INVESTMENT STRATEGY RESEARCH

RBC Capital Markets

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For Required Non-U.S. Analysts and Conflicts Disclosures, please see page 24.

2017 Year Look-Ahead: Canadian Equities

This flatbed Ford is not slowing down yet

- We continue to recommend overweight exposure to the S&P/TSX and introduce an 18-month price objective of 16,300, representing a ~12% total return from current levels.
- Our overweight thesis has been predicated on a combination of inexpensive relative valuations and cyclical catalysts such as a more dovish U.S. Fed and increased stimulus out of China.
- We see this dynamic potentially shifting in 2017 as the global macro shifts from one driven almost purely by monetary policy to one that better balances fiscal and monetary policy.
- The key to this theme will be the U.S. and how much of President-elect Trump's "good" policies become law. These policies centre around large tax cuts, increased infrastructure spending, fewer regulations and a more liberal energy policy.
- Compared to most global developed market indices, the S&P/TSX offers more sector exposure to those sectors and subsectors that figure to benefit from the direct and indirect impacts of President-elect Trump's major policy platforms.
- However, several risks exist in our view to our positive thesis, including: policy missteps, domestic Canadian problems caused by a general lack of growth drivers and rising rates, and geopolitics, which have become inherently more unpredictable in recent years.
- We would continue to recommend overweight exposure to lifecos, energy producers and gold. We also increase our recommendation on auto parts to overweight from market weight and reduce our recommendation on the rails from overweight to market weight following a period of strong performance.

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Table of contents

Market Call

For the better part of the past 7 years, the world has been firmly pointed down a low growth path. Governments, burdened by the debts of the prior cycle, shifted from stimulus in the immediate wake of the Financial Crisis to austerity, leaving the responsibility of reviving the economy to global central bankers. These central bankers used seemingly every tool on their utility belts to try to keep the economy above water, turning to all varieties of so-called "unconventional policies" when their primary tool – interest rates – was pushed to the zero bound.

Canada: the Canary in the Coalmine?

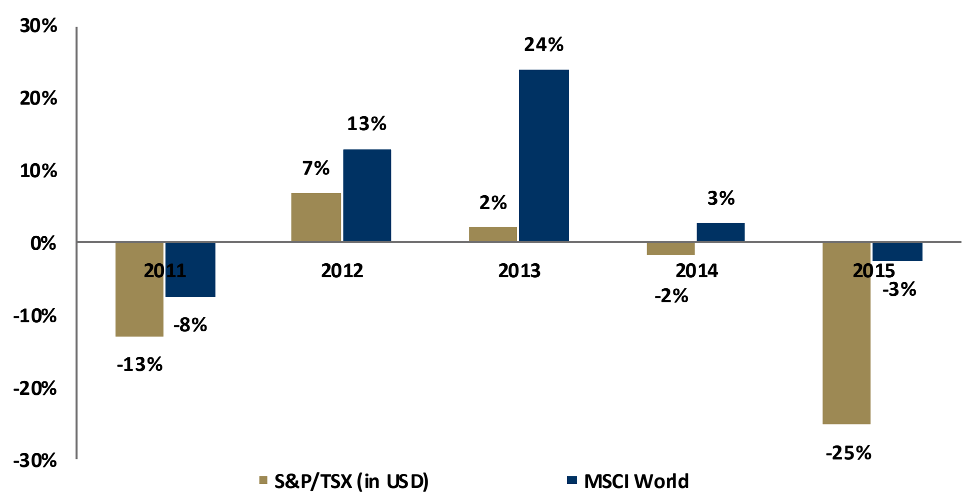
As 2015 came to a close, Canada voted to turn over leadership of its federal government for the first time in a decade. The Liberal Party swept to majority power in part on the promise of returning to a more pro-growth government platform in which austerity would shift to stimulus. Armed with majority rule (perhaps the first "surprise" election result in what would become a 2016 theme), the Liberals put forth an ambitious infrastructure spending plan that would largely eviscerate the prior government's focus on getting back to balanced budgets.

With the U.S. Federal Reserve raising rates for the first time in a decade as 2015 came to a close, perhaps the pieces were laid out for 2016 to experience a shift from monetary policy acting as the only engine for growth to fiscal policy at long last joining the proverbial party. It was surely not obvious at the time, but these shifts often are not evident until one is handed the gift of hindsight.

The Rebirth of the S&P/TSX

2016 began in much the same way that the prior 4+ years had gone for Canada. The slow growth, low rate world was not particularly conducive to Canadian stock market outperformance as the bank and resource heavy S&P/TSX prefers steep yield curves and tight resource supply/demand balances and the low growth, low rate world was unable to provide such. However, even when catalysts are not evident, investments can get pushed too far, pricing in close to all of the bad news.

Exhibit 1: Entering 2016, the TSX was on a 5-year losing streak

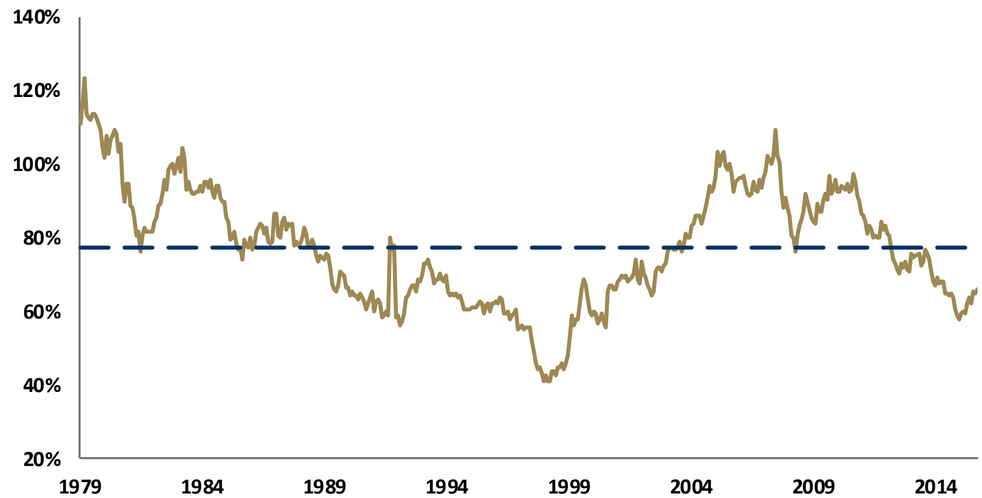


Source: Bloomberg

By mid-January of 2016, the S&P/TSX, which had underperformed the S&P 500 and frankly most other global indices for the prior 57-months, had been pushed to valuation extremes we had not seen since the late 1990's.

Exhibit 2: Earlier in 2016, the TSX approached its late-90's relative lows

Price-to-book value of S&P/TSX relative to S&P 500

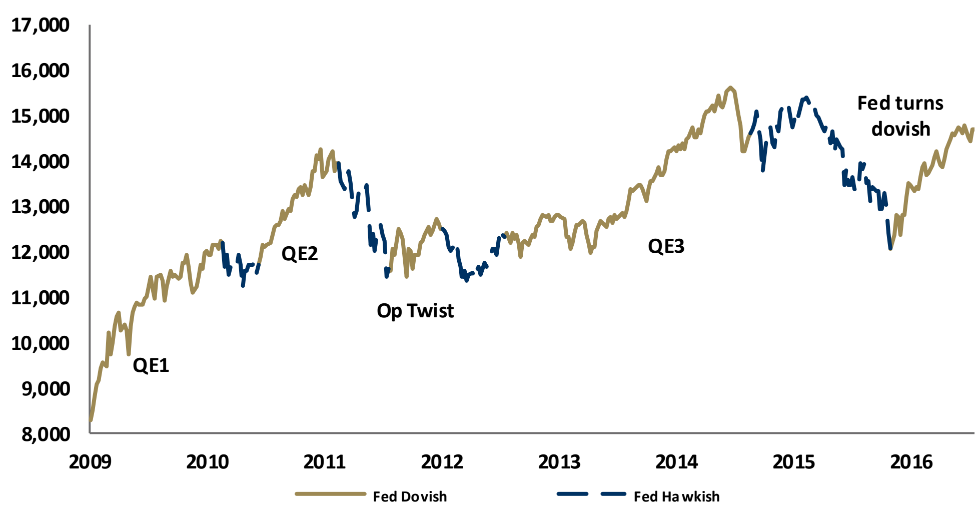


Source: RBC Capital Markets Quantitative Research

And even though catalysts were not obvious, some had begun to gather beneath the surface. China, which had gone through a tumultuous 2015, had begun a heavy stimulus program designed to try to steady growth, while Fed rate policy, which had been firmly pointed toward rate hikes as 2015 unfolded, became quietly more dovish in the early months of 2016. Both have proven to be powerful catalysts for stronger Canadian stock performance over the past decade and, more precisely, their absence has aligned with periods of significant TSX underperformance.

