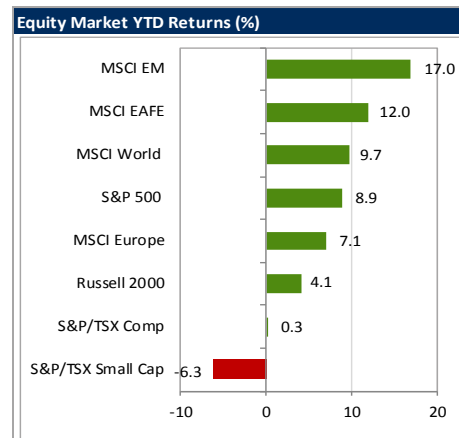


## Cleanup in Aisle Four

The S&P/TSX slipped below its 200-day moving average (MA) last week. On Monday, the index spent the day seesawing above and below the MA, but a further drop in WTI prices ensured the TSX's fate for the week. Oil prices entered bear market territory on Tuesday, as it fell 21% from its high for the year. This marks the first bear market in 10 months, but is preceded by five 20%+ corrections over the last 7 years. Despite the price action, there was one positive to focus on, that being OPEC and non-OPEC producers' compliance with the production-cut deal reached 106% in May, the highest since the agreement.

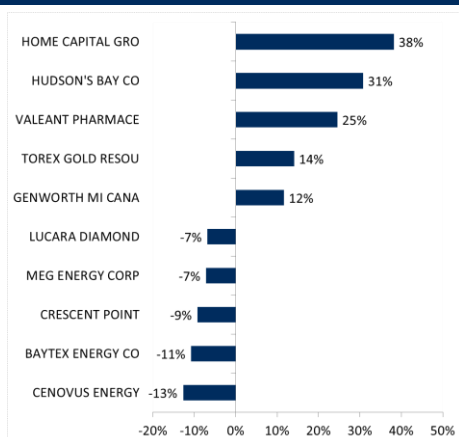
On the Canadian economic front, Canadian retail sales and CPI were the key items to watch this week given economists have become more aggressive in their BoC rate hike assumptions. Unfortunately, the data offered little clarity as retail sales rose an impressive 0.8% mom in April, well above the consensus view of 0.4% and inflation data was weaker than expected. The lack of inflationary pressure is putting both the BoC and US Fed in a difficult situation as they attempt to normalize monetary policy given their focus on price stability. Throughout the week a number of Fed officials expressed skepticism about a pickup in US inflation. On Tuesday, Chicago Fed President Evans said global forces, not just specific one-off reasons, could be behind recent inflation retreat. Evans pointed to disruptive technologies as one factor that is resulting in deflationary pressures (Amazon/Whole Foods deal could fall into this category). Dallas Fed President Kaplan expressed similar concerns and Vice Chair Fischer and Boston Fed President Rosengren suggested they are less concerned about raising rates too fast or too high than about keeping them low too long. In terms of each Fed officials leaning, Evans can be put in the dovish camp, Kaplan centrist-hawkish and Rosengren hawkish.



Canadian Sectors	Weight	Recommendation
Consumer Discretionary	5.4	Market weight
Consumer Staples	3.8	Market weight
Energy	19.9	Overweight
Financials	34.1	Overweight
Health Care	0.7	Underweight
Industrials	9.6	Overweight
Technology	3.4	Market weight
Materials	11.7	Market weight
Communications	4.9	Underweight
Utilities	3.3	Market weight
Real Estate	3.0	Market weight

Technical Considerations	Level	Target
S&P/TSX Composite	15,328	16,500

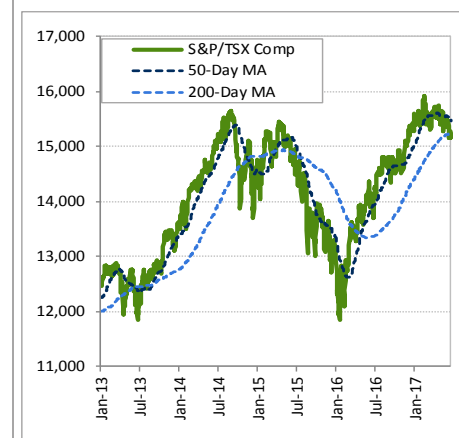
### S&P/TSX Top 5 Gainers/Laggards\*



### S&P/TSX Market Internals

Weekly Advance	65	26%
Weekly Decline	182	73%
Advance-Decline	-117	
New 52 wk high	6	2%
New 52 wk low	8	3%
No. Stocks Above 50-d	111	44%
No. Stocks Above 200-d	128	51%
Arms Weekly Index	0.99	Neutral
RSI (14-day)	42.4	Neutral
50-DMA	15,466	Downtrend
200-DMA	15,254	Uptrend

Source: Bloomberg, Raymond James Ltd; \* 5-day price return



Source: Bloomberg, Raymond James Ltd.

