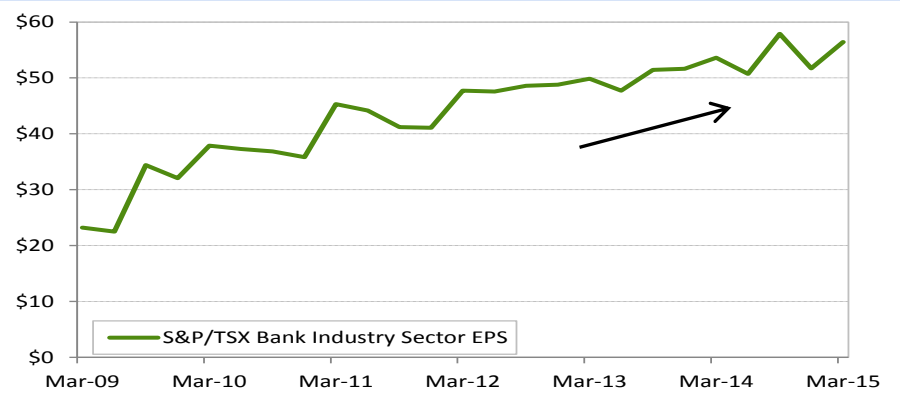
Canadian Banks Continue To Deliver Despite Headwinds

- The Big Six Canadian banks reported Q2/15 earnings last week, with results coming in above analysts' expectations. Overall, the Big Six banks delivered 6% Y/Y EPS growth in the quarter. Royal Bank and National Bank delivered the highest earnings growth of 9.5% Y/Y.
- Results were driven by solid retail banking profits (+5% Y/Y), wealth management, and capital markets (+14% Y/Y).
- Bank of Montreal, CIBC and National Bank each raised their quarterly dividend. The Big Six currently yield 4.2% on average, with CIBC offering the highest yield at 4.6% and TD the lowest at 3.8%.
- Overall, it was a positive quarter for the Canadian banks which delivered solid earnings against a difficult economic backdrop. For us, this reinforces our bullish long-term view of the Canadian banks and why we view them as core holdings.
- Within the financials sector our preferred names are **Manulife Financial, Element Financial** and **Royal Bank,** which we believe are positioned to outperform the sector.

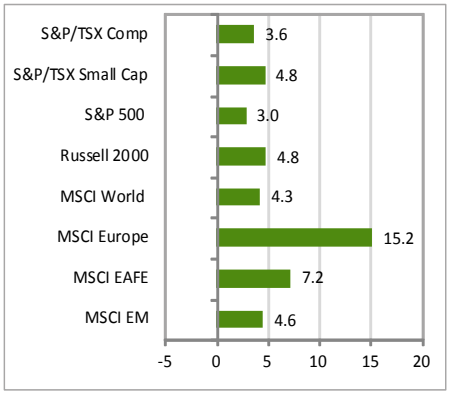
Chart of the Week

Canadian Banks Continue To Deliver Consistent Earnings Growth



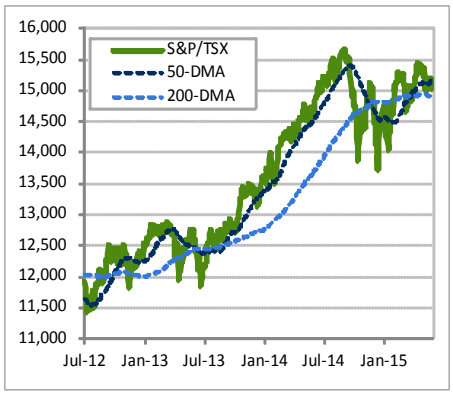
Source: Bloomberg, Raymond James Ltd.

Equity Market YTD Returns (%)



Canadian Sector	TSX Weight	Recommendation
Consumer Discretionary	6.7	Overweight
Consumer Staples	3.6	Market weight
Energy	20.6	Market weight
Financials	34.7	Market weight
Health Care	6.1	Market weight
Industrials	7.9	Overweight
Information Technology	2.4	Overweight
Materials	11.1	Underweight
Telecom	4.8	Market weight
Utilities	2.1	Underweight

Technical Considerations	Level	Reading
S&P/TSX Composite	15,166.4	
50-DMA	15,169.4	Downtrend
200-DMA	14,913.4	Uptrend
RSI (14-day)	48.1	Neutral



Source: Bloomberg, Raymond James Ltd.

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Canadian Bank Earnings Recap

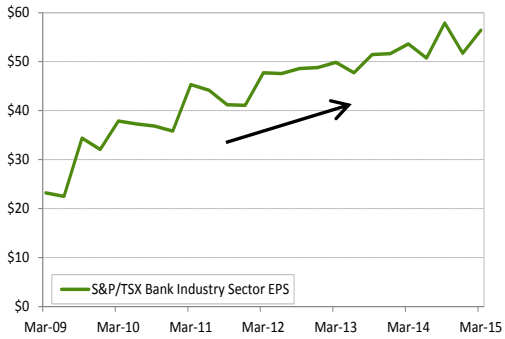
The Big Six Canadian banks reported Q2/15 earnings last week, with results coming in above analysts' expectations. In this week's publication we summarize the highlights from the Q2 earnings season and provide our preferred picks in the sector.

