Weekly Trends

PRIVATE CLIENT SOLUTIONS

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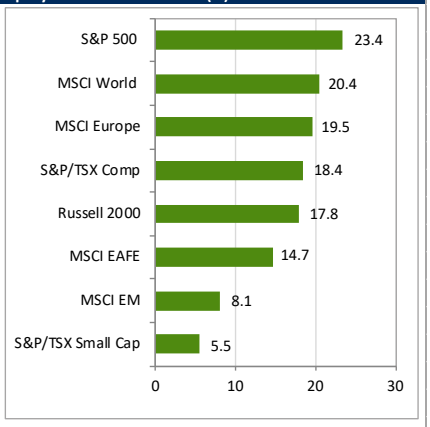
November 14, 2019

Welcome to the Melt Up

Over the past few months we've been watching the movement between risk-on and risk-off assets, and global market breadth. Despite equities performing well YTD, cross-asset price action for much of the past 12 months suggested a certain amount of caution was warranted.

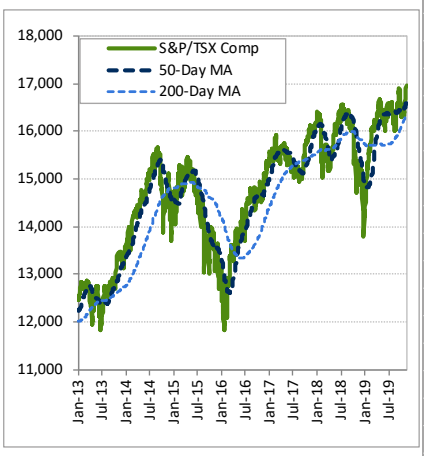
- We are also seeing most North American equity markets make new highs and global market breadth is improving with the MSCI All World (ex US) ETF just 6% off of its record high. Further, cyclical sectors have started to outperform defensives despite the global economic outlook remaining cloudy.
- This year's value rotation started in late August, which coincided with the easing of US/China trade tensions, and the style received yet another boost from the White House's phased approach in striking a deal. Whether this becomes a real rotation or a head fake remains to be seen, but the recent price action is hard to ignore and, given equity prices often lead fundamentals, we are incrementally more positive on the markets, particularly as we head in the seasonally strongest period of the year.
- Both bulls and bears can hang their hats on the re-steepening of the US yield curve (2yr10yr). The bulls will point to a steeper yield curve as an indication of improved future growth prospects, while the bears can point to the fact that the yield curve moves from inversion to positively sloping prior to every recession.
- We continue to favour quality growth, but recognize cyclical value has the most upside potential should the nascent global economic recovery be confirmed. As such, we recommend a barbell approach by taking profits, particularly among the bond-proxy areas of the market, and adding to cyclical areas and value stocks.

Equity Market YTD Returns (%)



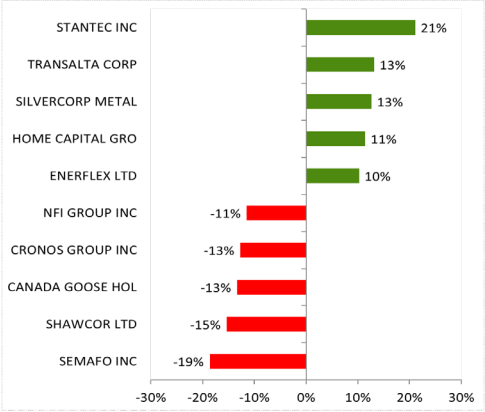
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	4.2	Underweight
Consumer Staples	3.9	Overweight
Energy	16.5	Underweight
Financials	33.1	Overweight
Health Care	1.3	Underweight
Industrials	11.2	Underweight
Technology	5.1	Market weight
Materials	10.9	Market weight
Communications	5.6	Market weight
Utilities	4.6	Market weight
Real Estate	3.5	Overweight

Technical Considerations	Level	'19 YE Target
S&P/TSX Composite	16,958	15,600



Source: Bloomberg, Raymond James Ltd.
Sectors are based on Bloomberg classifications

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	147	59%
Weekly Decline	84	33%
Advance-Decline	63	
New 52 wk high	20	9%
New 52 wk low	6	3%
No. Stocks Above 50-d	139	55%
No. Stocks Above 200-d	156	62%
Arms Weekly Index	0.88	Neutral
RSI (14-day)	76.3	Overbought
50-DMA	16,585	Uptrend
200-DMA	16,334	Uptrend