Sectors are based on Bloomberg classifications

Please read domestic and foreign disclosure/risk information beginning on page 5

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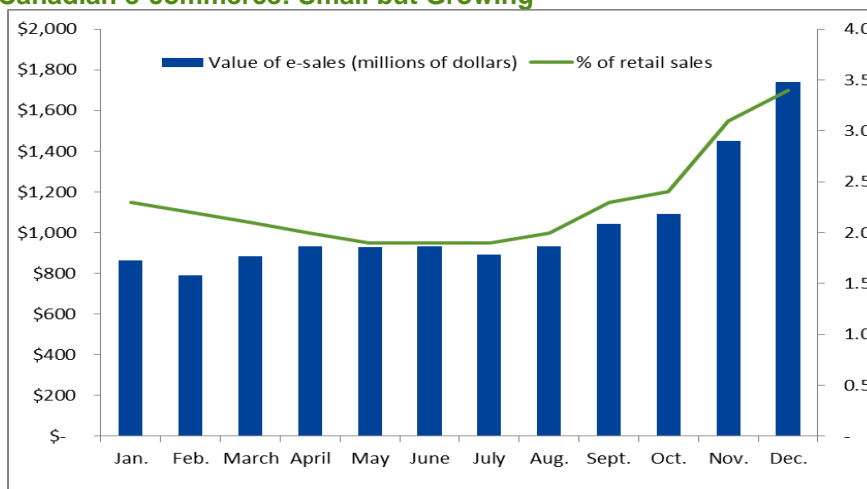
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## AMZN/WFM & Canadian Grocers

Last week, Amazon (AMZN-US) disrupted the grocery business with its announced acquisition of Whole Foods (WFM-US). Former Wal-Mart (WMT-US) CEO William Simon described the deal as transformational and said "Wal-Mart needs to watch their flank". However, it will be interesting to see if some of the US grocers, particularly Kroger (KR-US), will step up to make a retaliatory bid for WFM in the hopes of keeping AMZN from moving aggressively into the space. Given WFM shares are trading about a dollar rich compared to the US\$42/sh offer price, the market is speculating that a competing bid may be in the works. At its core, the grocery shopping experience hasn't changed much over the years. Grocers have done an admirable job to improve the overall shopping experience, but at the end of the day you're still placing items in a cart, pushing it around for ~40 minutes and placing those same items on a conveyer belt to have them scanned at checkout. This process reeks of inefficiencies, although we have to admit at times grocery shopping can be an enjoyable experience, inefficiencies and all. If AMZN is successful in winning over WFM shareholders, the transaction will likely be a significant turning point for the industry with important long-term implications. However, from a Canadian grocer perspective we see limited near-term impact for the following reasons:

- AMZN will certainly be a disruptive force, but change will not come overnight and it will allow those that see the change coming enough time to adjust their strategy in order to compete. An accelerated investment in an online offering will require additional capex and may disproportionately impact the smaller national chains. This would suggest Loblaw (L-T) is the best suited incumbent to deal with the potential threat.
- The Canadian consumer's adoption of online shopping has grown at a relatively slow pace compared to its US counterparts. US e-commerce sales represent ~8.5% of total sales versus ~3.4% in Canada, according to Statistics Canada. According to Nielsen, online sales are forecast to grow at a 20% CAGR over the next four years and will represent ~8.5% of total sales by 2022.

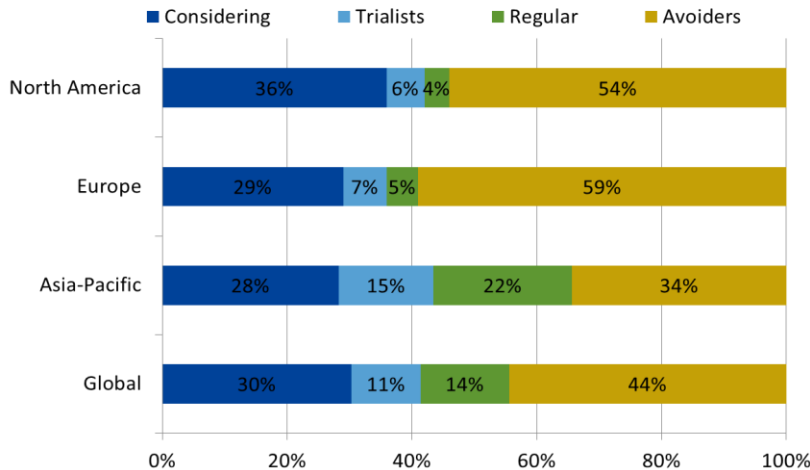
### Canadian e-commerce: Small but Growing



Source: Statistics Canada, Raymond James Ltd.

