Equities

Global Portfolio Advisory Group

Canadian & U.S. Morning Comments

October 3, 2017

Scotiabank GBM DailyEdge Summary by Warren Hastings and Sunny Singh

Portfolio Strategy – Broad Growth and (Slowly) Rising Yields = Late Stage

- Global macro momentum continues to surprise to the upside, most regions are posting significant year-over-year PMI improvements, and Central Bank bias is slowly shifting toward normalization. Yields have increased since June, and although the pace of monetary normalization is expected to remain gradual, we see further upside risk to bond yields.
- Robust PMIs and a weaker U.S. dollar are currently translating into positive earnings visibility, thus supporting mid-teen gains for the MSCI AC World in 2017. Emerging market leadership (MSCI EM +25% YTD; LatAm +25%) is coherent with broad growth, Fed tightening, and rising yields. Canada, Brazil, and Chile are outperforming the S&P 500 since the first fed rate hike in December 2015, similar to behavior experienced during the previous tightening cycle (2004-2006).
- ***Strategy view.*** Low inflation, and hence slow normalization, is enabling this cycle to continue, but we believe inflation/yield headwinds could challenge the equity cycle in 2018. We are still looking for equities to outperform bonds, but we recommend investors carry lower equity weightings compared to a year ago (raise cash). We continue to prefer LatAm/Canada over the S&P 500. Value-style also stands to gain in a rising yields scenario, which should benefit sectors such as Financials and Resources. In our view, portfolios should reflect late-stage dynamics, and investors should prepare for more muted equity returns in the next 12-18 months.
- ***What is the Asset Mix Model saying now?*** The signals from the model are +12.5% equities; -12.5% bonds; +2.5% corporate bonds; -2.5% Cash. The near maximum equity overweight (OW) signal has been constant since Q3/16, but some factors are starting to fade. Based on our model, the S&P 500/equities remain most supported by Technicals and Revisions, but the ISM signal is slipping as the model now anticipates mean-reversion. Bond indicators are (still) negative, and our calculated U.S. 10-Yr fair value stands at 3.21% (versus actual yield at 2.33% now). Cash could benefit in coming months as equity indicators fade and bonds remain expensive.
- ***TSX strategy and Strategic Edge Portfolio (SEP).*** Value outperformed in September, and the TSX was lifted by gains in Energy, Financials, and Materials. Our 2017 equity strategy is built to benefit from a weak U.S. dollar (OW

commodities/late cyclicals) and monetary policy normalization (Fed and BoC raising rates). The greenback could find near-term support after a tough summer, and we expect rising yields to have the biggest influence on leadership in Q4. The structure of the SEP remains unchanged (cyclicals over defensive), but we are making numerous changes to the line-up to reflect rankings from our quantitative model (new SQoRE version).

- ***U.S. Equity strategy***. Our U.S. sector strategy is positioned for higher bond yields, and a shift to Value over Growth leadership (Financials > Technology/Utilities).

RioCan REIT (REI.un, $24.18, SP, $27.00) – Taking a Long-Term View with Portfolio High-Grading at Work

- REI announced plans to accelerate its major market focus by selling ~100 secondary market properties valued at over $2B (14% of assets; ~6.5% IFRS cap rate) over the next 2-3 years. The ~$1.5B of net proceeds will be applied to ~$750M of unit repurchases (~31M units; 9.5% of total outstanding), with the rest to fund $300M-$400M of annual development spending on its substantial mixed-used pipeline. Our target price held firm, though our 2016A-18E AFFOPU CAGR slipped to 2.5%. Despite the modest dilution (Exhibit 1), we view the strategic initiative as supportive of a stronger longer-term growth profile in same-property (SP) NOI, AFFOPU, NAVPU, and distributions. Although execution risks are evident, we expect the residual higher quality, urban-centric assembly to support a more resilient valuation amid a shifting retail scene and potentially steeper yield curve. The units are trading at 15.4x 2018E AFFO/5.9% implied cap/3% below NAV (Exhibit 2). With its premium to the sector well below historical levels across metrics, we see a reasonable entry for longer-term capital.

Summary of target price / rating changes:

For a full list of changes, refer to today's Daily Edge, available on Scotiaview.com

- **Cameco Corporation (CCO, $12.14, SU, $10.00)** – Rating Cut from Sector Perform and target price decreased from $14.50
- **Copper Mountain Mining Corporation (CMMC, $1.30, SP, $1.50)** – Rating cut from Sector Outperform and target price decreased from $1.70
- **Sherritt International Corporation (S, $1.07, SP, $1.30)** – Rating raised from Sector Underperform and target price increased from $1.10
- **Uranium Participation Corporation (U, $3.56, SU, $3.25)** – Rating cut from Sector Perform and target price decreased from $4.50
- **Barrick Gold Corporation (ABX-US, US$16.11, SP, US$19.50)** – Target price decreased from US$21.00
- **Héroux-Devtek Inc. (HRX, $13.90, SO, $15.50)** – Target price increased from $14.50
- **Hudbay Minerals Inc. (HBM, $9.46, FS, $12.50)** – Target price decreased from $13.00
- **Kinross Gold Corporation (KGC-US, US$4.19, SP, US$5.00)** – Target price increased from US$4.75
- **Teck Resources Limited (TECK.B, $27.10, SO, $36.00)** – Target price decreased from $38.00