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

Please read domestic and foreign disclosure/risk information beginning on page 7

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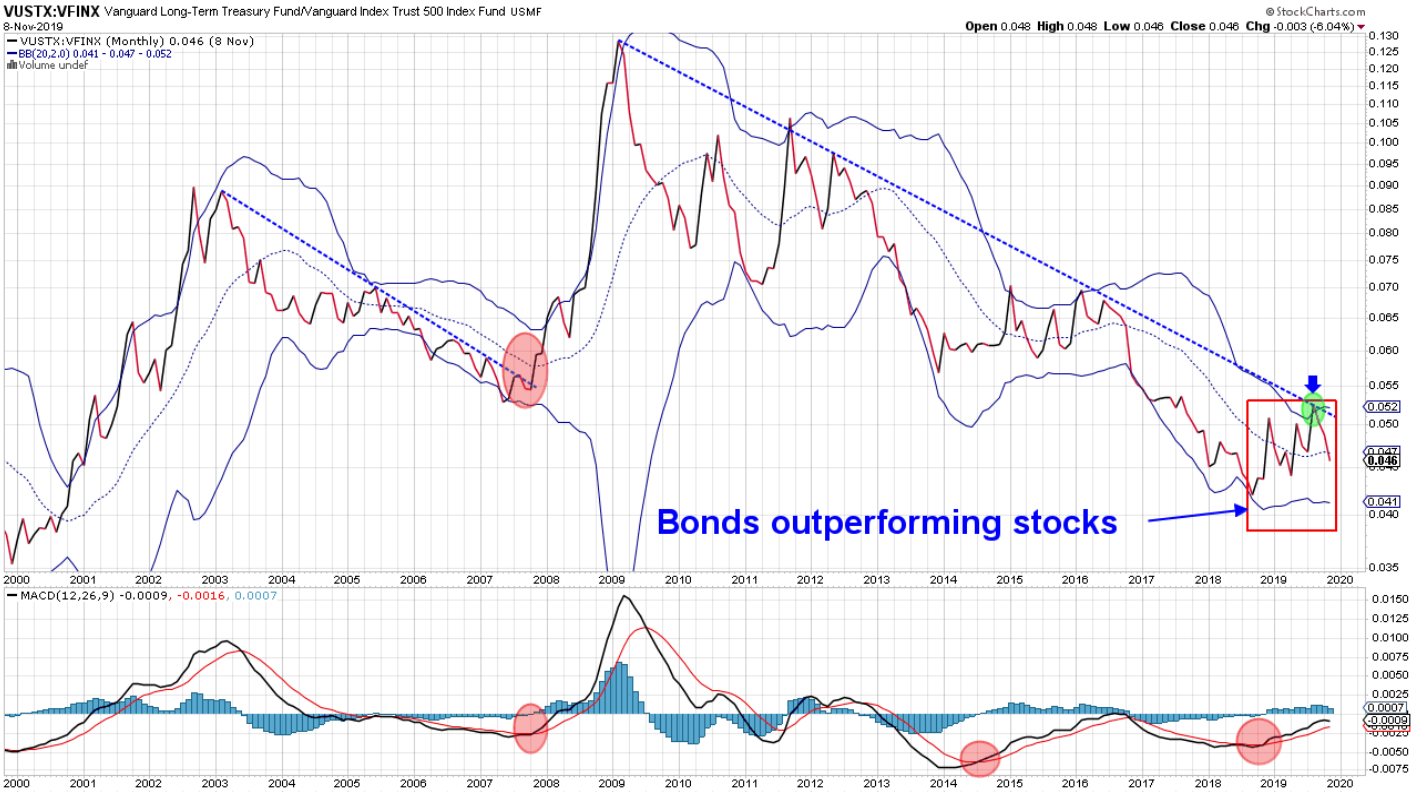
Over the past few months we've been watching the movement between risk-on and risk-off assets, and global market breadth. Despite equities performing well YTD, cross-asset price action for much of the past 12 months suggested a certain amount of caution was warranted. We have now moved into a tricky part of the cycle as risk-on assets approach an important inflection point relative to risk-off assets and have subsequently begun to outperform in recent weeks. We are also seeing most North American equity markets make new highs and global market breadth is improving with the MSCI All World (ex US) ETF just 6% off of its record high. In the chart below, we can see bonds relative to equities have approached the downward trendline established since 2009 and, in each case, has failed to break above. The most recent rejection occurred in September, followed by equities outperforming bonds.

