Portfolio Strategy

PRIVATE CLIENT SOLUTIONS

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Canadian Equities: Speed Bumps on the Road to Recovery!

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Our view: The S&P/TSX index has posted a strong first 8 months to the year with the index up ~19%. While this has been an impressive achievement, we believe there is still ample fuel left in the tank. We view the Canadian equity markets (S&P/TSX index) as attractive on both an absolute and relative basis (including on valuation and earnings growth) and believe that once we move past recent headwinds (e.g., Canadian elections, Delta variant, supply chain/labour disruptions, etc.), the S&P/TSX index will be in a good position to outperform major indices. We suggest investors use periods of volatility to add to their core positions.

Recent macro releases show signs of slowing but several exogenous factors at play. During the past several months, we have noticed signs that the Canadian economy was slowing. This has been clear in recent economic releases, including: **1)** August PMIs; **2)** Q2 real GDP; **3)** August CFIB Business Barometer index; and **4)** June/July (flash) retail sales. However, while we acknowledge the weakness, most of the softness was caused by factors which we expect should resolve as we head into 2022. This includes the uncertainty of the Delta variant and the potential for governments to impose new lockdowns/restrictions, ongoing supply chain and labour shortages, and cooling effects in some variables (e.g., housing starts/housing activity). We believe that despite the near-term softness, the economy remains in a sound position which supports our positive outlook for Canadian equities over the next 12-18 months.

Canadian Federal election – A tight race likely to end in a minority government. It was brave for the Trudeau Liberals to call a snap election. Hoping to capitalize on their COVID-19 policies to form a majority government has proven to be a bit more challenging than expected, notwithstanding that the election has coincided with the fourth wave of the pandemic. While we will avoid a deeper dive into the Liberals' COVID-19 policies or the platforms for each of the respective parties on the ballot, we believe that the unprecedented fiscal response launched over the past year and a half has been critical for the pace and strength of the rebound we have seen in the economy and in Canadian equity markets since the lows of the pandemic. While current opinion polls suggest a minority government (either Conservative or Liberal) as the most likely scenario, and thus a non-event for equity, bonds and FX markets, we advise investors to pay close attention to each party's stance on fiscal policy measures, as these will affect the economy and equity markets in the future.

Speed bumps not likely to derail the underlying momentum in the S&P/TSX index. We remain constructive on Canadian equities (S&P/TSX index) over the next 12-18 months, with a total return expectation of ~15%. This return expectation is based on our bottom-up EPS forecast of $1490 (vs. consensus at $1430, a forward P/E multiple of 15.5x), in line with history but a discount to the S&P 500 index, and a dividend yield of 2.6%. We continue to recommend an overweight allocation to sectors/industries that are more cyclically oriented, as we believe these perform better during the early/mid stages of an economic cycle.

Please read domestic and foreign disclosure/risk information beginning on page 9

Economic Indicators: A Mixed Bag, But Still Positive

August Canada Manufacturing PMI Hits Fourth-Highest in History

It was a strong August for Canadian manufacturers, with a robust pickup in manufacturing conditions. The headline seasonally adjusted IHS Markit Canada Manufacturing Purchasing Managers' Index® (PMI®) came in at 57.2 in August, up from 56.2 in July. The latest reading extended the period of growth to 14 successive months, with the latest expansion representing the fourth quickest in the near 11-year history of the survey. Stronger uptick in output, new orders, exports, and purchases underpinned growth and supported optimism following the release.

The PMI is an index of the prevailing direction of economic trends in the manufacturing and service sectors. It consists of a diffusion index that summarizes whether market conditions, as viewed by purchasing managers, are expanding (above 50), staying the same (50), or contracting (below 50). The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease.

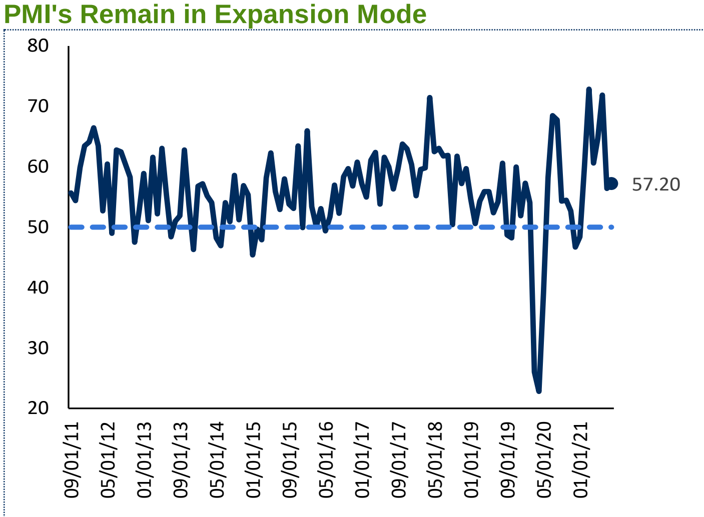
Key takeaways from the release:

- Delivery challenges, congestion in ports, material shortages, and delays were again mentioned as headwinds and the cause for longer lead times.
- Firms reported greater demand, including higher sales to both international and domestic markets.
- Production volumes at Canadian manufacturers rose sharply; around 23% of firms increased production in August compared to July, while 11% reported declines.
- Firms mentioned a general improvement in customer demand, with a notable increase in sales to US and European customers; however this increase in demand led to input price inflation which rose to a new series high.
- Higher output requirements and rising backlogs resulted in an increase in hiring in August, bringing the current period of job creation to 14 months; several firms found it difficult to source skilled replacements.

While we remain cautions against placing too much weight on any single economic data point, we do believe the longer-term trend for specific economic variables can provide helpful insights on the economy. The Canadian Manufacturing PMI is a leading indicator and for the last 14 months the measure has remained in growth territory, a positive sign for the general health of the economy.

Leading vs. Lagging vs. Coincident Indicators: Leading indicators are considered to point toward future events. Lagging indicators are seen as confirming a pattern that is in progress. Coincident indicators occur in real-time and clarify the state of the economy.

PMI's Remain in Expansion Mode



Source: FactSet, Statistics Canada

Q2/2021 Real GDP Contracts for the First Time Since Q2/2020

We were a bit surprised to see a contraction in Canadian real GDP in Q2 2021 (the first contraction since Q2 2020) by -1.1% on a seasonally adjusted basis. This compared to consensus calling for an increase of +2.5%. The decline left GDP around 2% below pre-pandemic (2019-Q4) levels during a quarter where many were expecting would mark a return to pre-pandemic activity for the economy. That is now likely to be pushed forward to 2022. The miss was primarily driven by a meaningful drop in residential investment (-12.4% Q/Q; +42.3% Y/Y), and exports (-15.0% Q/Q; +12.0% Y/Y).

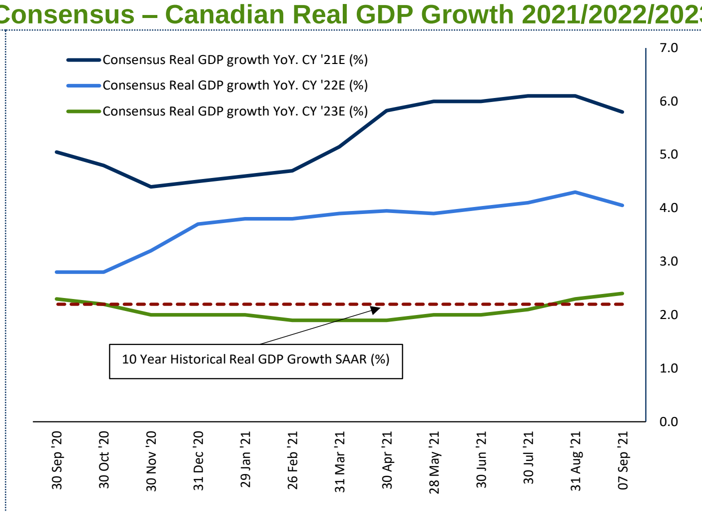
Housing, which has emerged as a key contributor to economic activities and capital stock since Q3/2020, declined due to lower home resale activity in the quarter. Exports were hurt by supply chain disruptions, in particular the semiconductor shortage, which had an adverse effect on the auto sector. However, on a positive note, real disposable incomes rose again in Q2 (+6.1% Q/Q), while household spending remained flat during the period, leaving the savings rate at 14.2%. The savings rate in Q2 was the highest it's been since Q2 2020, and continues to support our view that sufficient pent-up demand remains on the sidelines across Canadian households.