In terms of companies reporting results:

- **None to report**

Outside of earnings related news, we would highlight the following items:

- **The Jean Coutu Group (PJC) Inc. (PJC.A)** – Raised to Equalweight from Underweight at Barclays
- **Newalta Corp. (NAL)** – Initiated at Hold at TD Securities
- **Calfrac Well Services Ltd. (CFW)** – Raised to Buy from Speculative Buy at Cormark Securities
- **Wesdome Gold Mines Ltd. (WDO)** – Raised to Outperform at National Bank Financial
- **Heroux-Devtek Inc. (HRX)** – Raised to Buy from Hold at Desjardins Securities

U.S. Market Commentary by Paul Bhangu and Rakesh Gupta

Credit Suisse Research:

US Traditional Asset Managers – 3Q17 Preview

Forecast Better than Expected Flows & Earnings – BLK Top Long

- During 3Q17 results, which are due over the next month, we generally expect (1) better than expected/improved net flows, (2) higher AuM balances and revenues (strong market backdrop + 1 extra day), (3) improved operating margins (aided by revenue lift), and (4) better than expected EPS results (including some positive contribution from non-operating income). 3Q17 net flows/fee rates are especially resilient when you consider the bearish market expectations 6-12 months ago. And now given the 18-month Department of Labor (DOL) Rule delay (to July '19), along with the positive court rulings in favor of industry for several fiduciary related lawsuits, and better active performance in 2017 – we look for the pace of the three secular rotations (active-to-passive, high to low fee, mutual fund to ETF/separately managed account) to slow in 2018 in the US (but accelerate outside of the US given new regulations and lower maturity).
- Macro Backdrop Favorable: All major global equity markets generated strong returns again in 3Q17, with LATAM and EM leading the US. While not as strong as 2Q, bond returns were broadly positive across the board with all major categories generating positive returns (including US, global and high yield). Macro trends in the US were solid, with US GDP growth decent (ex-hurricanes), the unemployment rate still very low, and consumer sentiment indices tracking higher. Additionally, we believe de-regulation along with potential fiscal stimulus could be another tailwind for the US economy and positive EPS revisions.
- Net Flows - 3Q17 Trends Consistent with 1H17: Industry flow trends remained consistent – with inflows into ETFs/passive and active fixed income, but redemptions in active equities. However, active equity flows are tracking better than our initial forecasts and 2016 levels (fee rates holding up too). While we think that 2016-17 contained peak negative activity for traditional managers (active-to-passive rotation, high to low fee shift, frequency of fee cuts), we see these trends moderating in 2018-19 as passive share of equity assets reach 50% in the US.
- Industry Positioning – Favor ETF Managers & Alts to Traditionals (our Barbell Strategy): We have a mixed 12-month view of the traditional managers driven by (1) several secular headwinds to flows in traditional product classes, (2) elevated risk of fee pressure (more so on new product launches), and (3) risk of new regulations (especially in Europe) that focus on consumer protection and generally encourage investors to shift funds into low cost index products. However, the US asset manager stocks are cheap relative to their historical levels and long-only investors are generally underweight which could lead to better than expected stock performance. We forecast a 10-15% total return for the average traditional stock over the next 12-months (includes dividends). We favor the ETF managers (BLK, 3 October 2017 US Traditional Asset Managers – 3Q17 Preview 2 WETF) and illiquid alts (BX, ARES, CG, KKR) to the traditionals.

Earnings:

Lennar (LEN) – The homebuilder reported quarterly profit of $1.06 per share, five cents per share above estimates. Revenue also topped forecasts. Home deliveries were up 12 percent from a year earlier, with new orders up eight percent.

News:

General Electric (GE) — Chairman Jeff Immelt has stepped down three months ahead of schedule. John Flannery, who succeeded Immelt as CEO, will take over as chairman.

Tesla (TSLA) – The automaker missed its goal of building 1,500 Model 3 vehicles during the quarter, reporting that it built just 260 during the July through September period. Tesla said there are no fundamental issues with Model 3 production and that it understands what needs to be fixed. Overall, Tesla delivered 26,150 vehicles during the third quarter.

Wal-Mart (WMT) – Wal-Mart acquired New York-based delivery startup Parcel for an undisclosed amount. Parcel specializes in same-day and overnight delivery and operates 24 hours per day, seven days per week.