Bonds versus Equities: Trend Remains Intact; Favour Equities over Bonds



Source: stockcharts.com

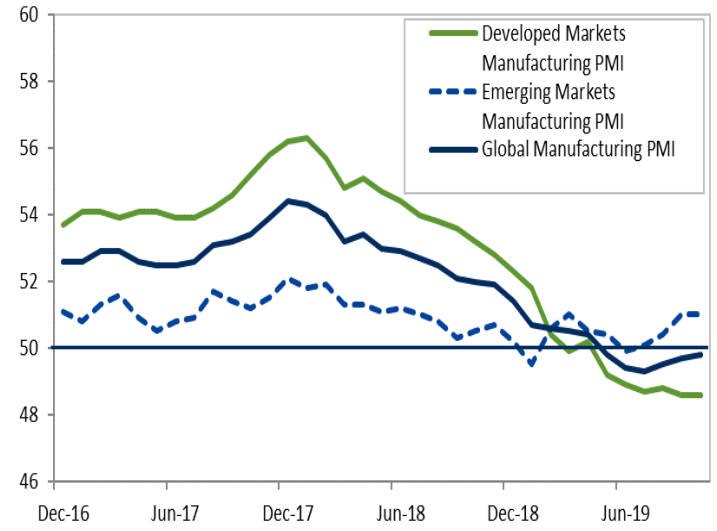
Further, cyclical sectors have started to outperform defensives despite the global economic outlook remaining cloudy. Looking at global PMI data, more countries saw their manufacturing industries sink into negative territory. In fact, the share of PMIs showing positive growth edged down to 40% from 46% in the prior month. This means that even more countries were reporting a contraction rather than an expansion than the previous reading. However, it's often the read beneath the headline that provides the greatest clarity. While global PMIs are firmly in negative territory, the pace of the deterioration has slowed. Global PMIs ticked up 0.1 to 49.8 in October, its sixth straight month of contraction, but the rate of change improved. October marked the third successive month where things got less worse and the longest winning streak since December 2017. Perhaps the easier monetary conditions are beginning to show up in the real economy as the share of global central banks in easing mode is over 80%, the

highest level since April 2010 and up from just 38% at the beginning of the year. As we believe higher rates globally have had more to do with the global economic slowdown than the trade war, it would make sense that easing could reverse the trend we've witnessed over the past 12 months.

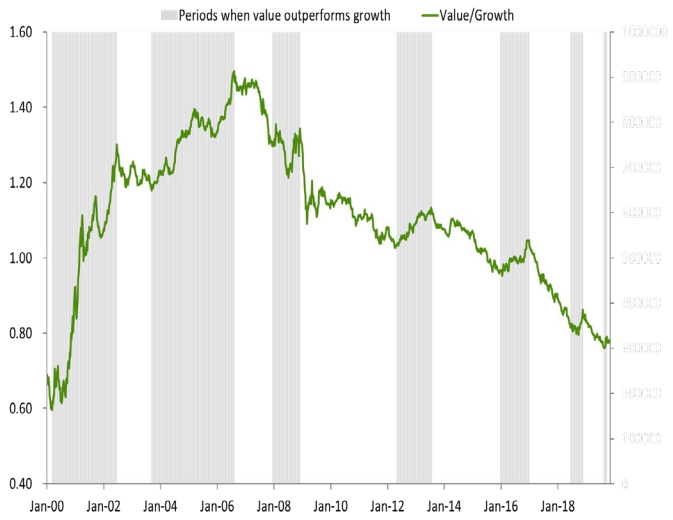
Value Rotation

The potential bottoming in the global slowdown has provided value investors with a much needed glimmer of hope. This year's value rotation started in late August, which coincided with the easing of US/China trade tensions, and the style received yet another boost from the White House's phased approach in striking a deal. Whether this becomes a real rotation or a head fake remains to be seen, but the recent price action is hard to ignore and, given equity prices often lead fundamentals, we are incrementally more positive on the markets, particularly as we head in the seasonally strongest period of the year. In the chart below, we illustrate and highlight periods where value has outperformed growth since 2000. As you can see, growth has dominated since the financial crisis, but there have been periods during the current expansion where value made a comeback. While we continue to believe growth will outperform value over the longer term, there are opportunities to add value for alpha generation. If value is on the cusp of a temporary recovery, the average period of outperformance is 27 weeks since 2008/9. If we extend this to the early 2000s and assume value is back in favour, the average period of outperformance is extended to 52 weeks.