Following the softer real GDP print, we have seen Street consensus numbers revised lower from a median growth of ~6% for 2021, and 4.2% for 2022, prior to the latest print, to ~5.8% and ~4.0% for 2021 and 2022, respectively. While growth could come in lower than consensus due to the uncertainty of the Delta variant, ongoing supply chain challenges, and the shift in consumption patterns from goods to services, we remain optimistic on the outlook as real GDP growth still remains well above trend by 1.5-2x historical levels (10-year real GDP growth median: ~2.2%).

As expected following the weak Q2 GDP print, the Bank of Canada (BoC) kept its target overnight rate at the effective lower bound of 0.25%. This was reinforced and supplemented by the Bank's quantitative easing (QE) program which was also maintained at a target pace of $2 billion per week. The BoC also noted that the GDP contraction in the second quarter was weaker than anticipated in the Bank's July Monetary Policy Report (MPR). We believe this and other factors are likely to impact the pace of the BoC's tapering plans moving forward – a positive for equity markets.

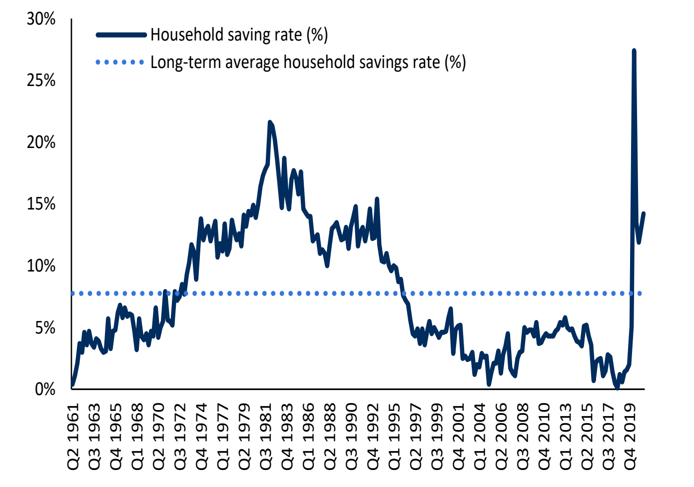
Canadian Q2/2021 Real GDP Breakdown [LHS]; Street Consensus – Canadian Real GDP Growth 2021/2022/2023

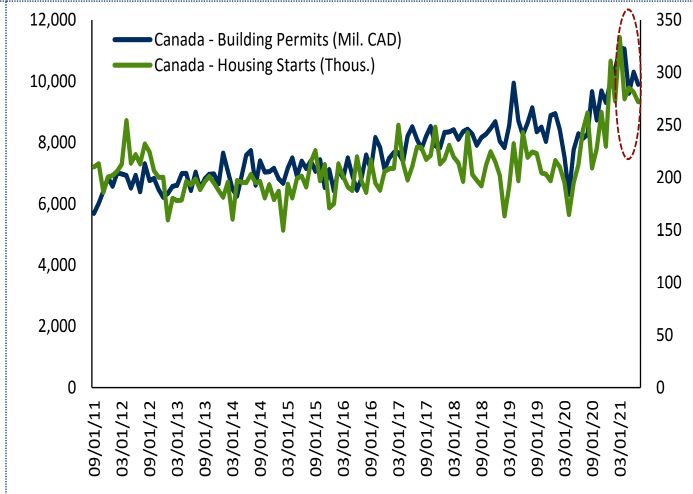
National accounts (period/period % chg, annual rate)	2020	Q3 2020	Q4 2020	Q1 2020	Q2 2021	Q2 2021 Y/Y
Real GDP (chained 2012$)	**-5.3**	**41.7**	**9.3**	**5.5**	**-1.1**	**12.7**
Final domestic demand	-4.3	53.3	4.3	6.5	0.7	14.4
Household consumption	-6	63.9	0.9	2.6	0.2	14.2
Government	0.4	23.2	6.1	7.1	3.8	9.8
Residential investment	4.1	181.9	16.9	42.1	-12.4	42.3
Business fixed investment	-13.6	20.4	5.9	-5.8	12.1	7.7
Business inventory investment ($Bln)	-16	-35.1	-1.1	-6.2	9.7	NA
Exports	-10	72.3	4.1	3.3	-15	12
Imports	-11.2	117.4	11.6	4.3	-0.1	26.1
GDP implicit chain price index	**0.7**	**9.5**	**5.5**	**12.6**	**9.2**	**9.7**
Pre-tax profits	**-4**	**232.6**	**10.8**	**113.2**	**1.6**	**28.8**
Real disposable income	**9.5**	**-22**	**-4.3**	**6.3**	**6.1**	**-4.2**
Personal savings rate (%)	**14.8**	**13.5**	**11.9**	**13**	**14.2**	**-**



