Equity Income Guided Portfolio

December 1, 2016 | Quarterly Report

Portfolio Advisory Group – Equities

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Balancing act

Positioning for growth while protecting for higher bond yields

The incoming Trump administration appears set to pursue policies that we believe will boost U.S. GDP growth for at least a couple of years and should be positive for Canadian companies with exposure to that economy, especially within sectors such as Financials and Energy.

The U.S. Federal Reserve has signaled an intention to raise rates further in 2017; however, we do not expect any increase to central bank rates in Canada. RBC Capital Markets continues to forecast bond yields will increase in 2017 and expects the GoC 10-year bond yield to rise from 1.25% at the end of 2016, to 2.0% twelve months from now.

Rising interest rates are among the biggest macroeconomic risks associated with owning a dividend portfolio, as higher bond yields generally have a negative effect on valuations. The challenge in managing a dividend portfolio is to manage the exposure to growing dividends while not abandoning the traditional dividend-paying defensive sectors too early. We witnessed the sell-off of the traditional defensive sectors during the summer months when the 10-year bond yields started to rise on both sides of the border. Historically, valuations of companies with a higher dividend yield and lower dividend growth tend to experience a larger sell-off in a rising rate environment.

To meet the Portfolio's objective of providing a dividend yield that is approximately 150% that of the S&P/TSX Composite Index, while minimizing the risk of higher interest rate, we continue to focus on names that will likely hike dividends over the medium term and/or are more-positively leveraged to economic growth.

Dividend growth

The dividend growth rate of the S&P/TSX Index has been on a downward trajectory for the past four years and is expected to fall into negative territory in 2016 for the first time since the Great Recession (see chart below). Going forward, we are encouraged by the expected recovery in dividend growth for 2017; however, we also note that the expected dividend growth is more-muted compared to our previous analysis.

For an overview of the Portfolio, please click here.

Click here for authors' contact information.

For required disclosures, see page 19.

All values in Canadian dollars and priced as of November 30, 2016, market close unless otherwise noted.

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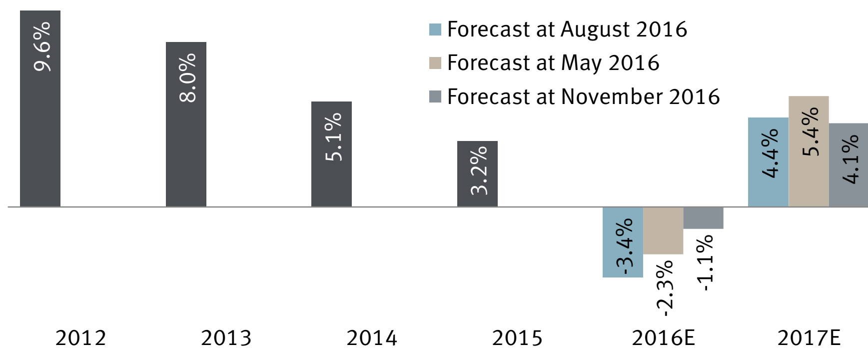
Wealth Management
Dominion Securities

From a sector perspective, consensus is calling for dividend growth to be strongest in the Industrials and Financials sectors.

S&P/TSX Index year-over-year change in dividends



Source - Bloomberg estimates; data as of 11/25/16

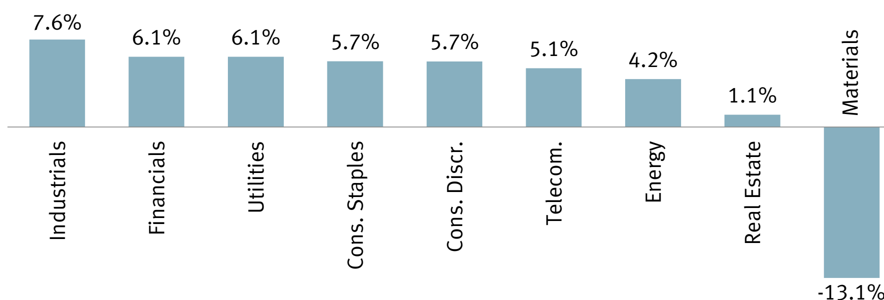
Sector allocation

From a sector perspective, consensus is calling for dividend growth to be strongest for the Industrials and Financials sectors. Despite the lower dividend yield associated with most Industrials stocks, we have maintained our three positions to benefit from potential dividend growth. We have maintained our overweight position in Financials because of its combination of expected dividend growth and potential to benefit from a rising rate environment.