Global PMIs Negative But Improving…



…Waking Up Value



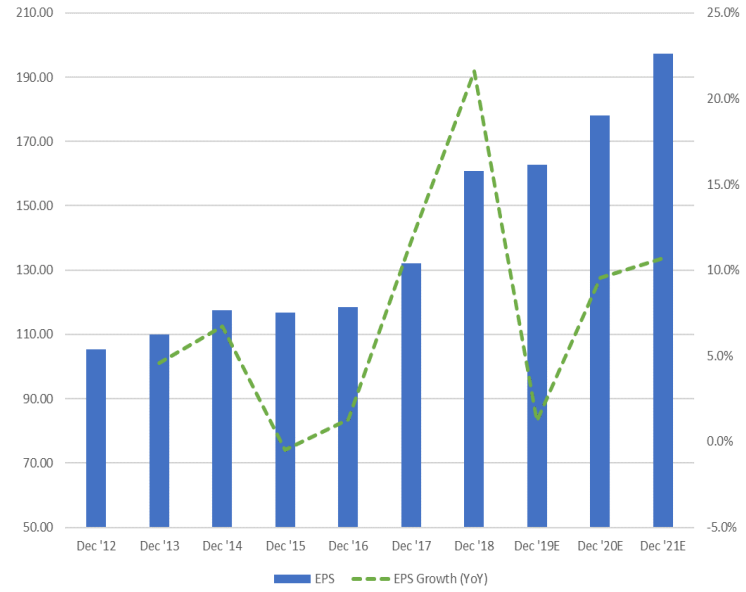
Source: Bloomberg

Earnings Good Enough

Earnings season has given the market another reason for optimism, as earnings have been coming in largely above expectations. We're pretty much through US earnings season with about 90% of the companies in the S&P 500 having reported quarterly results. In terms of earnings, 75% of reporting companies have beaten analysts' EPS expectations and the average EPS surprise was 3.8%. In terms of sales, 60% of companies have reported above the consensus estimate with sales topping

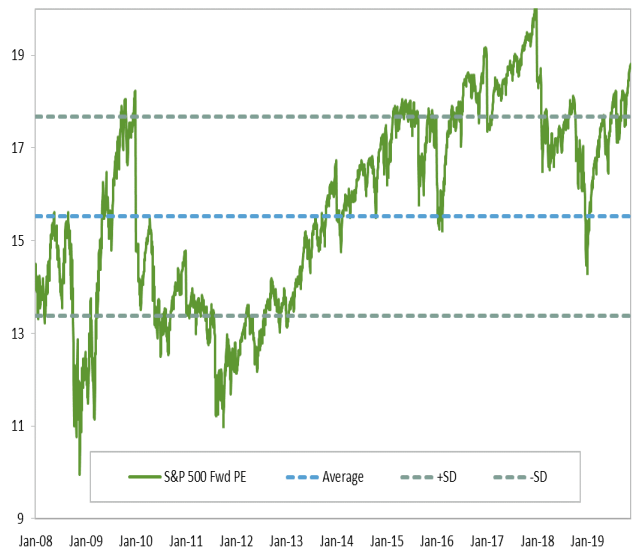
expectations by 0.9%. The blended (combined actual results for companies that have reported and estimated results for companies that have yet to report) earnings decline for the third quarter is -2.4%. If -2.4% is the actual decline for the quarter, it will mark the first time the index has reported three straight quarters of year-over-year declines in earnings since Q4 2015 through Q2 2016. It will also mark the largest year-over-year decline in earnings reported by the index since Q2 2016 (-3.2%), according to Factset. With final 2019 earnings likely to finish flat to low-single-digits growth, much of this year's gains have come from multiple expansion. Considering easier monetary conditions and lackluster inflation, this can help explain the expansion in price to earnings multiples this year. The S&P 500 started 2019 trading at 14.5x forward EPS and now trades at 17.6x, which is now one full turn above the standard deviation from the 10-year average.