Despite the challenging macro backdrop (e.g., weak Q1 economic growth, low energy prices, overleveraged consumer balance sheets) Canadian banks continue to defy skeptics, delivering consistent and solid earnings growth. Overall, the Big Six delivered 6% Y/Y EPS growth in the quarter. Royal Bank and National Bank delivered the highest earnings growth of 9.5% Y/Y. CIBC, Toronto-Dominion Bank and Bank of Montreal were in the middle of the pack with roughly 5% growth. The Bank of Nova Scotia delivered the weakest growth of 2.1%, with their foreign operations continuing to weigh on results. Other positives in the quarter include:

- **Solid Retail Profits On Improving Loan Growth.** The biggest concern heading into the quarter was around the retail divisions given the weakness in energy prices and the slowdown in the Canadian economy. However, retail banking came through with 5% Y/Y growth, which was helped by loan growth of 4.6% Y/Y. Royal Bank, National Bank and the Bank of Nova Scotia delivered the strongest retail gains while Bank of Montreal the weakest.
- **Solid Wealth Management.** While not across the board, wealth management was broadly up with Bank of Montreal, CIBC and National Bank posting solid Y/Y growth. Royal Bank's wealth unit disappointed with a 3% decline in Y/Y profit. With our expectations for slower growth in lending and retail in the coming quarters, our preference is for wealth management, so it is encouraging to see positive momentum in these areas.
- **Strong Capital Markets Results.** The big driver of growth this quarter came from the capital markets divisions. Solid trading and underwriting activity helped Royal Bank, CIBC, National Bank and Toronto-Dominion Bank deliver strong gains from their wholesale/capital markets divisions.
- **Some Dividend Increases.** Bank of Montreal, CIBC and National Bank each raised their quarterly dividend, while the remaining banks left their dividends unchanged. The Big Six banks currently yield 4.2% on average, with CIBC offering the highest yield at 4.6% and TD the lowest at 3.8%.

Overall, it was a solid quarter for the Canadian banks which delivered strong earnings against a difficult economic backdrop. For us, this reinforces our bullish long-term view of Canadian banks and why we view them as core holdings.

Canadian Banks Continue To Deliver Steady Earnings



Source: Bloomberg, Raymond James Ltd.

Big Six Canadian Banks Deliver Solid Q2/15 Earnings Results

Company	Ticker	Quarterly EPS	EPS Surprise	Y/Y EPS Growth	Quarterly Dividend	Dividend Yield (%)	Dividend Change
Toronto-Dominion Bank	TD-CA	$1.14	$0.03	4.6%	$0.51	3.77	No change
Bank of Montreal	BMO-CA	$1.71	$0.05	4.9%	$0.80	4.32	$0.02 to $0.82
Canadian Imperial Bank of Commerce	CM-CA	$2.28	$0.04	5.1%	$1.06	4.59	$0.03 to $1.09
Bank of Nova Scotia	BNS-CA	$1.43	$0.04	2.1%	$0.68	4.16	No change
Royal Bank of Canada	RY-CA	$1.61	$0.02	9.5%	$0.77	3.90	No change
National Bank of Canada	NA-CA	$1.15	$0.03	9.5%	$0.50	4.29	$0.02 to $0.52

Source: Bloomberg, Raymond James Ltd.

Preferred Financial Picks

While we view Canadian banks as core holdings, we downgraded the financials sector to market weight earlier this year given our expectation of muted returns. We expect valuations to remain largely unchanged this year, with returns being driven by EPS growth (mid-single digit in 2015) and dividends. We continue to favour other sectors, notably the consumer discretionary and information technology sectors, which have nicely outperformed the market year-to-date by over 5%. However, within the financials sector our preferred names are **Manulife Financial, Element Financial** and **Royal Bank**. Below we outline our bullish thesis on each:

Manulife Financial (MFC-T)

- Lifeco's are strongly correlated with bond yields, which we expect to rise further over the next few years. This should provide a tailwind for MFC and the life insurance industry.
- The earnings outlook for MFC looks solid with consensus forecasting a 20% rise in 2015 and 17% in 2016.
- MFC currently pays a quarterly $0.17/share dividend, equating to an attractive 2.9% dividend yield. Further, we see the potential for additional dividend increases over the next few years.
- From a technical perspective, MFC recently broke above an important technical resistance level of $22.50.

Element Financial (EFN-T)

- EFN is a financial leasing company which currently is said to be in discussions to acquire General Electric's vehicle fleet-management business. The acquisition, should it be completed, would provide another leg of growth for Element which already is positioned for solid growth. Consensus estimates are for 30%+ growth over the next few years.
- Despite the strong earnings growth potential the shares trade at a reasonable 15x 2016 EPS estimates.
- EFN's technical profile is bullish with the stock in an uptrend and above its rising 50-day moving average (MA).

Royal Bank (RY-T)

- RY remains our top pick within the Big Six given its best-in-class management team and franchise.
- Additionally, RBC's wealth management division and significant US exposure provide ballast to the retail business which we expect to slow in the coming quarters.

Conclusion

So there you have it. Canadian banks delivered another solid quarter capturing the benefits of their large diversified businesses and their ability to navigate in challenging economic environments. While we believe the financials sector will deliver "market" returns this year, we see the potential for **Manulife Financial, Element Financial** and **Royal Bank** to outperform and deliver solid returns over the next few years.

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