Despite the prospect of higher oil prices over the medium term, we remain slightly underweight the Energy sector because of the lower dividend yield paid by the oil & gas producers.

Expected dividend growth for select S&P/TSX sectors

(2017 compared to 2016)



Source - Factset

Performance

The Equity Income Guided Portfolio generated a total return of 4.17%, 106 basis points ahead of the S&P/TSX High Dividend Index, which returned 3.11% for the quarter, and ahead the broader index return of 4.08%. The Portfolio's outperformance was due to the overweight position in Life Insurance companies and larger exposure to the oil & gas producers.

Total return for the fall quarter (9/1/16 – 11/30/16)	
Equity Income Guided Portfolio	4.17%
S&P/TSX Composite Index	4.08%
S&P/TSX High Dividend Index	3.11%

Source - FactSet

	Company name	Weight	Market cap (B)	Price 11/30/16	52-wk range ($)	EPS / AFFO / CFPS 2015A	2016E	2017E	Price to Earnings/AFFO/CFPS 2015A	2016E	2017E	Div yield	Forecasted Payout Ratio 2015A	2016E	2017E	Forecast growth in EPS/AFFO or CFPS	Forecast dividend growth rate to 2017
Interest sensitive																	
BMO	Bank of Montreal	5.0%	$57	$88.53	90 - 69	7.00	7.32	7.52	12.6x	12.1x	11.8x	3.9%	46%	46%	47%	3%	3%
BNS	Bank of Nova Scotia	5.0%	$90	$74.14	74 - 51	5.67	5.99	6.40	13.1x	12.4x	11.6x	4.0%	48%	48%	48%	7%	3%
NA	National Bank	5.0%	$17	$50.32	50 - 35	4.70	4.17	5.05	10.7x	12.1x	10.0x	4.4%	43%	52%	46%	21%	5%
RY	Royal Bank of Canada	5.0%	$129	$87.08	90 - 65							3.8%					
TD	TD Bank	5.0%	$118	$63.57	65 - 49	4.61	4.91	5.07	13.8x	12.9x	12.5x	3.5%	43%	44%	47%	3%	8%
BAM'A	Brookfield Asset Mgmt****^	2.5%	$44	$44.73	48 - 38	1.59	1.94	2.09	28.1x	23.1x	21.4x	1.6%	39%	36%	36%	8%	7%
MFC	Manulife	5.0%	$46	$23.39	24 - 15	1.68	1.86	2.25	13.9x	12.6x	10.4x	3.2%	40%	40%	37%	21%	12%
IFC	Intact Financial	5.0%	$12	$93.50	97 - 77	6.38	4.97	6.59	14.7x	18.8x	14.2x	2.5%	33%	47%	36%	33%	3%
TRI	**Thomson Reuters ^**	**2.5%**	**$43**	**$57.99**	**58 - 48**	**1.39**	**1.36**	**1.65**	**41.7x**	**42.6x**	**35.1x**	**3.1%**	**96%**	**100%**	**83%**	**21%**	**1%**
HR.UN	H&R REIT *	2.5%	$6	$21.81	24 - 18	1.48	1.52	1.54	14.7x	14.3x	14.2x	6.3%	91%	89%	90%	1%	0%
SRU.UN	SmartREIT *	2.5%	$4	$31.12	39 - 29	1.99	2.09	2.10	15.6x	14.9x	14.8x	5.5%	81%	79%	81%	0%	1%
BCE	BCE	5.0%	$50	$57.89	63 - 52	3.36	3.49	3.75	17.2x	16.6x	15.4x	4.7%	77%	78%	76%	7%	4%
FTS	Fortis	5.0%	$16	$40.04	45 - 36	2.11	2.16	2.42	19.0x	18.5x	16.5x	4.0%	66%	69%	66%	12%	0%