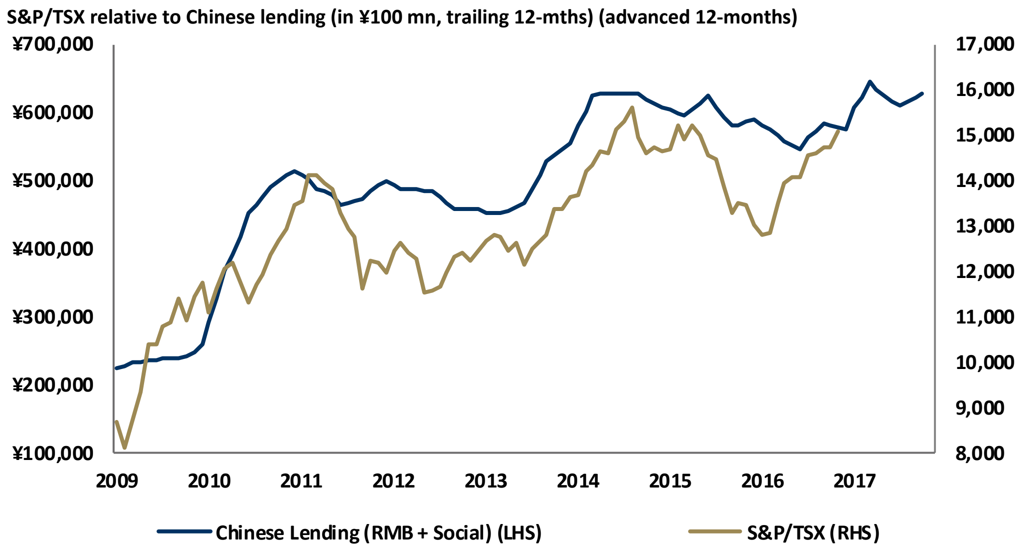
Exhibit 3: Since the Financial Crisis, the TSX has struggled during periods of Fed hawkishness

S&P/TSX during periods of Fed hawkishness and dovishness



Source: Bloomberg, RBC Capital Markets Quantitative Research

Exhibit 4: Chinese lending has tended to lead the TSX by about 12-months

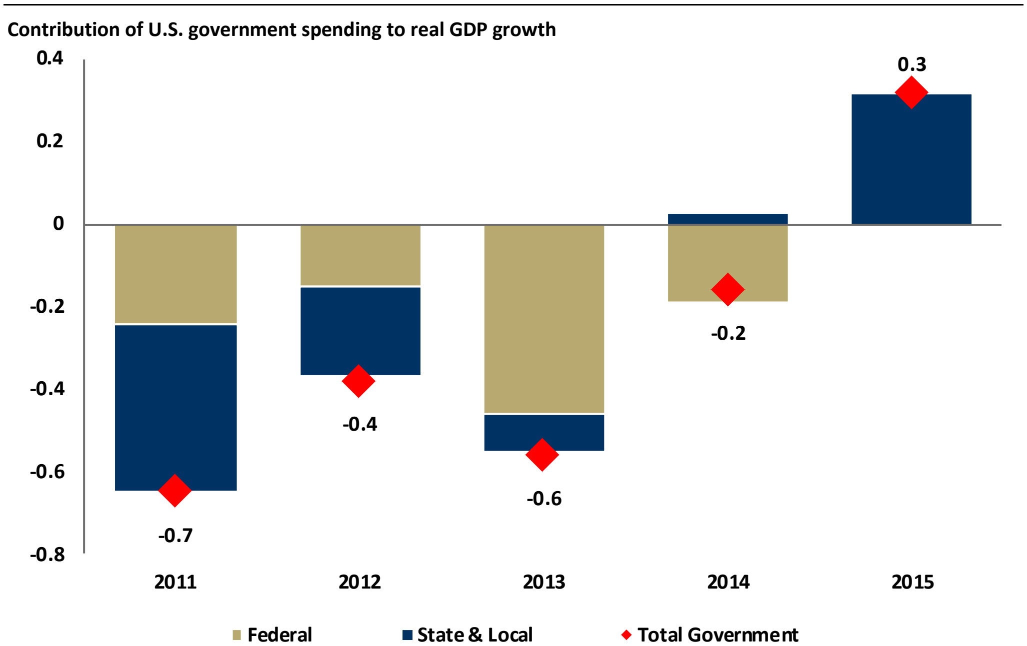


Source: Haver Analytics, RBC Capital Markets Quantitative Research

The Canary becomes a Brexit

Perhaps the shift from monetary stimulus to fiscal stimulus was inevitable, but the British vote to leave the European Economic Union seemed to act as the match that lit the flame. In the wake of Brexit, first South Korea, then Japan followed with fiscal stimulus plans, while the British suggested a plan was coming. The elephant in the room, however, remained the United States, which was in the midst of a rancorous Presidential Election that seemed at most times destined to end in a version of the status quo in which the Democrats would continue to control the White House, while the Republicans would continue to control some or all of Congress.

Exhibit 5: Fiscal policy has been a notable drag



Source: Council for Economic Advisors

Of course, the status quo was eschewed by the U.S. electorate, setting the stage for a major shift in U.S. policy that our U.S. strategy team has described as the **biggest potential shift in nearly 40-years**.

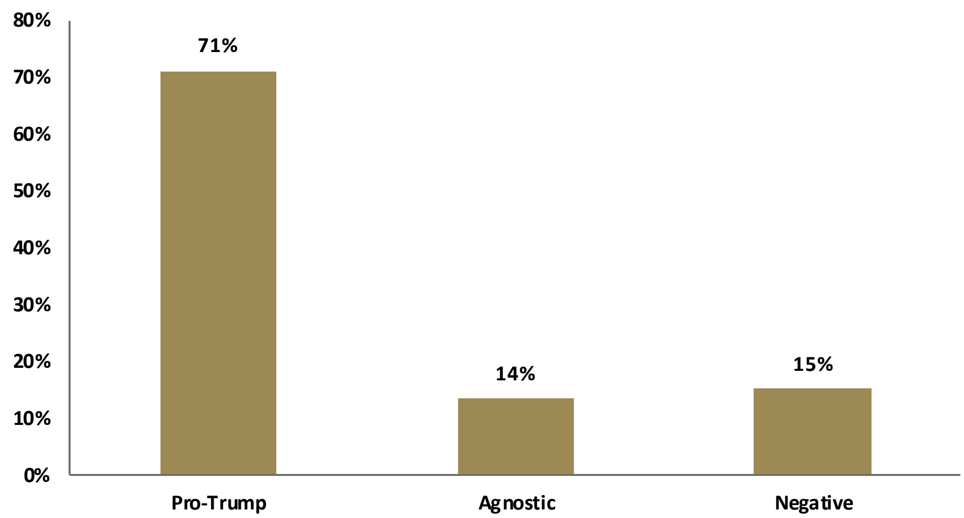
Setting the stage for strong Canadian performance … with some caveats

The status quo of 2010 to 2015 was quite simply not a good set-up for Canadian stock performance. As mentioned, things could get cheap enough that windows would open for TSX outperformance; however, when these extremes had been corrected, investors (both domestic and international) would likely be better off looking to other markets for their overweights.

But the "new normal" may provide the opportunity for Canadian stocks to continue their 2016 resurgence. President-elect Donald Trump has put forward an ambitious economic plan that combines across the board tax cuts (personal, corporate and repatriation) with infrastructure spending, a more liberal energy policy and a reduction in regulations. On the surface, these policies should be supportive to Canadian stock performance, as the S&P/TSX is heavy in those stocks that benefit from steeper yield curves (banks and lifecos), not to mention the potential for increased resource demand on the back of a stronger U.S. economy.

Exhibit 6: The S&P/TSX appears well positioned for Trump

Sector exposure of the S&P/TSX to President-elect Trump's major policies

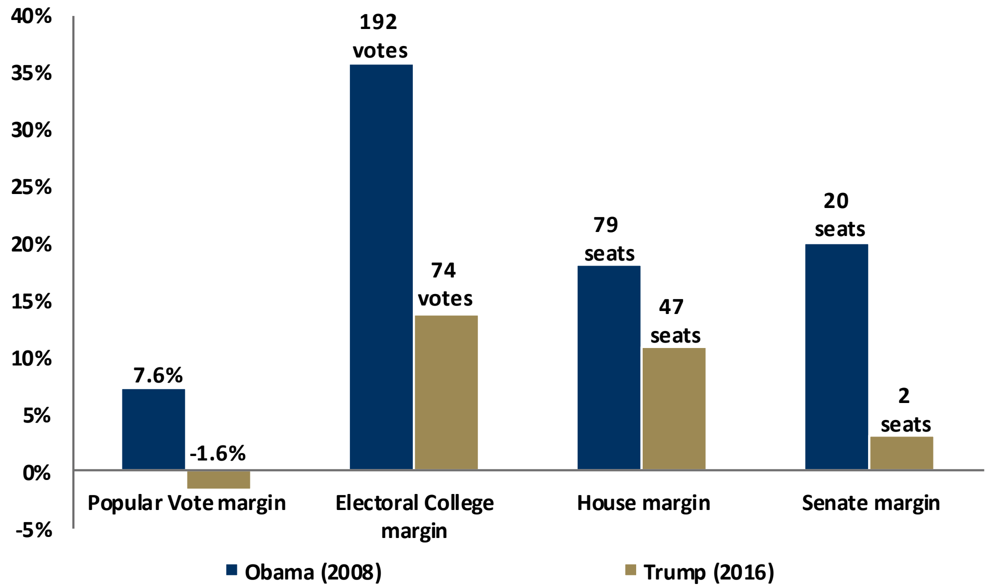


Source: RBC Capital Markets Quantitative Research; Note: Pro-Trump includes banks, lifecos, Health Care, Industrials, Energy and Materials; Agnostic includes Financials (ex banks and lifecos), Consumer Disc., and Technology; Negative includes Utilities, Telcos, REITs and Consumer Staples.

However, as **we have pointed out before**, the "new normal" rests on two big assumptions: 1) the U.S. will truly embark on a meaningful shift in policy and 2) we do not get too much of "bad Trump". President Barack Obama swept to power in 2008 with not only Electoral College and popular vote mandates, but also large majorities in the House and Senate. By contrast, while President-elect Trump comes to power with the Republicans in full control of Congress, he does not approach the mandates that President Obama enjoyed.

Exhibit 7: Obama swept to power with much bigger majorities

Comparison of 2008 election to 2016 election



Source: Wikipedia; RBC Capital Markets Canadian Equity Strategy; Note: 2016 results are estimates

We note this because President Obama's first two-years in power were a constant struggle. While the Republicans were down, they were not out and despite facing large Democratic majorities and a President seemingly empowered by an electoral sweep, the Republicans managed to stand in the way of much of what President Obama attempted to achieve. The market has assumed that President-elect Trump will be able to overcome Democrat resistance and get much of his agenda through and while this may indeed be the case, we would be cautious assuming that this will be as easy as the market seems to assume.

As for "bad Trump", we would note that President-elect Trump did not win the election because of massive tax cuts that will mostly accrue to the wealthy and corporations. Rather, he swept to power in large part because of a populist agenda centered around "fair trade" and a reshaping of the U.S.'s immigration policy. These policies and Trump's fiery rhetoric resonated with a large swath of the electorate propelling him to victory on November 8th.