- According to a Nielsen survey, attitudes towards buying fresh and household groceries online point to a certain level of anxiety and/or apprehension. Among North American respondents, the majority actively *avoid* purchasing groceries online, while 36% are considering shopping online for groceries. Just 4% of respondents said they regularly shop online for groceries, significantly below the global level of 14%.

### Attitudes Towards Buying Groceries Online



Source: Nielsen, Raymond James Ltd.

- Another factor that we believe will limit the near-term impact on Canadian grocers is that WFM's footprint in the Canadian market is relatively small. Taking a quick visit to WFM Canada's website reveals just 13 stores compared to Loblaw boasting just under 1,100 stores across various banners. The Canadian grocery landscape is controlled by very few national retailers, which will make it difficult for WFM to draw customers away from their usual brand. Further, AMZN has yet to roll out a fresh food offering in Canada, choosing to only sell packaged goods online. A fresh food online offering is therefore unlikely to occur in the near term. However, in the event of an e-commerce grocery offering, its impact should be inconsequential given the current penetration rate of online grocery at just 0.7% of total sales, according to Nielsen. Even with this category anticipated to grow at a 20% CAGR over the next 4 years, it will represent less than 2% of total sales by 2022.
- The most likely scenario is that AMZN will build, test and refine its strategy in the US before moving into other markets. For investors, it will be key to watch how AMZN/WFM's offering evolves to assess the potential impact on the Canadian grocery industry. But remember Walmart's entry into Canada? How about Target? Each time Canadian retail stocks sold off, but eventually overcame the concerns regarding the new entrants. The AMZN acquisition of WFM has caused a similar overreaction sending grocery operators down as much as 4%, presenting a buying opportunity for long-term investors.

The three main Canadian grocers now trade at an average 15.4x next year's earnings and offer upside of 11.5% to the consensus target price. Given Loblaw's dominant position, the benefits it is realizing from the Shopper's Drug Mart acquisition and the implementation of SAP/IT integration on profitability, we

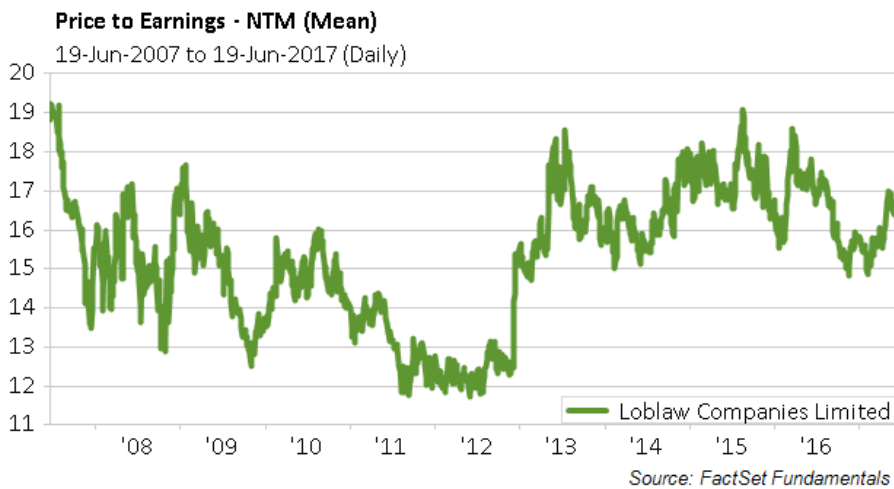
consider the company a core Canadian holding. Shares currently trade at 16.3x this year's earnings, in line with its 10 year historical average.

### Canadian Grocers Comps

Company Name	Ticker	Last	Yld	Current	Next Yr	Consensus	Upside
				Yr PE	PE	Target	to Target
Loblaw Companies Limited	L-CA	\$ 72.98	1.5%	16.3x	15.0x	\$ 82.38	12.9%
Metro Inc.	MRU-CA	\$ 43.19	1.5%	16.5x	15.1x	\$ 50.33	16.5%
Empire Co. Ltd. Class A	EMP.A-CA	\$ 19.12	2.1%	29.6x	16.0x	\$ 20.14	5.3%
<b>Average</b>			<b>1.7%</b>	<b>20.8x</b>	<b>15.4x</b>		<b>11.6%</b>

Source: Factset, Raymond James Ltd.

### Loblaw (L-T) – PE Historical Chart



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