H	Hydro One	2.5%	$14	$23.08	27 - 22	1.12	1.22	1.23	20.6x	18.9x	18.8x	3.6%	0%	69%	72%	1%	5%
Consumer																	
SJR'B	Shaw Communications	5.0%	$12	$26.29	28 - 23	1.85	1.25	1.47	14.2x	21.0x	17.9x	4.5%	63%	96%	82%	18%	1%
CGX	Cineplex	2.5%	$3	$50.31	53 - 45	1.68	1.45	1.89	29.9x	34.7x	26.6x	3.2%	92%	110%	88%	30%	2%
Industrial																	
CNR	Canadian Nat. Railway	5.0%	$69	$89.81	91 - 67	4.45	4.53	5.06	20.2x	19.8x	17.7x	1.7%	28%	34%	32%	12%	10%
MG	Magna International ^	2.5%	$21	$54.28	62 - 42	4.49	5.23	5.70	12.1x	10.4x	9.5x	2.5%	20%	19%	19%	9%	10%
TIH	Toromont Industries	2.5%	$3	$44.04	44 - 27	1.86	1.95	2.14	23.7x	22.6x	20.6x	1.6%	37%	37%	34%	10%	0%
Resources																	
ARX	ARC Resources****	2.5%	$8	$23.52	25 - 14	2.27	1.69	1.92	10.4x	13.9x	12.3x	2.6%	53%	38%	31%	14%	0%
SU	Suncor Energy****	2.5%	$71	$42.78	43 - 27	4.71	3.63	6.38	9.1x	11.8x	6.7x	2.7%	24%	32%	18%	76%	0%
VET	Vermilion Energy****	2.5%	$6	$54.49	55 - 30	4.55	4.39	5.91	12.0x	12.4x	9.2x	4.7%	57%	59%	44%	35%	0%
ENB	Enbridge* ^^	2.5%	$53	$56.50	59 - 40	3.72	R	R	15.2x	R	R	3.8%	50%	R	R	R	R
TRP	**TransCanada**	**5.0%**	**$52**	**$60.33**	**63 - 41**	**2.48**	**2.67**	**2.83**	**24.3x**	**22.6x**	**21.3x**	**3.7%**	**84%**	**85%**	**88%**	**6%**	**10%**
ALA	AltaGas *	2.5%	$5	$32.64	36 - 27	2.84	2.94	3.00	11.5x	11.1x	10.9x	6.4%	70%	71%	74%	2%	6%
IPL	Inter Pipeline Ltd *	2.5%	$10	$27.31	29 - 18	1.88	1.93	2.13	14.5x	14.2x	12.8x	5.9%	78%	81%	76%	10%	0%
AGU	Agrium ^	5.0%	$19	$135.39	136 - 105	7.25	4.72	5.01	18.7x	28.7x	27.0x	3.5%	47%	74%	70%	6%	0%

Source - RBC Capital Markets estimates, Bloomberg

^ The EPS and dividend are in U.S. dollars.
^^ This security is restricted pursuant to RBC Capital Markets policy and, as a result, its continued inclusion in the Equity Income Guided Portfolio has not been reviewed or confirmed as of the date hereof.
* Adjusted funds from operations (AFFO) instead of earnings per share (EPS)
**** Cash flow per share (CFPS)
Payout ratios based on earnings per share, except for the above.
Dividend growth rate is based on RBC Capital Markets' 2016 forecast dividend compared to the current annualized dividend.
Growth in EPS/AFFO/CFPS are based on the RBC Capital Markets' 2016 forecast compared to current.

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Sector commentary

Canadian bank valuations are trading close to historical average levels.

The recent sharp move up in bond yields, following the results of the U.S. election, resulted in large share price gains by the Canadian life insurance companies.