We grant it is possible that Trump eschews this agenda in favour of the pro-growth policies outlined above, but at the very least, risks exist that he pursues some of this "bad" agenda, which potentially could create headwinds for the Canada story. At this point, in our view, the good outweighs the bad, but we also hold the view that investors may need to be more nimble over the next four years.

Has anti-establishment become the new normal?

Brexit, Trump and perhaps even Canada's surprise Liberal majority in 2015 may represent the tip of the spear of a fundamental shift in the global political landscape. No longer can pundits or investors dismiss far right or left of centre candidates as mere bothers to the greater world order, but rather, with more elections than not seeming to go to the outsider (or the outside view) in the past year, the base case may well be now that the establishment is the underdog.

2017 will present several important elections, including French Presidential elections in the spring and German federal elections between August and October. We, of course, have no idea how these elections will play out at the present time; however, unlike past years in which one might have assumed that the establishment candidate(s) were almost certain to prevail, we are not so sure that this will be the consensus view as these and other elections approach. As the old saying goes, fool me once, shame on you, fool me twice - Donald Trump.

Tying it all together

2017 sets up well for Canadian stocks, in our view. We maintain our overweight recommendation and introduce an 18-month price objective of 16,300 (15,800 previously), representing a ~12% total return from current levels. We provide more details on the rationale for this overweight below.

Our view is that the shifts described above present a compelling potential set-up for Canadian stocks. However, at the same time, in our view, the range of outcomes has become much wider than it was previously. For the better part of 7 years, we were on a low growth path that offered very little variability, but was at the very least fairly reliable. U.S. recession risks remained low for the most part, while at the same time, big upside economic surprises were essentially non-existent.

With the election of Donald Trump, not to mention Brexit and other upcoming votes, the potential for an up-shift in U.S. and global growth has grown in our view. However, so have the downside risks, as policy missteps become a greater risk. Put another way, the amplitude of the U.S. and global economy has been fairly narrow for more than half a decade; we would not be surprised to see this amplitude widen considerably.

Our overweight Canada recommendation rests on several pillars

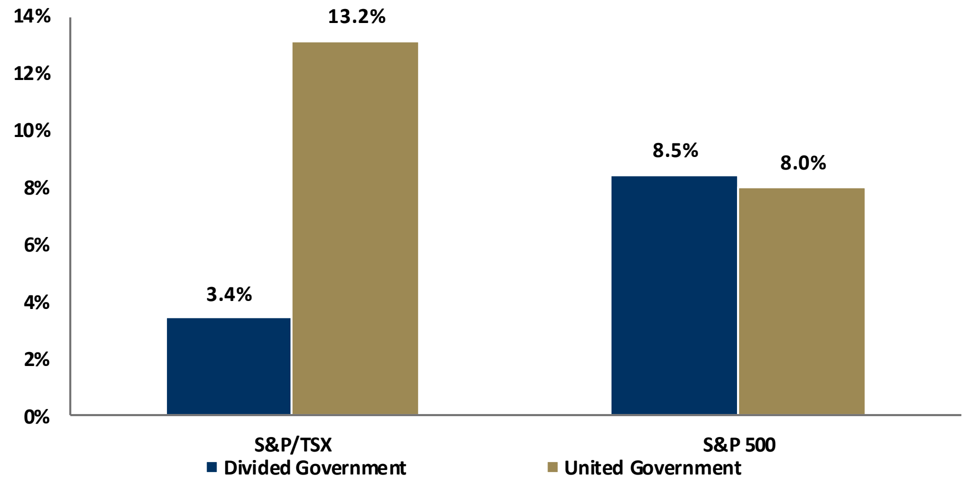
Pillar #1: United we stand

Heading into U.S. Election Day we pointed out on several occasions that the historical canon was not favourable to sustained Canadian stock outperformance. Over the past seven decades, divided U.S. government had translated into relatively consistent underperformance of Canadian stocks relative to U.S. stocks. Our base case for this argument was that Hillary Clinton was likely to prevail on November 8th.

With Donald Trump's victory and the Republican sweep of Congress, the historical canon flips in favour of Canada. Over the past 7-decades, the S&P/TSX has generated an average annual return of ~13% when the U.S. government has been united. Further, the TSX has outperformed the S&P 500 ~2/3rds of the time when the U.S. government has been united (20 of 29).

Exhibit 8: The S&P/TSX has done better under "united" U.S. governments

Annual return under one-party and two-party U.S. gov't control (1946-2015)



Source: Bloomberg; Wikipedia; RBC Capital Markets Canadian Equity Strategy; Note: Returns are before dividends

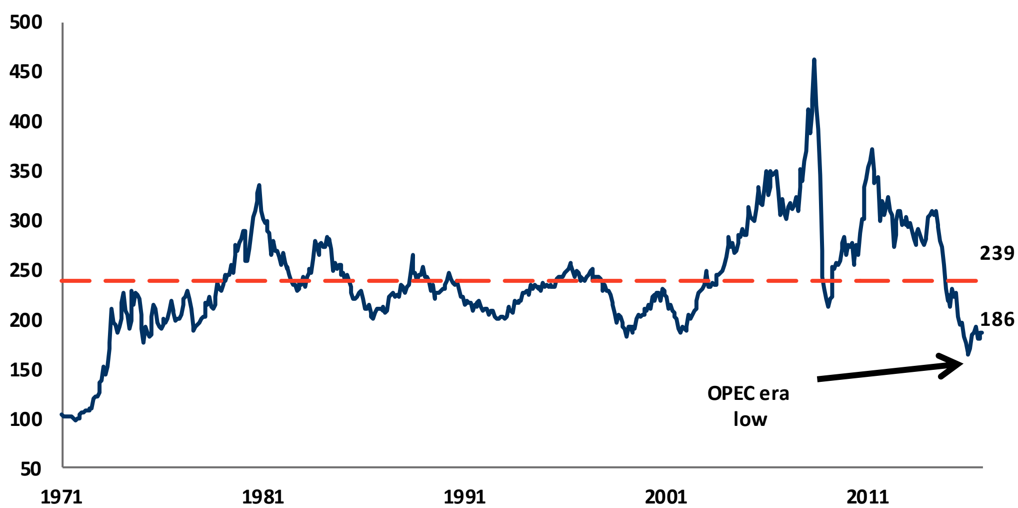
Now, we are not naïve enough to believe that a united U.S. government guarantees anything; however, we would note that united government makes the achievement of some of the policies that tend to be favourable to Canada – tax cuts (pro-U.S. growth, higher long-term rates), infrastructure spending (pro-growth, higher long-term rates, resource demand), reduced regulations (pro-Financials and Energy), liberal energy policy (pro-demand for oil services and pipelines) – much more likely than under a divided U.S. government.

Pillar #2: Commodities leave much room for upside

While commodity prices have come off the bottom, they remain at depressed levels relative to historic norms. With the potential for increased U.S. demand, coupled with significant supply curtailments, in our view, the stage is set for some recovery in commodity prices.

Exhibit 9: The Reuters CRB Index remains well below historic average

Reuters CRB Commodity Index (long-term average in red)



Source: Haver Analytics

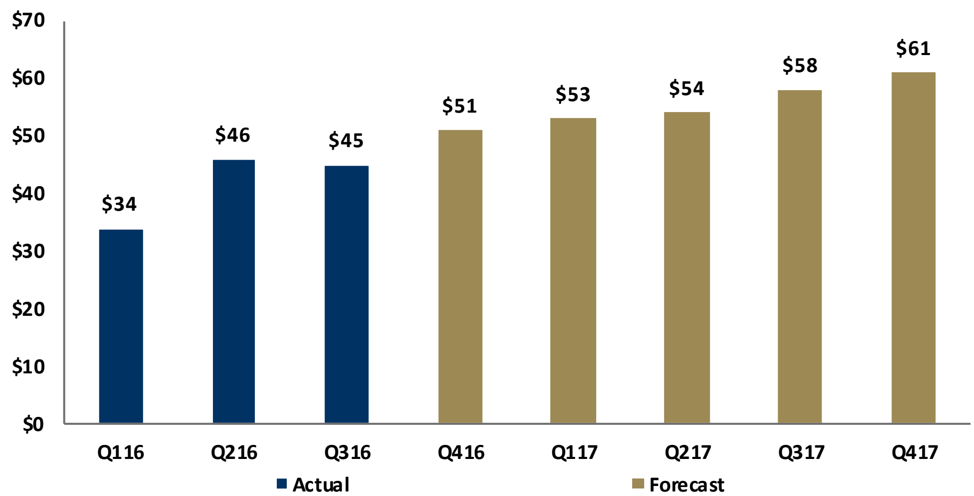
We would note that from a starting point below 200 on the Reuters CRB Index as we are now, the S&P/TSX has averaged a return of 20% in the ensuing 12-months and has been positive 92% of the time.

Pillar #3: 2017 should be another 10%+ oil year

Our Commodity Strategy team along with our Oil and Gas team are of the view that oil prices will continue to rise into year-end 2017, approaching $60 per barrel.