S&P EPS Flat Lines in 2019…



Source: Factset

…Market Advances on Multiple Expansion



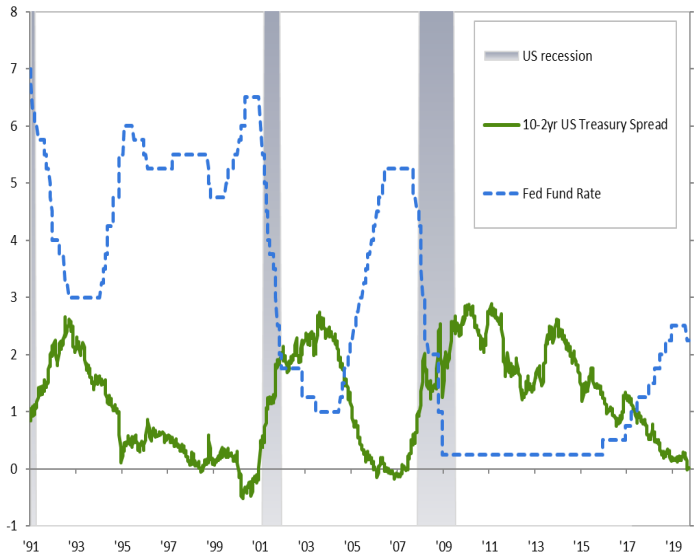
Source: Bloomberg

What about the Yield Curve?

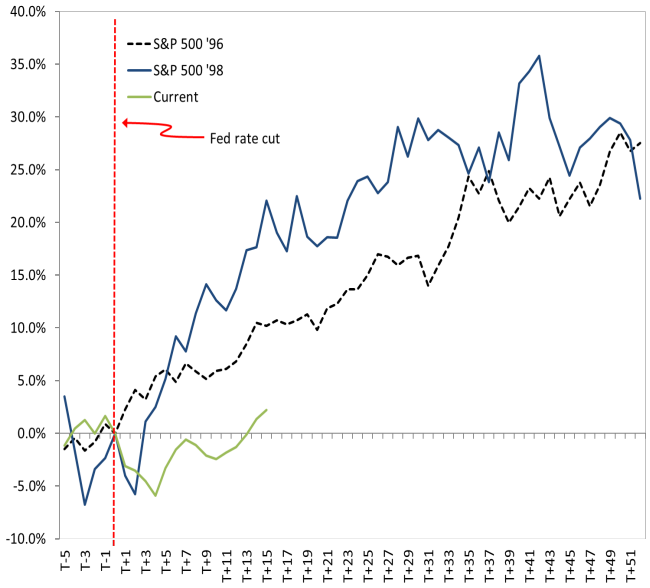
Both bulls and bears can hang their hats on the re-steepening of the US yield curve (2yr10yr). The bulls will point to a steeper yield curve as an indication of improved future growth prospects, while the bears can point to the fact that the yield curve moves from inversion to positively sloping prior to every recession. While this is entirely true, historically the curve inverts for a sustained period before re-steepening followed by a recession. This has not been the case as the 2yr10yr curve inverted for just 6 days in August in this year, compared to the average inversion duration of 152 days prior to a US recession. We also tend to see the 2yr10yr experience deeper incursions into negative territory, typically inverting by 46 bps compared to just 4 bps of inversion that occurred in August. As of last week, the entire yield curve has completely un-inverted, which is the first time this has occurred since November 2018. We think the re-steeping in the curve is reminiscent of the "mini" easing cycles that occurred during non-recessionary periods – 1995 and 1998. In each instance, the S&P 500 advanced greater than 20% one year after the Fed began to cut rates. As you can

see in the chart, the S&P 500 is following a similar performance pattern that occurred back in the mid-1990s.

2yr10yr Yield Curve & Fed Funds Rate



Rate Cuts in Non-Recessionary Periods



Source: Bloomberg

The Screen

We continue to favour quality growth, but recognize cyclical value has the most upside potential should the nascent global economic recovery be confirmed. As such, we recommend a barbell approach by taking profits, particularly among the bond-proxy areas of the market, and adding to cyclical areas and value stocks. Below, we run two screens – quality and value. Each screen identifies companies that screen well on the metrics listed below relative to their respective sectors. For example, Magna screens well based on valuation metrics relative to the overall consumer discretionary sector.