Banks and Insurance

Canadian life insurance better positioned to deliver earnings growth

Canadian bank valuations are trading close to historical average levels despite uncertainty about near-term earnings power and longer-term returns as the global capital regulatory regime evolves. RBC Capital Markets expects Canadian bank earnings could come under pressure from a potential real estate bubble, slower consumer growth, normalizing credit conditions, or a prolonged low oil price environment. As such, RBC Capital Markets believes cost control will continue to be a key driver of earnings growth for the foreseeable future.

We are maintaining 5% positions in **Royal Bank of Canada** (RY), **TD Bank** (TD), **National Bank** (NA), **Bank of Montreal** (BMO), and **Bank of Nova Scotia** (BNS).

RBC Capital Markets continues to believe life insurance stocks have the potential to generate superior earnings growth relative to banks due to higher exposure to the U.S. dollar, growth in their wealth and asset management business, and lower exposure to the Energy sector.

A significant decline in long-term interest rates would be the biggest risk to this view as life insurance stocks tend to benefit from rising rates, which is counter to most other dividend-paying stocks. The recent sharp move up in bond yields, following the results of the U.S. election, resulted in large share price gains by the Canadian life insurance companies.

We are maintaining our 5% position in **Manulife Financial** (MFC) because of its strong dividend yield and the ballast it provides the Portfolio should bond yields rise.

Intact Financial (IFC), 5%, is Canada's largest property & casualty insurer. While not a high yielder, IFC has a strong track record of growing earnings and book value over time, which we believe will translate into sustainable dividend growth. RBC Capital Markets believes IFC has solid growth potential over the next couple years driven by a generally positive industry backdrop plus strong fundamental execution with opportunities for improvement in the commercial sectors. In addition, IFC shares offer downside risk protection given that property and casualty insurance trends tend to be less sensitive to economic changes.

Brookfield Asset Management (BAM'A), 2.5%, provides exposure to a global alternative asset manager that derives approximately 80% of its revenues outside Canada.

We like **Thomson Reuters** (TRI), 2.5%, because its significant international exposure leverages potential economic recoveries in the U.S. and Europe. However, its position has been reduced from 5% due its sector reclassification from S&P that resulted in Financials exceeding the Portfolio's 40% per-sector maximum.

Real Estate

Trading below fair value

The recent rise in bond yields has resulted in a slump in unit prices during the last quarter. Compared to the 10-year Government of Canada bond yield, the Real Estate sector looks attractive with an AFFO yield of 6.9%. From a valuation perspective,

the sector is trading at a 13% discount to NAV, well below the long-term historical average of a 2% premium.

We continue to believe slightly lower valuations reflect the weaker economic growth prospects for Canada and that certain property sectors, notably office and retail, are facing more-challenging supply/demand dynamics. However, the sector continues to be good for income-oriented investors given the improving payout ratios and strong balance sheets.

Compared to the 10-year Government of Canada bond yield, the Real Estate sector looks attractive.

We continue to hold 2.5% positions in **H&R REIT** (HR.UN) and **SmartREIT** (SRU.UN).

Energy and Materials

Fewer options for dividend-oriented investors

RBC Capital Markets slightly reduced its 2016 crude oil forecast, to US$44 per barrel (/bbl), and slightly lowered its 2017 oil price forecast by 5% to US$56/bbl. The trend of lower commodity prices continued with the 2018 forecast reduced to US$62/bbl, from US$65/bbl.

Because of its strong growth profile, we are keeping the **ARC Resources** (ARX) 2.5% position. We are maintaining the 2.5% position in **Suncor Energy** (SU) as its refining operations provide a partial hedge to lower oil prices, and we expect the company will be cash flow positive in 2017 and 2018. We have maintained the 2.5% position in **Vermilion** (VET) because of its growing production base in Europe and attractive dividend yield.

We are maintaining the 5% position in **Agrium** (AGU) because we believe new projects, rising prices, and the benefits from a merger with Potash Corp. (currently pending) would result in higher cash flows.

Utilities, Pipelines, and Midstreams

Staying defensive

The sector's forward price-to-earnings ratio remains near its all-time high. However, relative to the S&P/TSX Composite Index multiple, valuation levels continue to come down and are at the low point of the historical range of the past 10 years.