Exhibit 10: Our commodity strategy team sees oil prices ~30% higher by year-end 2017

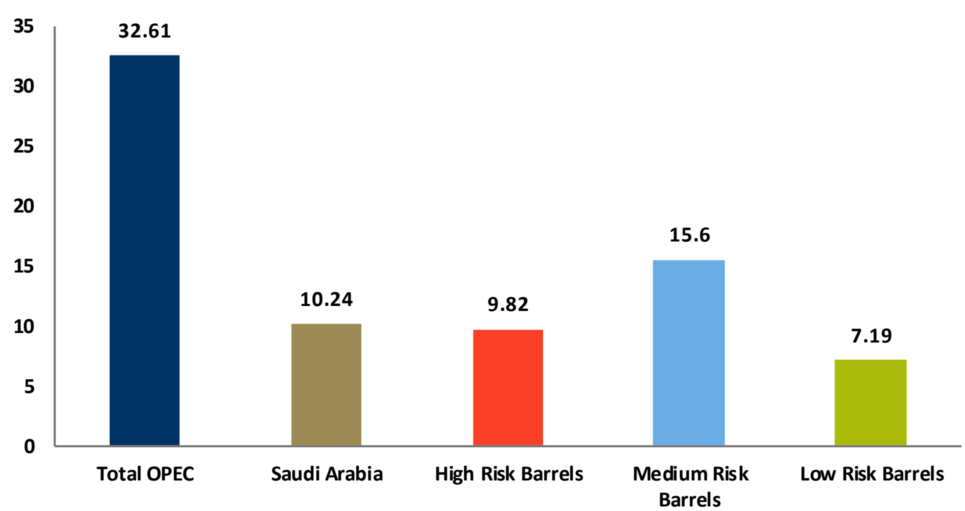
Actual and forecasted WTI price



Source: RBC Capital Markets

Exhibit 11: 1/3rd of OPEC production remains high risk

Production of oil per day (in millions of boe/day)



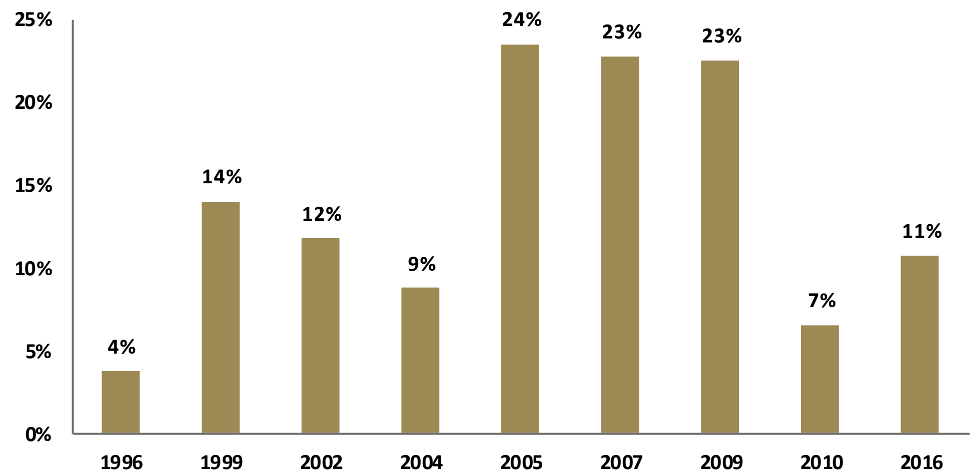
Source: RBC Capital Markets; Note: Risks are based on RBC Capital Markets' 10-point risk scale. Low risk is 3 or less, Medium risk is 4-6. High risk is 7 or greater. Saudi Arabian production is also included in Medium Risk Barrels

This thesis is predicated on the major cuts to long-term investment that have taken place over the past two years as well as the likelihood of an **OPEC agreement on some sort of production cut.**

Looking back over the past 20 years, oil prices have risen 10%+ on nine occasions. The S&P/TSX has outperformed the S&P 500 on each of these occasions and by an average of 14% (currency adjusted).

Exhibit 12: The S&P/TSX has consistently outperformed in 10%+ oil years

Performance of the S&P/TSX vs. the S&P 500 (in CAD) during years in which WTI rose 10%+ (1996-2016)



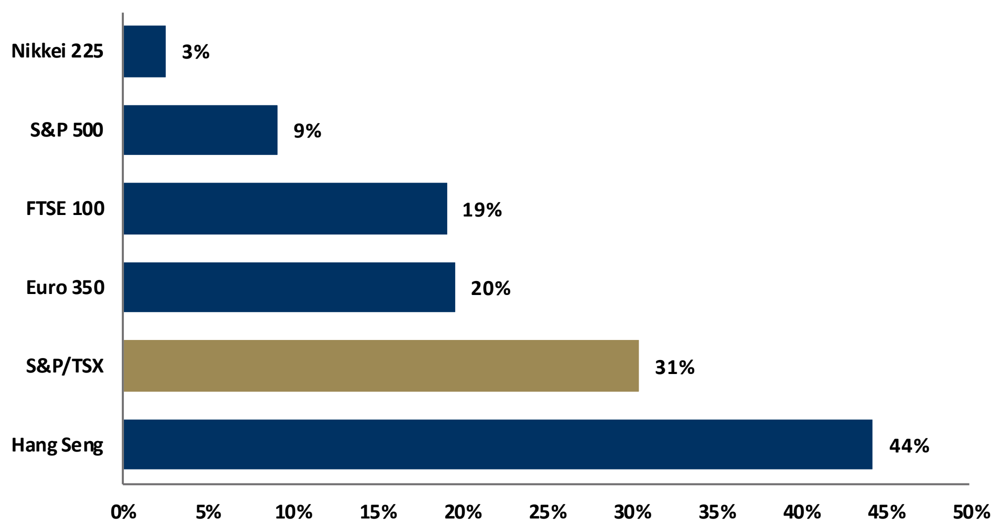
Source: Bloomberg; RBC Capital Markets Canadian Equity Strategy; Priced at as 11/28/16

Pillar #4: Steeper yield curve should drive banks and lifecos

The collective weighting of banks and lifecos in the S&P/TSX is greater than that of most other major global developed market indices.

Exhibit 13: The S&P/TSX has significant yield curve exposure

Combined weighting of the Bank and Lifeco sub-indices

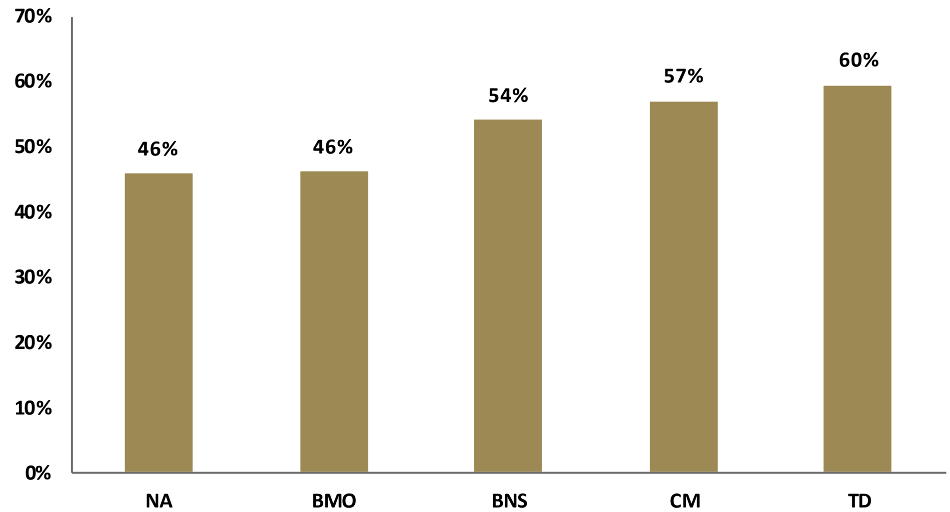


Source: Bloomberg; RBC Capital Markets Canadian Equity Strategy; Note: Euro 350 denotes Financials weighting

With the recent steepening of most global yield curves, these two subsectors are poised to benefit. The Canadian banks generate between 45-60% of their earnings from net interest margins.

Exhibit 14: A steeper yield curve should translate to better earnings for CAD banks

Percentage of total revenue derived from net interest income (2015 actual)



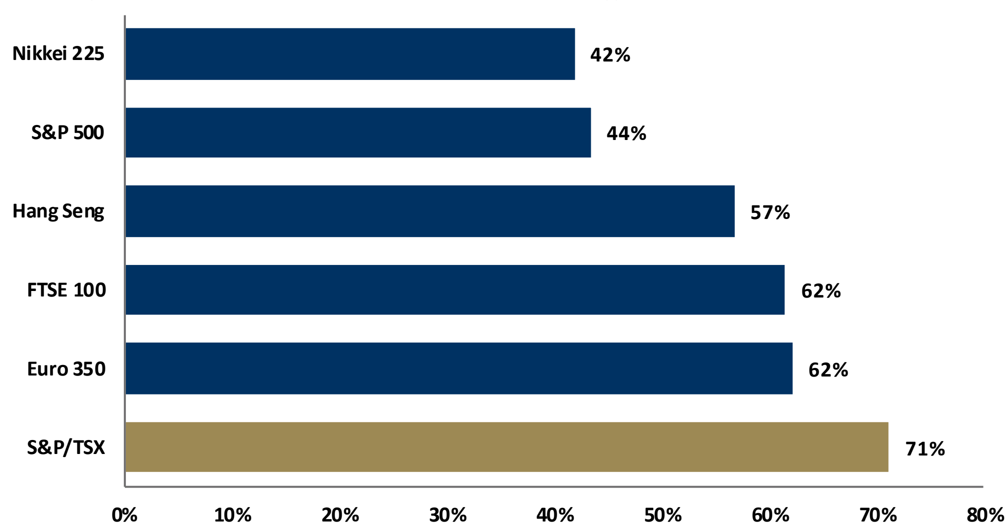
Source: RBC Capital Markets; Note: RBC Capital Markets does not cover Royal Bank of Canada (RY)

Roughly 2/3rds of the market well positioned

If we add up the above – banks, lifecos, energy and materials – roughly 2/3rds of the S&P/TSX is well positioned in our view for strong performance. Cut another way, if we take the collective weights of Utilities, Telcos, REITs and Consumer Staples – those sectors that would not be well positioned for a more pro-growth agenda – the S&P/TSX has only ~15% exposure to these groups, which puts it near the low-end of global indices.