Source: FactSet, Statistics Canada

Canadian Household Savings Rate [LHS]; Canada Building Permits & Housing Starts Normalize [RHS]





Source: FactSet, Statistics Canada

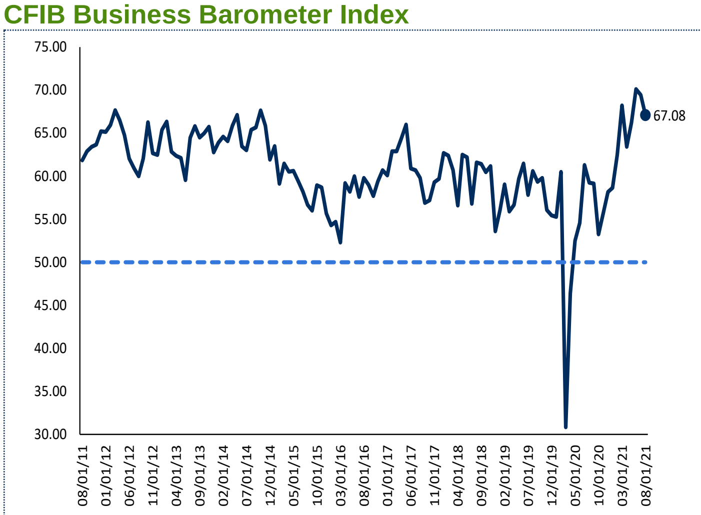
CFIB Business Barometer Index for August Remains Well Above 50

The CFIB Business Barometer index (a leading economic indicator), is a measure of small business confidence expectations and operating conditions in Canada over the next 12 months. This is an important measure for the Canadian economy and investors as small businesses remain the engine of the economy and their success is vital to Canada's prosperity.

For August, the CFIB Business Barometer index declined to 67.1, down from 69.4 in the prior month, while the more immediate 3-month ahead outlook deteriorated modestly, falling by 1.2 points to 55.9. We believe the weakness in expectations over the near-term are due to concerns around the fourth wave of the virus, the ongoing supply chain bottlenecks, and shortages of inputs and labour which intensified in August. Despite this near-term setback, we believe the general state of the economy and small business health continues to be strong as we look ahead to the next 12 months.

CFIB Business Barometer index: Measured on a scale between 0 and 100; an index above 50 means owners expecting their business performance to be stronger in the next year outnumber those expecting weaker performance.

CFIB Business Barometer Index



Source: CFIB, FactSet

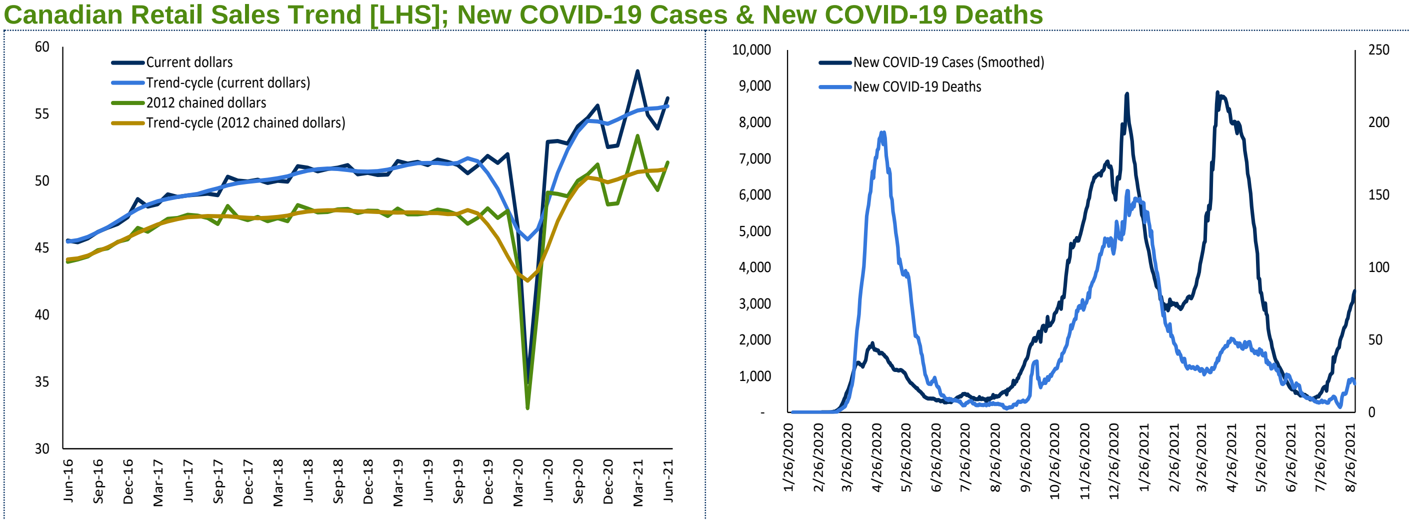
Retail Sales Staged a Major Comeback in June