Goldman Sachs (GS) – Goldman is considering a new operation dedicated to trading bitcoin and other digital currencies.

Rating Changes

Domino's Pizza (DPZ), Darden Restaurants (DRI), Texas Roadhouse (TXRH), Wendy's (WEN), Yum Brands (YUM) – In new coverage of the restaurant industry, Stifel Nicolaus considers these stocks "buy" rated. Stifel said these businesses have healthy sales momentum, significant expansion plans, and a desire to return cash to shareholders. It is cautious on chains that have seen traffic declines for several years, such as Brinker International and Buffalo Wild Wings.

MGM Resorts (MGM) – Susquehanna downgraded the stock to "neutral" from "positive" in the wake of the Las Vegas tragedy, even though it believes over the long term, MGM's business will rebound. In the short term, Susquehanna notes the possibility of downward earnings revisions.

Fixed Income

Morning Comment

Yields Mildly Higher on a Quiet Day

Government bond yields finished higher yesterday on strong PMIs. U.S. Treasury yields ended higher across the curve along with Canadian government bond yields after stronger-than-expected manufacturing PMI data. U.S. September Markit manufacturing PMI came in slightly higher than economists expected (act: 53.1 vs est: 53.0), while ISM manufacturing PMI registered a strong beat last month (act: 60.8 vs est: 58.1) as well. Meanwhile, Canadian Markit manufacturing PMI for the same period came in a touch higher than the previous month (act: 55.0 vs prev: 54.6). U.S. Treasury yields finished 1bp higher across the curve, while Canadian government bond yields were up 3bp on the medium-to-long end of the curve and 1bp higher for the 2-years.

Yields are flat-to-up in a quiet morning. U.S. Treasury yields are little changed on the short end of the curve, while up 1bp for the 5-years and beyond. On this side of the border, Canadian government yields are 1bp higher across the curve. It will be a very quiet day on the economic front with no tier-1 economic data release in the U.S., while Fed Governor Jerome Powell's speech on regulatory reform will be in focus. In Canada, no economic data release is scheduled until Thursday, while Bank of Canada's Deputy Governor Sylvain Leduc will speak at 12:30pm followed by a Q&A session. Following Poloz's dovish speech last Friday, Leduc's speech today will capture market attention in Canada as investors watch for any hints on the BoC's interest rate outlook.

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Research Analyst Tanya Jakusconek visited Pueblo Viejo, an operating mine, on February 28, 2013. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Barrick Gold Corporation**

Research Analyst Tanya Jakusconek visited Goldstrike, Cortez, and Goldrush, producing mines and exploration property, on September 17-18, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Barrick Gold Corporation**

Research Associate Joanne van Ballegooie visited the Cortez gold mine, a producing mine in Elko, Nevada, on June 20, 2017. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Associate to visit this site. **Barrick Gold Corporation**

Research Analyst Orest Wowkodaw visited the McArthur River mine, an operating mine, in 2012. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Cameco Corporation**

Research Associate Ian Grundy visited the Cigar Lake mine, an operating mine, on September 15, 2016. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Associate to visit this site. **Cameco Corporation**

Research Associate Ian Grundy visited Copper Mountain Mine, an operating mine in Princeton, British Columbia on August 18, 2017. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Associate to visit this site. **Copper Mountain Mining Corporation**

Research Analyst Anthony Zicha visited the Runcorn and Nottingham, U.K., plant facilities, on September 18, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Héroux-Devtek Inc.**

Research Analyst Anthony Zicha visited Héroux Devtek's Laval facility, a manufacturer of small to medium landing gear systems and components and for flight control actuators, on April 26, 2017. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Héroux-Devtek Inc.**

Scotiabank acted as a financial advisor for HudBay Minerals Inc. in a precious metals stream transaction with Wheaton Precious Metals Corp. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited mining assets at Flin Flon, Manitoba, on April 15-17, 2013. No payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited Constancia, a mine under development, on October 2, 2013. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited the Constancia project, a copper mine, on September 8, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited the Rosemont project, an undeveloped copper asset, in April 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Orest Wowkodaw visited the Constancia mine, a copper mine, on September 23, 2015. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Hudbay Minerals Inc.**

Research Analyst Tanya Jakusconek visited the Bald Mountain and Round Mountain mines, operating mines in Nevada, on June 29 and 30, 2016, respectively. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Kinross Gold Corporation**

Research Analyst Tanya Jakusconek visited the Tasiast mine, a producing mine, on October 3, 2017. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Kinross Gold Corporation**

Una M. Power, a Director of the Bank of Nova Scotia, is a member of the Board of Directors of Kinross Gold Corporation. **Kinross Gold Corporation**

Research Analyst Orest Wowkodaw visited Ambatovy, a nickel mine, on March 28-29, 2014. Partial payment was received from the issuer for the travel-related expenses incurred by the Research Analyst to visit this site. **Sherritt International Corporation**

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