Exhibit 15: The S&P/TSX has a heavy weighting to "good" Trump

Percentage of index in Banks, Lifecos, Health Care, Industrials, Energy and Materials



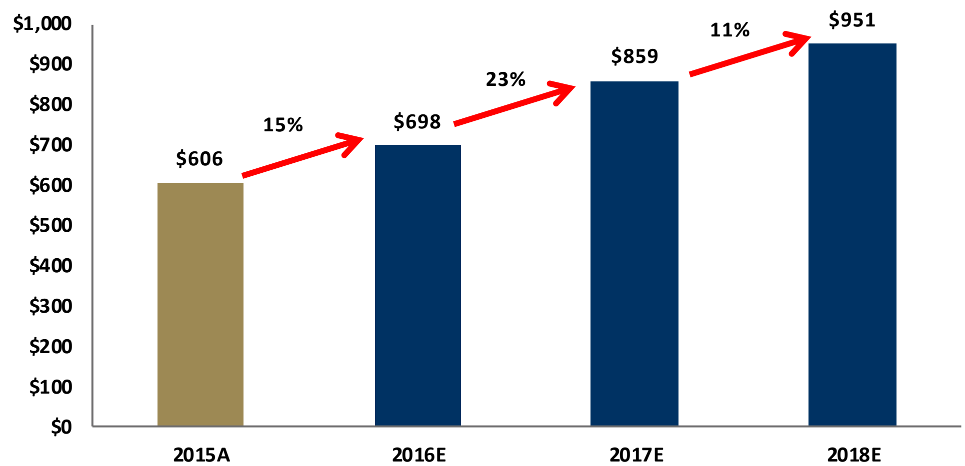
Source: RBC Capital Markets Canadian Equity Strategy

Earnings and Price Objective

We value the S&P/TSX using a combination of top down and bottom up estimates (both RBC Capital Markets and consensus). We average the three to arrive at earnings estimates for the current year and next year. Because we are at year-end 2016, we also introduce our 2018 earnings per share estimate for the S&P/TSX of $951. This blends consensus with RBC Capital Markets' bottom up estimate. We then discount this 5% as 1) we do not provide a top down check beyond 12 months forward and 2) we have found historically that bottom up expectations tend to be inflated by 3-8% for more than a 1-year look forward.

Exhibit 16: Oil recovery should drive a continued recovery in TSX earnings

Actual and estimated EPS for S&P/TSX

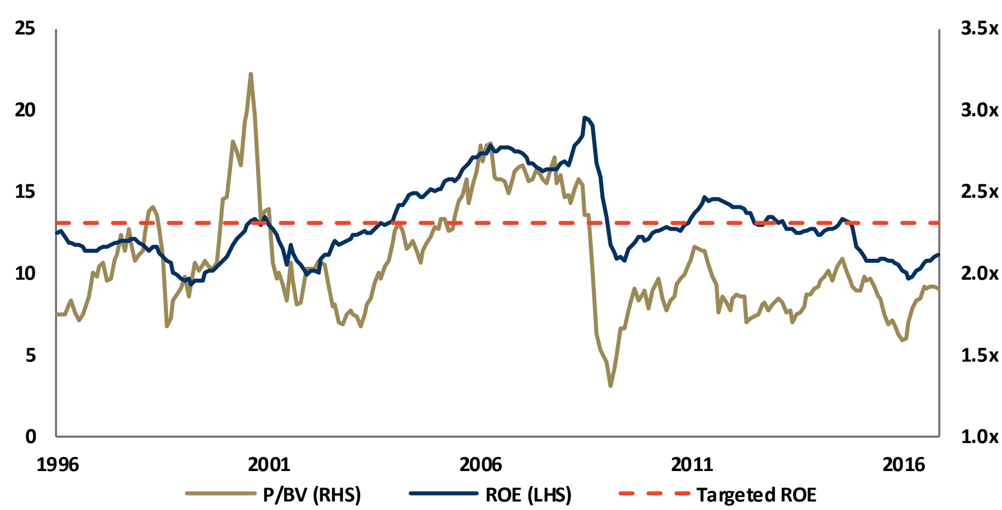


Source: Bloomberg; RBC Capital Markets Quantitative Research; RBC Capital Markets; Note: 2016 and 2017 are an average of Consensus, RBC Capital Markets' bottom up and top down estimates. 2018 is based on RBC Capital Markets' bottom up and top down estimates discounted 5%.

In order to generate a price objective for the market, we look at historic normalized ROEs for the S&P/TSX to generate a targeted price-to-book multiple for the market.

Exhibit 17: ROEs have begun to converge toward the long-term average

Price-to-book value for the S&P/TSX vs. ROE (%)

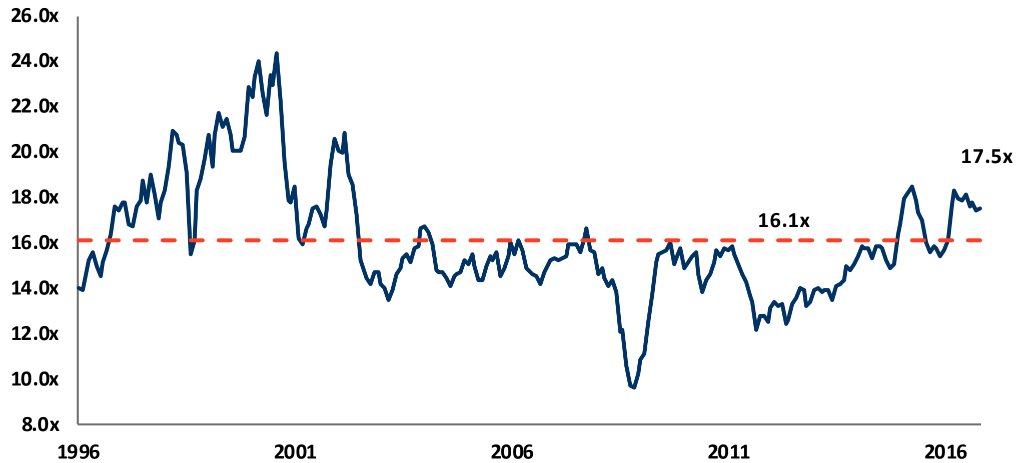


Source: RBC Capital Markets Quantitative Research

Based on a 13% targeted ROE and a 2.1x price-to-book value multiple (currently 1.9x), we arrive at an 18-month price objective of 16,300 for the S&P/TSX. As a check against this, we look at the S&P/TSX versus a blend of current year expected earnings and next year's expected earnings.

Exhibit 18: The TSX is roughly 1-turn above its long-term average on a forward multiple basis

Forward PE of S&P/TSX vs. historic average (1996-2016)



Source: RBC Capital Markets Quantitative Research

Our 16,300 objective equates to 18x a blend of our 2017 and 2018 estimates. This would represent about a two-multiple point premium to historic averages and roughly a half-point premium to current levels, which we believe is appropriate considering the S&P/TSX's exposure to the themes described above.

Sector Thoughts

Our sector views are primarily driven by a combination of historic and relative valuation comparisons with a macro overlay. In some instances, these views are more art than science, which we realize in a rules-driven world may cause discomfort for some. However, this methodology has generally treated us well for 15 years and we expect it to do so for the next 15, especially in a world in which the rules of convention have been broken so easily on seemingly a weekly basis.

From a broad GICS perspective, we currently recommend overweight exposure to one sector – Energy. We have maintained this overweight recommendation since we initiated coverage on the S&P/TSX in early May and it has thus far served us well. On the flip side, we currently recommend underweight exposure to Health Care and Utilities, both of which we have had rated as such since our initiation. The combined weight in these two sectors in Canada is only ~3.5%, so we grant that we are not going out on an especially long limb with these recommendations.

On a subsector basis, we have introduced recommendations on six new subsectors – Commercial Services, Capital Goods, Retailing, Consumer Services, Media and Diversified Financials. We have done so in order to provide views on all subsectors in the S&P/TSX that have a weighting of greater than 1%. Out of the gate, we recommend market weight exposure to all these new subgroups, which we doubt will make the newspapers, but will, in our view, provide us with more flexibility to be tactical going forward.

Exhibit 19: Our sector recommendations remain largely unchanged

RBC Capital Markets Canadian Equity Strategy sector recommendations

Sector	Rated Sub-Sectors	TSX Weight	Recommended Weight	Prior Recommendation	Current Recommendation
Energy		20.5%	22.5%	Overweight	Overweight
	Oil Producers	11.8%	13.5%	Overweight	Overweight
	Storage & Transportation	7.3%	8.0%	Market Weight	Market Weight
Materials		12.1%	12.5%	Market Weight	Market Weight
	Fertilizers	1.9%	1.4%	Underweight	Underweight
	Diversified Metals & Mining	1.2%	1.5%	Market Weight	Market Weight
	Gold	5.9%	7.5%	Overweight	Overweight
Industrials		9.1%	8.7%	Market Weight	Market Weight
	Railroads	5.2%	5.2%	Overweight	Market Weight
	Commercial Services	1.6%	1.4%	NA	Market Weight
	Capital Goods	1.9%	1.9%	NA	Market Weight
Consumer Discretionary		5.2%	5.5%	Market Weight	Market Weight
	Automobiles & Components	1.2%	2.0%	Market Weight	Overweight
	Retailing	1.3%	1.2%	NA	Market Weight
	Consumer Services	1.1%	1.0%	NA	Market Weight
	Media	1.1%	1.0%	NA	Market Weight
Consumer Staples		4.0%	3.8%	Market Weight	Market Weight
	Food Staples Retailing	3.2%	3.0%	Market Weight	Market Weight
Health Care		0.6%	0.0%	Underweight	Underweight
Financials		34.9%	36.0%	Market Weight	Market Weight
	Banks	23.7%	23.7%	Market Weight	Market Weight
	Insurance	7.1%	8.5%	Overweight	Overweight
	Diversified Financials	4.2%	3.8%	NA	Market Weight
Real Estate		3.0%	2.3%	Market Weight	Market Weight
Information Technology		2.9%	2.9%	Market Weight	Market Weight
Telecom Services		5.0%	4.7%	Market Weight	Market Weight
Utilities		2.8%	1.2%	Underweight	Underweight