Canadian retail sales were up 4.2% to $56.2 billion in June, led by higher sales at clothing and accessories stores, a positive for the Canadian consumer discretionary sector. Gains were relatively broad, with 8 of 11 subsectors rising. During the month of June, public health restrictions were eased in many regions across the country as case counts and death rates declined with the % of the population fully vaccinated rising to ~30% as of the end of June (up from ~1.8% at the end of March). Core retail sales—which exclude gasoline stations and motor vehicle and parts dealers—increased 4.6%.

Amid the ongoing COVID-19 pandemic in Canada, provincial governments have eased public health restrictions in several regions across the country, which has been a positive tailwind for the retail sector. Both retailers and consumers have learned and adapted to ongoing restrictions.

While the Delta variant makes its way across Canada, the death toll remains low despite rising case counts. The continued vaccination efforts should remain a positive tailwind for retail sales and the broader economy, which will hopefully avoid the reintroduction of harsh restriction/closures observed during past surges. While the recent Statistics Canada's flash estimate for July retail sales suggested a somewhat disappointing 1.7% retreat in sales, it's likely just a by-product of households spending more on services again versus durables, which would be less affected by shutdowns should they occur again to combat the fourth wave of the pandemic. The trend remains on a positive trajectory and is supportive of our positive outlook on the economy and the Canadian consumer.

Canadian Retail Sales Trend [LHS]; New COVID-19 Cases & New COVID-19 Deaths



Source: FactSet, Statistics Canada; As of September 7, 2021

Elections - Usually a Non-Event, How About this Time?

Canadian elections usually garner little attention from investors. However, this election may matter as it's now a vote on the most contentious issue across party lines - COVID-19 policies. The call for a snap election after months of speculation was likely an attempt by the Trudeau government to capitalize on the positive feedback received for its COVID-19 policy to secure a majority government. Despite a very slow and embarrassing start, the % of the population fully vaccinated was ~68% as of September 7, 2021, up substantially from only 1.8% at the end of March 2021. Canada's share of the population fully vaccinated continued to lead all of its G7 peers. However, this has come at an enormous cost, including billions in stimulus, a blown budget, and provinces like Ontario that have had lengthy lockdowns, and inconsistent policy implemented across the country.

The call for a snap election might have appeared as a good idea for the Trudeau Liberals to form a majority government. However, according to the recent polls, the most likely Federal election outcome is a minority government. More often than not, this translates to the status quo. Despite major fluctuations in the polls, the 2019 campaign period did not see any unusual volatility in either the Canada-US exchange rate, 10-year bond spreads, or equity markets. This one might well pass quietly as well.

However, given the positive influence that fiscal spending has had on the economy and equity markets over the past year and a half to help offset the impacts of COVID-19, any material changes to the level of support/spending by the Federal government could affect the pace and strength of the recovery in the future.

Based on recent costing plans released by both the Liberals and Conservatives (announced last night), it appears their fiscal spending plans are quite similar. The Conservatives plan includes $50 billion in net spending over the next five years. The Liberals plan include $78 billion or 0.4% of GDP in new spending over the same period, which will be partially offset by new revenues of $25.5 billion from higher taxes (including a 3% tax on bank profits and 15% minimum rate on top earners).