Quality Growth Screen

ROE > Relative Sector; Operating Margins > Relative Sector; Positive Change in forward EPS estimates

Company Name	Ticker	Sector	Last	Cons. Target	Upside to Target	P/B	P/E	ROE
Restaurant Brands International Inc	QSR	Cons. Disc.	$89.83	$103.35	15.1%	8.6	23.4	28.2
Great Canadian Gaming Corp	GC	Cons. Disc	$38.83	$47.25	21.7%	3.9	15.2	35.7
Aritzia Inc	ATZ	Cons. Disc	$19.26	$23.13	20.1%	7.9	26.2	29.3
Canadian Natural Resources Ltd	CNQ	Energy	$36.82	$43.91	19.3%	1.3	16.1	11.9
TC Energy Corp	TRP	Energy	$67.58	$70.65	4.5%	2.4	16.4	15.7
Encana Corp	ECA	Energy	$5.86	$8.51	45.3%	0.6	5.7	15.5
Keyera Corp	KEY	Energy	$33.76	$39.94	18.3%	2.4	17.2	20.5
Enerplus Corp	ERF	Energy	$8.63	$14.11	63.5%	1.0	7.1	22.5
Equitable Group Inc	EQB	Financials	$114.10	$131.29	15.1%	1.4	10.3	14.7
National Bank of Canada	NA	Financials	$69.37	$66.35	-4.4%	1.9	11.2	17.8
Canadian Imperial Bank of Commerce	CM	Financials	$114.29	$113.31	-0.9%	1.5	9.5	15.1

CI Financial Corp	CIX	Financials	$21.10	$21.89	3.7%	3.2	9.5	35.9
Air Canada	AC	Industrials	$48.87	$56.44	15.5%	3.2	16.1	24.2
Chorus Aviation Inc	CHR	Industrials	$8.15	$9.45	16.0%	2.2	9.9	24.1
Canadian Pacific Railway Ltd	CP	Industrials	$315.66	$330.49	4.7%	6.0	19.4	32.4
Thomson Reuters Corp	TRI	Industrials	$91.83	$90.31	-1.7%	4.0	153.9	35.5
Winpak Ltd	WPK	Materials	$46.31	$50.83	9.8%	2.3	19.7	12.1
Silvercorp Metals Inc	SVM	Materials	$6.23	$5.81	-6.7%	2.2	22.0	13.2
Barrick Gold Corp	ABX	Materials	$22.08	$26.65	20.7%	1.5	43.0	9.5
Wesdome Gold Mines Ltd	WDO	Materials	$8.61	$8.92	3.6%	6.1	37.5	18.2
ERO Copper Corp	ERO	Materials	$19.13	$20.09	5.0%	8.5	17.9	44.1
Kirkland Lake Gold Ltd	KL	Materials	$62.45	$67.41	7.9%	6.1	20.2	35.0
Labrador Iron Ore Royalty Corp	LIF	Materials	$22.55	$30.63	35.8%	2.6	7.2	35.8
Tricon Capital Group Inc	TCN	Real Estate	$10.83	$13.06	20.6%	1.0	12.7	8.1
Atco Ltd/Canada	ACO/X	Utilities	$49.54	$51.07	3.1%	1.4	7.6	14.9
Algonquin Power & Utilities Corp	AQN	Utilities	$18.04	$19.05	5.6%	2.1	21.8	12.9
Canadian Utilities Ltd	CU	Utilities	$39.25	$40.59	3.4%	2.1	15.0	19.8

Source: Bloomberg

Value Screen

Current P/B, P/FCF and P/E < Relative Sector

Company Name	Ticker	Sector	Last	Cons. Target	Upside to Target	P/B	P/FCF	P/E
Magna International Inc	MG	Cons. Disc.	$73.01	$77.96	6.8%	1.6	7.8	8.9
MTY Food Group Inc	MTY	Cons. Disc.	$54.00	$63.43	17.5%	2.1	14.0	12.4
Imperial Oil Ltd	IMO	Energy	$33.67	$36.80	9.3%	1.0	10.0	9.6
iA Financial Corp Inc	IAG	Financials	$67.61	$75.10	11.1%	1.4	13.0	11.4
Genworth MI Canada Inc	MIC	Financials	$55.27	$57.00	3.1%	1.2	8.6	10.8
Sun Life Financial Inc	SLF	Financials	$60.99	$62.33	2.2%	1.7	13.9	14.8
Russel Metals Inc	RUS	Industrials	$22.97	$23.67	3.0%	1.5	7.7	11.1
WestJet Airlines Ltd	WJA	Industrials	$30.64	$31.00	1.2%	1.5	17.2	15.7
ATS Automation Tooling Systems Inc	ATA	Industrials	$19.99	$23.63	18.2%	2.3	24.0	22.2

Source: Bloomberg

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