Source: RBC Capital Markets Canadian Equity Strategy

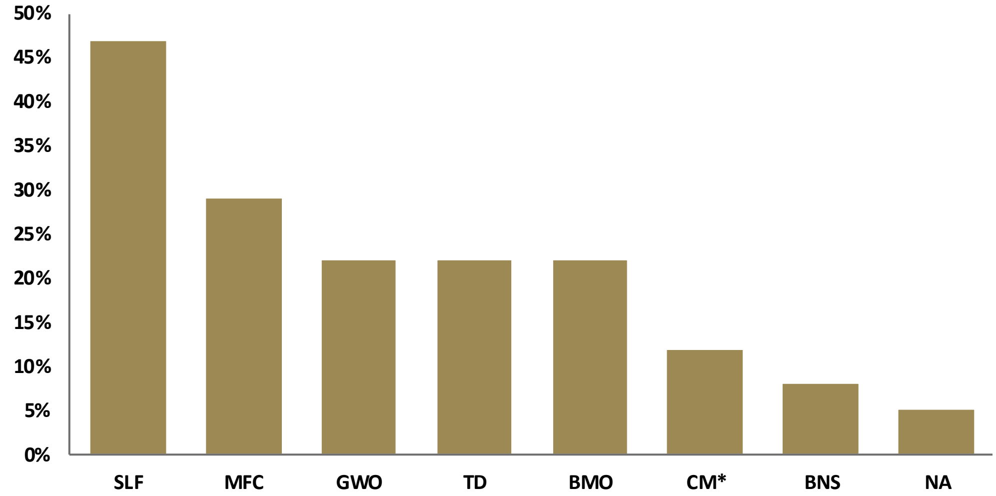
Financials

We continue to recommend overweight exposure to the lifecos and market weight exposure to the banks. We also introduce a market weight recommendation for diversified financials, which is largely dominated by one stock – Brookfield Asset Management (BAM.A).

As described above, the banks and lifecos offer positive leverage to rising long-term interest rates, while both subgroups have exposure to the U.S., although the lifecos tend to have more.

Exhibit 20: Banks and lifecos have varying degrees of U.S. exposure

% of revenues derived from U.S.

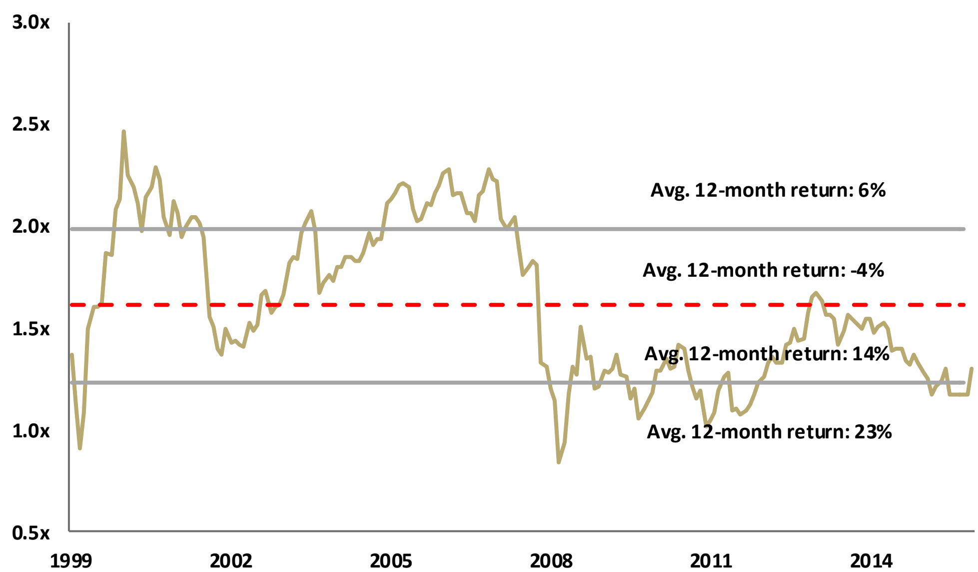


Source: RBC Capital Markets; *Note: Pro forma recently announced acquisitions

Overall, despite recent strong performance, we continue to favour the lifecos to the banks primarily on a more compelling relative and absolute valuation thesis.

Exhibit 21: We continue to favour the lifecos for overweight exposure

Price-to-book value multiples for S&P/TSX lifeco sub-index vs. historic norms (+/- 1 σ bands)



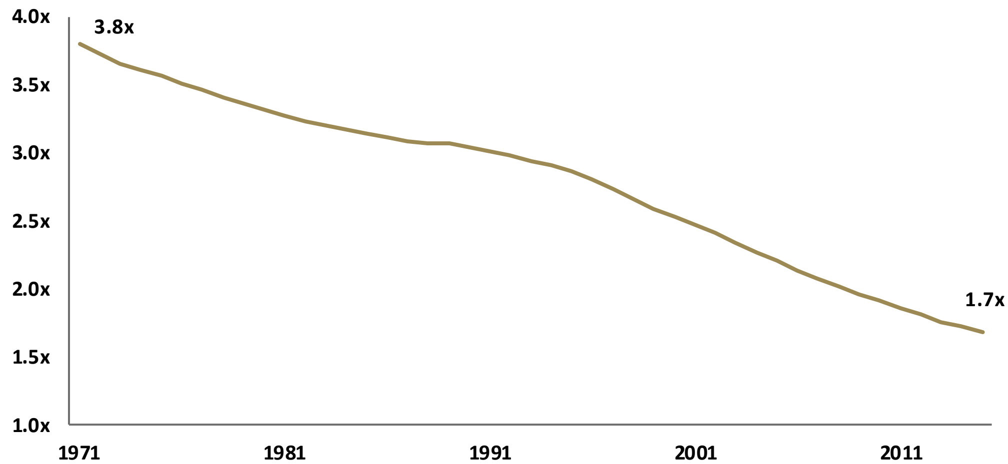
Source: RBC Capital Markets Quantitative Research; Note: Total returns are indicated

Utilities, Telcos and REITs

We currently recommend underweight exposure to Utilities and market weight exposure to Telcos and REITs. The current environment does not necessarily benefit so-called yield plays; however, we would be vigilant in the coming months as the election of Donald Trump cannot alter the reality of demographics.

Exhibit 22: We are running out of young people

Ratio of Canadians 0-50 vs. Canadians 50-100



Source: Haver Analytics

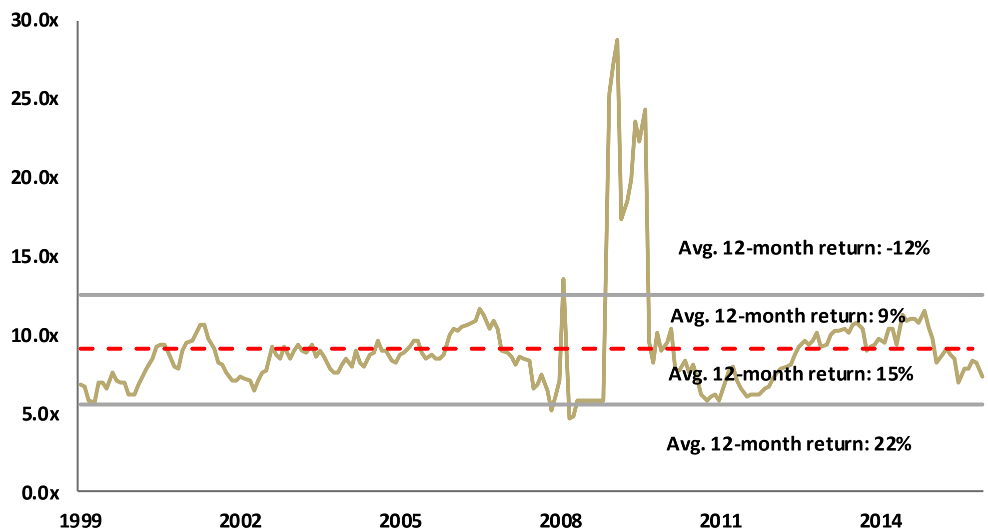
An aging population is likely to continue to put demand on safe investments that pay a sustainable coupon or dividend. While the current environment does not necessarily favour these sectors, we would not be surprised to see compelling buying opportunities develop in the coming months.

Consumer

Combined, the three Consumer sectors in Canada – Staples, Discretionary and Health Care – amount to only about 10% of the S&P/TSX. Within the group, we favour auto parts manufacturers, primarily driven by two things: 1) compelling valuations; and 2) the likelihood that Trump-induced fears are overblown and the positive impact of President-elect Trump's policies on the U.S. economy will trump (pun fully intended) any NAFTA-related concerns. As such, we increase our recommendation on the auto parts manufacturers to overweight from market weight.

Exhibit 23: We have increased our recommendation on the auto parts manufacturers

Price-to-earnings multiples for S&P/TSX automobiles and components sub-index vs. historic norms (+/- 1 σ bands)



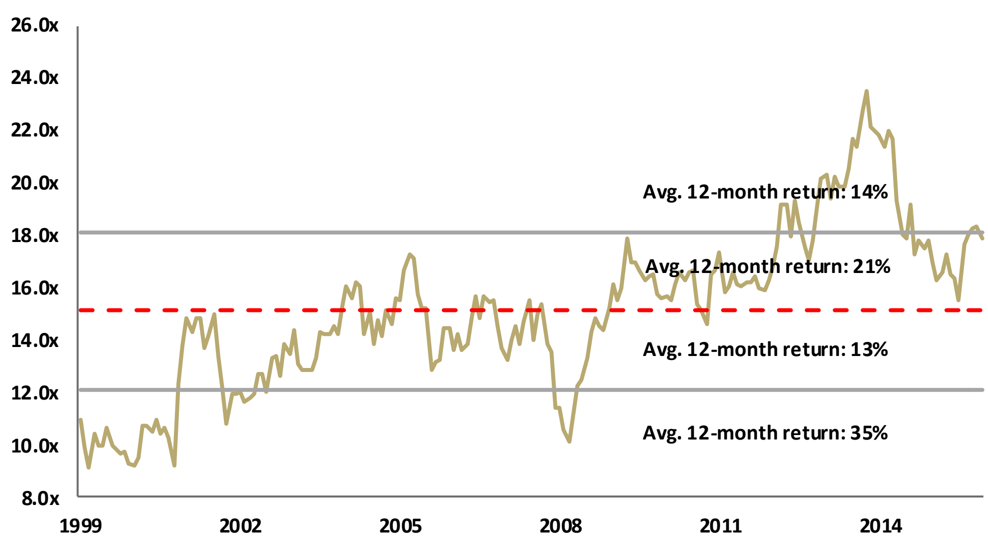
Source: RBC Capital Markets Quantitative Research; Note: Total returns are indicated

Industrials and Technology

We increased our recommendation on the Canadian rails in mid-July primarily based on what we viewed as a compelling valuation opportunity. Since early July, the two Canadian rails – CN Rail (CNR) and CP Rail (CP) – have risen about 15%. We continue to favour exposure to the group, but considering the strong run and the fact that valuations have pushed to nearly one standard deviation above 15-year averages, we have chosen to reduce our recommended weight.