The key difference is that the increases in the Conservative plan would be equate to a bigger budget this fiscal year, resulting in a budget deficit that is ~$10 billion larger than under the Liberal plan. Over the next five years, the Liberals say they expect budget deficits of $336 billion, similar to the $331.9 billion shortfall projected in the April budget. This is well above the baseline projected by the Parliamentary Budget Officer (PBO) of $266 billion. The Conservatives on the other hand are also expecting a deficit larger than the baseline projected by the PBO, but would aim for smaller budget deficits next year and over the next five years.

If the opinion polls are correct (they should be taken with a grain of salt), the likely scenario of a Conservative or Liberal minority would cause more or less the status quo. That said, we do not expect this to be a huge event for investors and it would not likely change our positive outlook on the Canadian economy/equities over the next 12-18 months.

Fundamentals Supportive for our Positive Stance on Canadian Equities

Speed Bump not Likely to Derail Our Positive Thesis

We remain constructive on Canadian equities (S&P/TSX Index) over the next 12-18 months, with a total return expectation of ~15%. This return expectation is based on our bottom-up EPS forecast of $1490, a forward P/E multiple of 15.5x and a dividend yield of 2.6%. We continue to recommend an overweight allocation to most cyclical sectors/industries, as we believe these perform the best during the early/mid stages of an economic cycle. Historically, a strong rebound in economic activity and improving employment trends have been supportive of economically sensitive areas of the markets. Despite recent performance of the cyclical group being affected by fears of the Delta variant and significant supply chain challenges, we expect these will moderate in the months ahead.

Sector Recommendations for the next 12-18 months

Canada S&P/TSX Composite	Recommendation	Sector Weight
S&P/TSX / Energy	Overweight	12%
S&P/TSX / Materials	Market	11%
S&P/TSX / Industrials	Overweight	12%
S&P/TSX / Consumer Discretionary	Overweight	4%
S&P/TSX / Consumer Staples	Underweight	4%
S&P/TSX / Health Care	Underweight	1%
S&P/TSX / Financials	Overweight	31%
S&P/TSX / Information Technology	Market	12%
S&P/TSX / Communication Services	Market	5%
S&P/TSX / Utilities	Market	5%
S&P/TSX / Real Estate	Overweight	3%

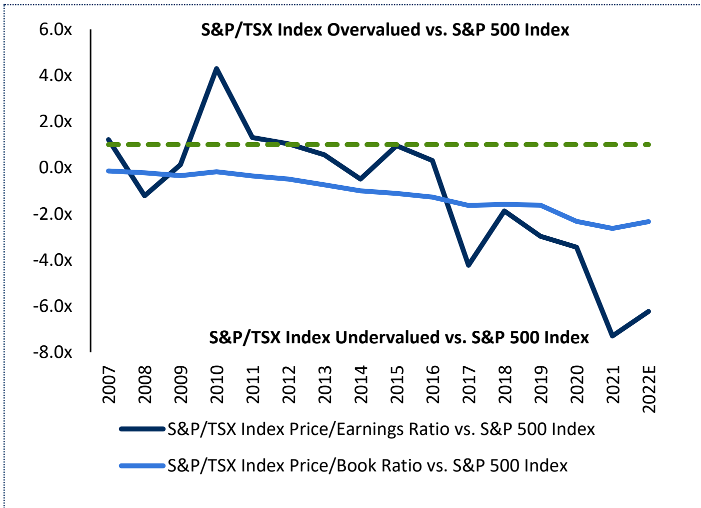
Source: FactSet, Raymond James Ltd.

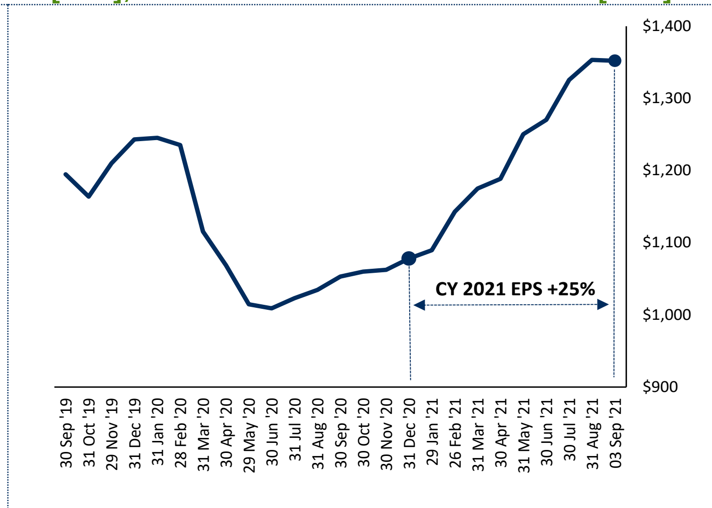
While the S&P/TSX index has staged a strong showing since the beginning of the year, with the index up 19%, in line with the major North American indices, including the S&P 500 index (+20%), we see a stronger relative upside for the S&P/TSX index from here. The S&P/TSX index still continues to trade at a wide spread versus the S&P 500 index, despite posting solid EPS growth in 2021. Street consensus estimates are up 25% from the beginning of year - the sharpest revision for the first 8 months of the year in two decades.