Exhibit 24: We have reduced our recommended weighting on the rails to market weight

Price-to-earnings multiples for S&P/TSX railroad sub-index vs. historic norms (+/- 1 σ bands)



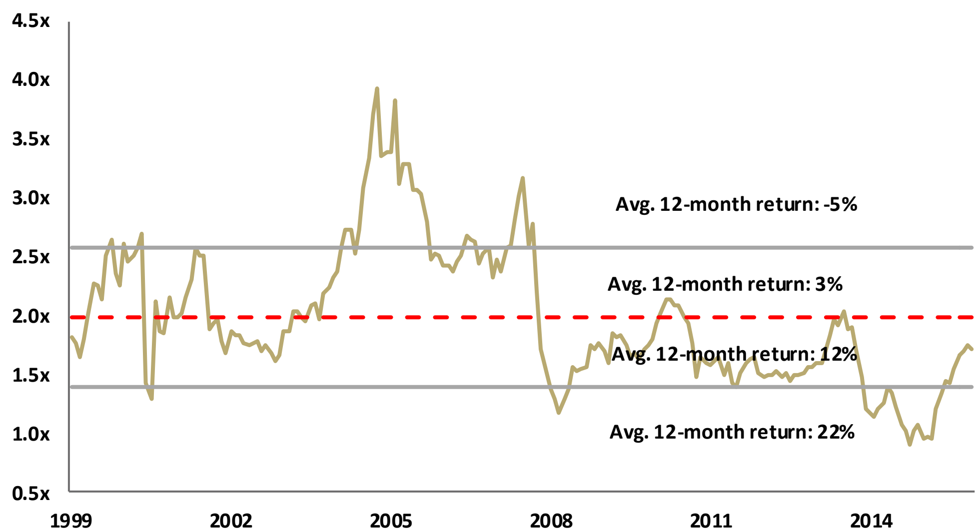
Source: RBC Capital Markets Quantitative Research; Note: Total returns are indicated

Energy

We initiated coverage on the energy producers (E&Ps and Integrateds) with an overweight recommendation when we initiated on the S&P/TSX back in May. Despite strong performance from the group, we maintain this overweight recommendation as in our view: 1) the continued rise in oil prices will be conducive to the group (see prior comments); 2) President-elect Trump's policies have the potential to add some upside to an already compelling risk/reward; and 3) valuations, while off the bottom, still offer upside.

Exhibit 25: We maintain our overweight recommendation on oil producers

Price-to-book value multiples for S&P/TSX E&P sub-index vs. historic norms (+/- 1 σ bands)



Source: RBC Capital Markets Quantitative Research; Note: Total returns are indicated

Materials

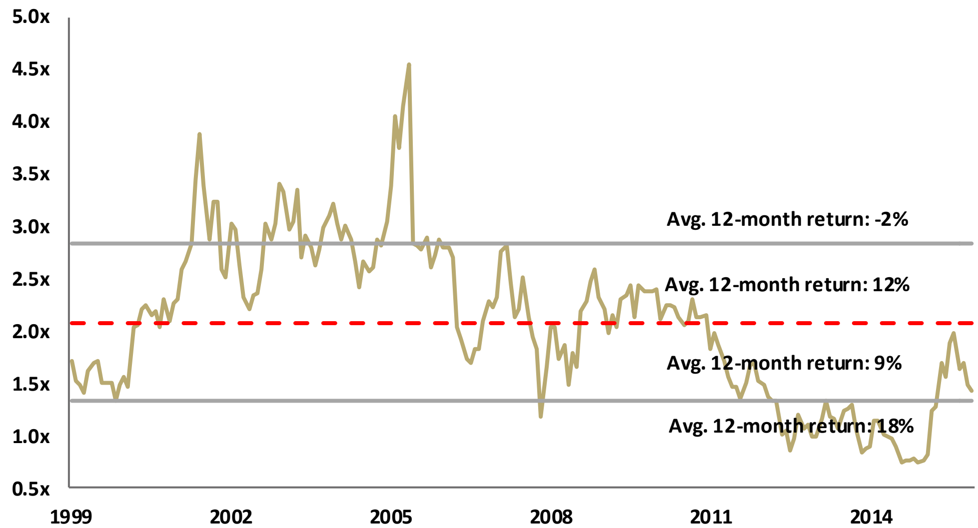
We maintain our overweight recommendation on golds, which has been one of our more painful calls since we initiated coverage on the Canadian market. Our thesis has been predicated in part on the global macro uncertainty that exists in the world; while we readily acknowledge that at certain points gold fails to reflect the uncertainty, at other times it proves to be a worthy hedge.

With the election of Donald Trump, we expected gold to perform well as: 1) the uncertainty factor increased; and 2) President-elect Trump's policies, both good and bad, are inherently inflationary, so even in a rising rate environment, real rates would potentially remain low.

Of course, through the roughly 4-weeks since Donald Trump was elected, this has not played out. However, with valuations pushing to the low end of historic norms and our view that the combination of global macro uncertainty and inflation risks could be prominent themes in 2017, we maintain our overweight recommendation.

Exhibit 26: We still have faith in gold

Price-to-book value multiples for S&P/TSX gold sub-index vs. historic norms (+/- 1 σ bands)



Source: RBC Capital Markets Quantitative Research; Note: Total returns are indicated

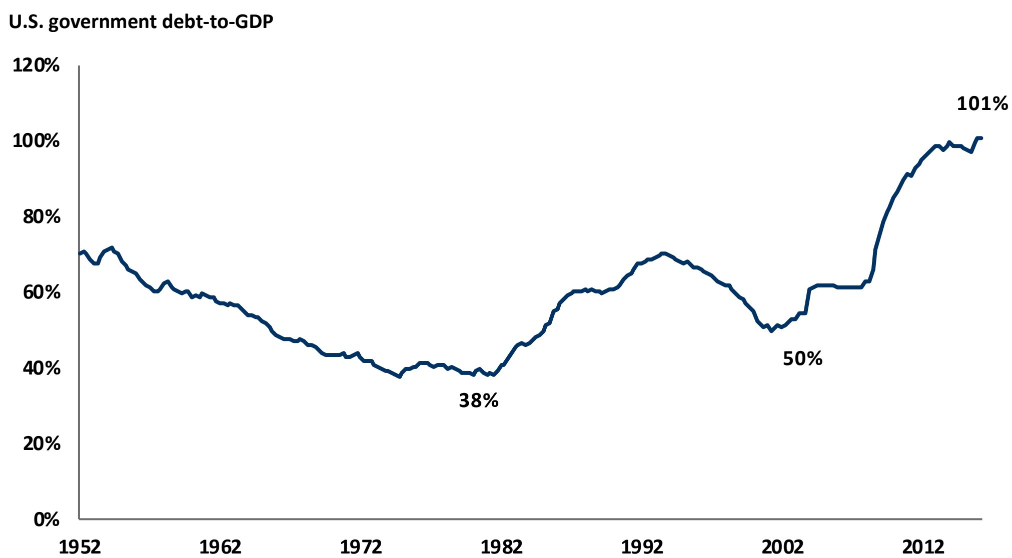
Key Risks

Key risks to our call include the following:

President-elect Trump's policies do not have the desired impact or passage proves difficult: Even under a "good Trump" scenario, there is the risk that U.S. growth does not respond in a meaningful way. While personal tax cuts would likely provide some boost, most of them would accrue to the wealthiest Americans, who are least likely to spend them. Further, corporate tax cuts should provide some boost; however, corporate profits have suffered more from top-line issues since the Financial Crisis as opposed to issues of margins.

Further, and as we noted, President-elect Trump may face challenges in getting some of his policies through Congress. Debt-to-GDP ratios are significantly higher in the U.S. than they were under either Ronald Reagan or George W. Bush, which may make it more difficult to push through major changes to the budget.

Exhibit 27: Cutting taxes and increasing spending may face some headwinds

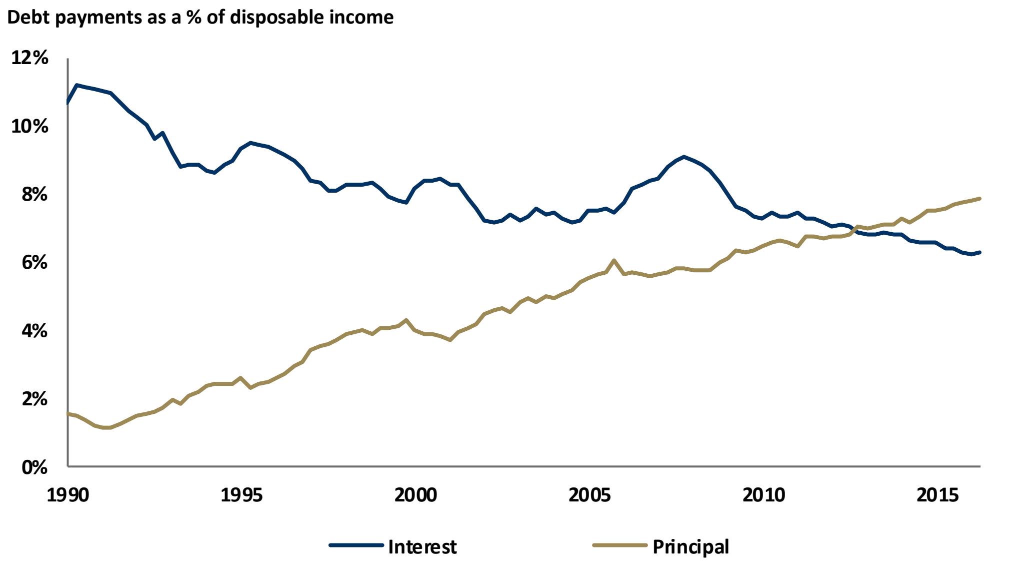


Source: Haver Analytics

More "bad" Trump than feared: Markets have taken a very positive stance toward the policies that we are likely to get from President-elect Trump. However, as we have noted, Mr. Trump likely did not get elected on the back of big tax cuts for the wealthy nor for fewer financial regulations. Rather, his anti-trade, anti-immigration stances likely played some role in his election. Should he aggressively pursue the stances that he took during the election as they pertain to trade and immigration, risks would rise significantly in our view.

Interest rate increases cause an "accident": Higher rates should prove to be positive for the Canadian stock market overall; however, higher rates could pose a headwind not only for the Canadian economy, but also most global economies. While Canadians have taken on significant debts over the past decade+, this has been buffered by the continuous decline in interest rates.

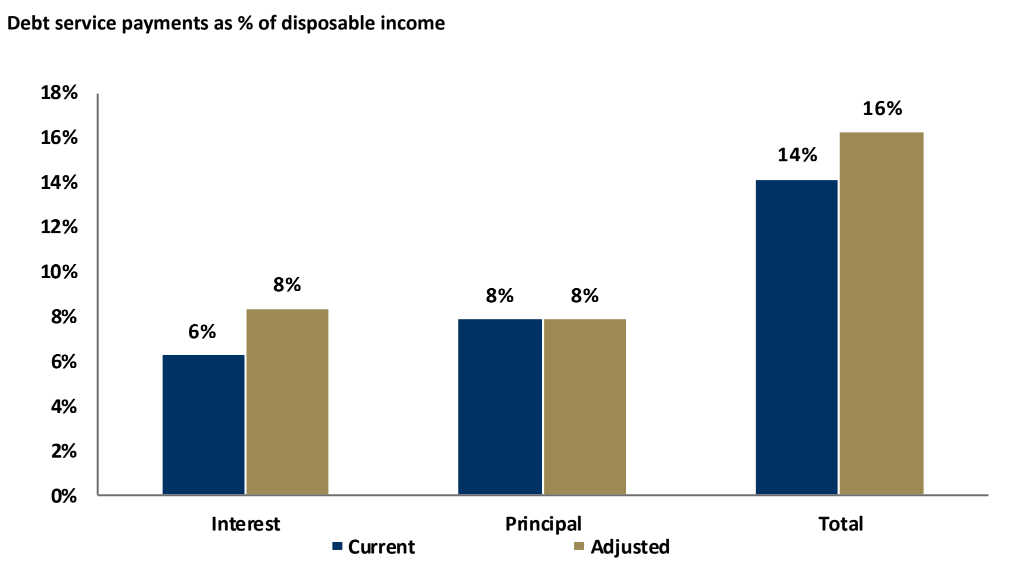
Exhibit 28: Principal payments now are a greater outflow than interest payments



Source: Haver Analytics

Should rates continue to back-up, there is a risk that this would take a significant enough bite out of already low domestic and international growth so as to cause problems of some sort. To put it in perspective, a 100-basis point increase in overall borrowing rates for Canadians would drain roughly as much out of the Canadian economy as the Canadian government's stimulus plan would add:

Exhibit 29: A 100-BP back-up in yields would cost Canadians about $25 billion annually



Source: Haver Analytics; RBC Capital Markets Canadian Equity Strategy; Note: Adjusted assumes 100-basis point increase in interest costs off of current ~3% effective interest rate

Oil prices fail to recover: Our positive call on Canada rests in part on a continued recovery in oil prices. Should oil prices fail to recover, not only would this negatively impact our forecasted earnings for the S&P/TSX, but it would also likely impact the overall performance of the market as many sectors and subsectors in Canada benefit indirectly from higher oil prices.

Geopolitics: If 2016 taught us anything, it is that no political result is certain. As mentioned, several important votes will be held in 2017, including elections in Germany and France. While the market absorbed these votes quite well in 2016, it is possible that the next adverse outcome to the established norm, should one occur, could prove more difficult for markets to overcome.

Companies mentioned

Brookfield Asset Management Inc. (NYSE: BAM; $33.30; Top Pick)

Canadian National Railway Company (TSX: CNR.TO; C$89.81; Outperform)

Canadian Pacific Railway Limited (TSX: CP.TO; C$205.63; Outperform)

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As of 30-Sep-2016

			Investment Banking Serv./Past 12 Mos.	
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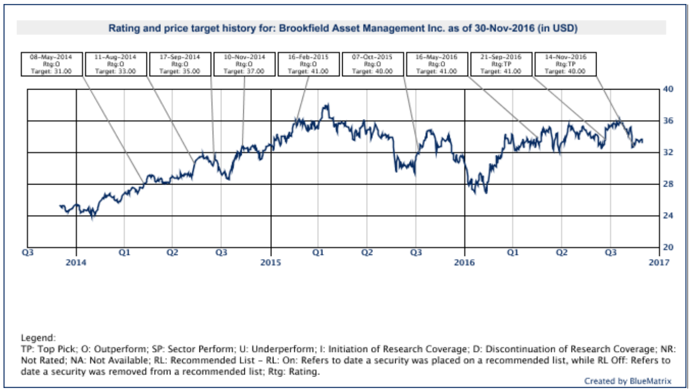
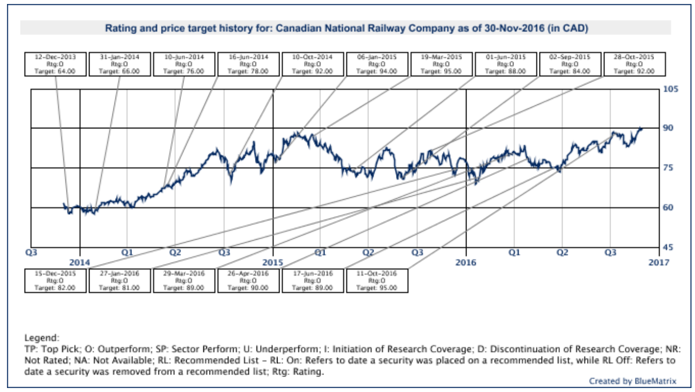
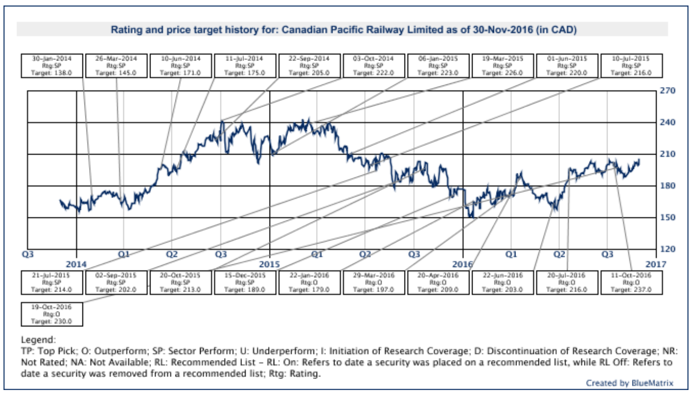
HOLD [Sector Perform]	716	42.82	134	18.72
SELL [Underperform]	109	6.52	10	9.17







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Brookfield Asset Management Inc.

Risks to rating and price target

Impediments to our earnings estimates, price target, and rating include rising interest rates, which might negatively impact earnings at the company's home-building operations and reduce the value of its long-dated assets (commercial properties, power generation, transmission and infrastructure assets), a hard cyclical downturn in the commercial property sector (BAM's largest industry exposure), and any economic shock that causes lending spreads to widen and/or loan to value ratios to decline, which could have a notable impact on BAM's weighted average cost of capital (and hence, its equity value).

Valuation

Our $40 price target continues to equate to parity with our estimated Intrinsic Value per share one-year hence, and it implies an ~18x multiple on our 2018 Operating FFO estimate. Overall, we believe our target valuation metrics are appropriate in light of BAM's high-quality asset base and the growing profitability of its asset management platform. We believe there are few if any companies that are truly comparable to Brookfield Asset Management and we continue to view BAM's shares as a "core holding". Based on risk-adjusted relative return prospects, we rate BAM's shares Top Pick.

Canadian National Railway Company

Risks to rating and price target

Impediments to achieving our rating and price target include but are not limited to extreme fluctuations in fuel prices, unusual weather conditions that could impact grain crops or railway operating efficiencies, and weaker economic conditions than currently envisioned.

Valuation

Our $95 price target is based on our $5.39 2018 EPS estimate and a 17.5x P/E multiple, which is above the peer average. Our favorable view of CNR's relative advantages (superior network, industry leading O/R, service-excellence advantage), impressive execution in both strong and weak demand environments, and volume tailwinds from a bumper grain crop support our premium multiple and our Outperform rating.

Canadian Pacific Railway Limited

Risks to rating and price target

Impediments to achieving our price target and rating include: 1) significant re-regulation resulting from the ongoing review of the Canada Transportation Act; 2) persistent oil price weakness impairing crude-by-rail economics; 3) severe weather impacting crop quality and network fluidity; 4) unfavourable currency fluctuations impacting cross-border freight flows; and 5) economic volatility tempering industrial production and consumer demand throughout North America.

Valuation

Our $230 price target is based on a P/E multiple of 17.0x applied to our 2018 EPS estimate of $13.51. The 17.0x multiple is above the peer average due to CP's operating momentum, unique operating model, strong management team and growing momentum of the Bulk volume recovery. These factors also justify our Outperform rating.

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