The pace of revisions and the absolute levels of EPS growth for 2021 have been far stronger than the S&P 500 index. As of September 7, 2021, the Street is calling for 2021 EPS growth for the S&P/TSX Index of ~82% and ~6% for 2022. Given how strong 2021 numbers have been, including the pace of upward revisions by the analyst community, we expect there is still room for additional revisions to the 2021 number. As for 2022 numbers, we expect these to move higher as investors look past 2021.

We expect supply chain bottlenecks to moderate heading into 2022 and believe empty shelves will be restocked and pricing power will be maintained. Consumer spending should also improve as the unemployment rate drops further, accompanied by higher wages and the release of some savings still sitting on the sidelines. Continued progress on vaccinations gives us further confidence in our positive outlook for Canada/Canadian equities.

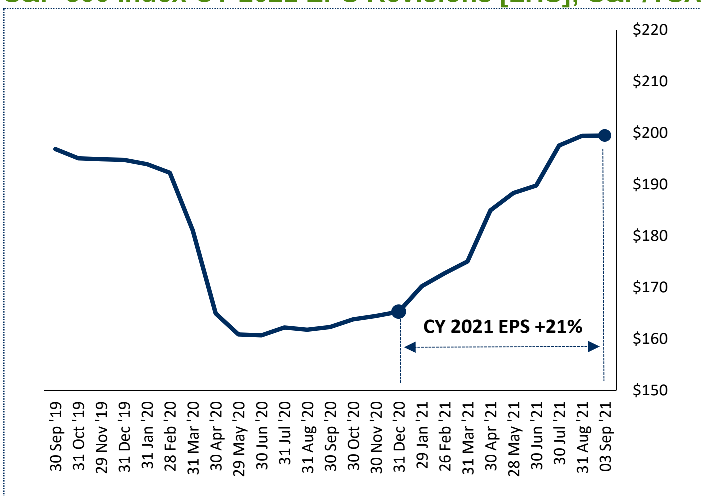
S&P/TSX & S&P 500 Index Relative Valuation on P/E & P/B [LHS]; S&P/TSX Index 2021 EPS Revisions [RHS]

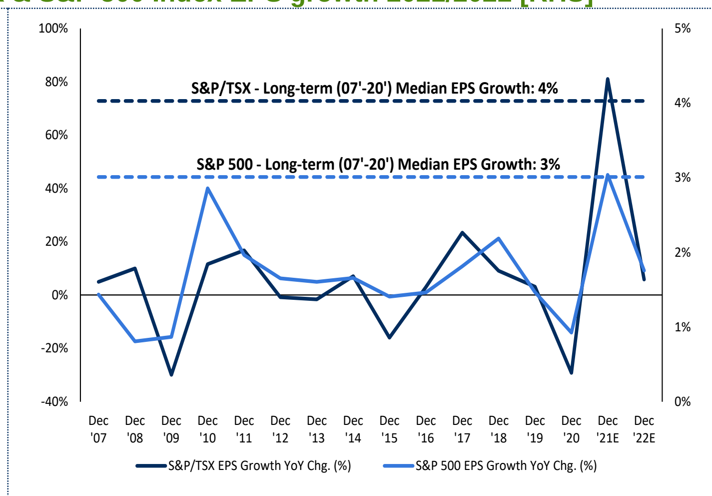




Source: FactSet, As of September 7, 2021

S&P 500 Index CY 2021 EPS Revisions [LHS]; S&P/TSX & S&P 500 Index EPS growth 2021/2022 [RHS]





Source: FactSet, As of September 7, 2021

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