We believe the risk of project delays in the oil sands is partially reflected in the current share prices of some of the midstream companies.

We are cognizant that a material increase in interest rates could pressure valuations. As a result, we believe investors in this sector would be best served focusing on companies that have the capacity to increase dividends.

Additional potential sector-specific risks include lower natural gas prices, lower crude oil prices, or potential royalty rate changes given the recent government change in Alberta. We believe the risk of project delays in the oil sands is partially reflected in the current share prices of some of the midstream companies.

We have increased our position in **TransCanada** (TRP) to 5% because of its strong near-term growth potential, which could result in attractive dividend increases, and the possibility of Keystone XL approval.

There is no change to our 2.5% position in **Inter Pipeline** (IPL). While RBC Capital Markets expects the company to provide investors with dividend increases over the next two years, we are cognizant that a continued low crude oil price environment could curtail dividend hikes. In the meantime, we believe its dividend is safe over the medium term.

AltaGas (ALA) is maintained as a 2.5% position.

There are no changes in the Utilities sector. **Hydro One** (H), 2.5%, still has an attractive dividend and low operating risk profile, while we believe **Fortis** (FTS), 5%, has an attractive dividend yield and ability to generate strong dividend growth over the medium term.

Income-oriented investors are finding few options in the Consumer sector.

Consumer

Challenging search

Income-oriented investors are finding few options in the sector as most companies have below-average dividend yields.

Cineplex (CGX), 2.5%, has a market-leading box office share and attractive dividend yield. Going forward, we believe Cineplex's share price upside potential is limited because of the lackluster movie slate for the upcoming quarters and higher valuation levels.

Industrials

Still looking for U.S. exposure and stability

We maintained **Magna International** (MG), 2.5%, to keep our exposure to the global economy and believe the company will continue to return capital to shareholders in the form of dividend increases and share buybacks.

There is no change to our 2.5% position in **Toromont Industries** (TIH) as we like the management team and the company's long-term dividend growth potential.

We have also kept the 5% **Canadian National Railway** (CNR) position. While not a high yielder, the company has a long-term track record of consistently increasing its dividend, and we believe that the strong free cash flow makes the stock a good defensive alternative given the headwinds facing most sectors in Canada.

Compared to the overall S&P/TSX Composite Index, the Telecommunications sector offers higher dividend yields.

Telecommunications

Benefiting from fund flows, but dividend increases could be more muted

Compared to the overall S&P/TSX Composite Index, the Telecommunications sector offers higher dividend yields and has traditionally been viewed by investors as defensive. RBC Capital Markets believes the wireless sector will provide a growth avenue to mitigate lower advertising revenues and replacement risks in the traditional business sectors. While fundamentals still appear generally positive, we believe dividend growth rates expectations will have to be adjusted downward because of higher financial leverage and dividend payout ratios.

We are maintaining the 5% positions in **BCE** (BCE) and **Shaw Communications** (SJR'B).

TransCanada Corporation

(TSX: TRP, $60.33)

TransCanada's assets include natural gas pipelines, power generation, and natural gas storage. The company has more than 68,000 km of wholly owned pipelines in North America, owns or has interests in about 10,900 MW of power generation (hydro, gas, nuclear, and coal) in operation or under development, and 368 bcf of natural gas storage.

RBC Capital Markets:	Outperform

We are increasing our position in TransCanada Corporation by 2.5%

Rationale for increase

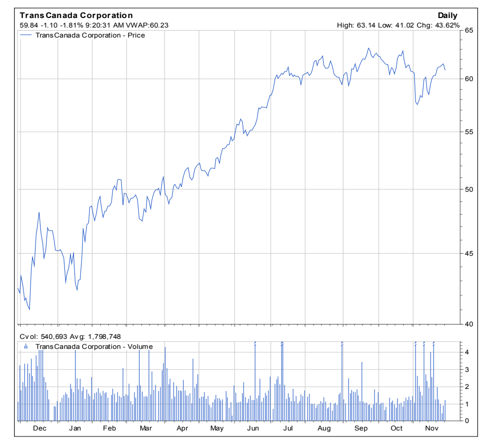
We are increasing our position in TransCanada to 5% for the following reasons:

- **Strong near-term dividend growth:** TransCanada reiterated its 8%–10% dividend per share CAGR to 2020. The company's confidence is underpinned by the small to medium-sized growth projects having a lower degree of execution risk (i.e., no presidential permits, not in environmentally sensitive areas).
- **Potential Keystone XL (KXL) approval:** Thanks to the U.S. presidential election result, the Keystone XL oil pipeline project is back as a topic of conversation. RBC Capital Markets pegged the project at roughly $4 per share (unrisked PV) although we note that there are a number of questions outstanding, including whether it can actually be approved and how long that would take, changes in costs, changes in contracts and what President-elect Trump meant when he talked about wanting a share of the profits from KXL.

Risks

Risks include, but are not limited to, reduced gas flows on the Canadian Mainline, inability to complete new projects, large disconnect between actual and forecast power and natural gas prices, and the ability to fund new growth projects at reasonable costs of capital.

1-year TRP pricing chart



Source - FactSet; data intraday 11/29/16

Thomson Reuters Corporation

(TSX: TRI, $57.99)

Thomson Reuters is an information publisher serving professionals in three primary businesses: financial & risk, legal, and tax & accounting. Thomson generates the majority of its revenue outside of Canada, which should be positive as we believe the U.S. economy is poised for stronger growth.

RBC Capital Markets:	Sector Perform

We are decreasing our position in Thomson Reuters Corporation by 2.5%

Rationale for decrease

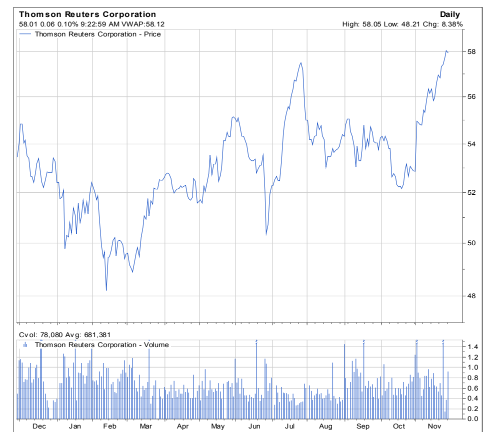
We are decreasing our position in Thomson Reuters to 2.5% for the following reasons:

- **Sector allocation:** S&P's recent reclassification of Thomson Reuters from Consumer Discretionary to Financials has resulted in the Equity Income Guided Portfolio's Financials weighting exceeding the 40% maximum individual sector weighting of equities allowed in the PIM program. As a result, we are reducing the position from 5% to 2.5%.
- **Lower dividend yield:** Thomson was added to the EIGP in the summer of 2013 because of its international diversification and attractive dividend yield. The share price appreciation of approximately 70% over that time has pushed the dividend yield closer to the S&P/TSX Composite average. Going forward, we continue to await visibility on the company's 3% organic growth revenue objective, which according to RBC Capital Markets is the main catalyst for the share price.

Risks

Risks include, but are not limited to, a stronger Canadian dollar, cyclical downturn in financial markets and/or major deterioration in the global economic outlook, further broker bankruptcies and/or major broker consolidation and restructuring, and inability to complete the Eikon rollout and migration.

1-year TRI pricing chart



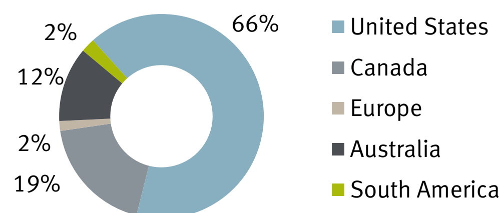
Source - FactSet; data intraday 11/29/16

Portfolio companies

Agrium Inc. (AGU) – 5.0%

- Agrium operates North America's largest agricultural retail network with a major presence in Australia. The wholesale business produces nitrogen, phosphate, and potash fertilizers.
- Agrium has capitalized on a tough agricultural market by focusing on operational improvements and growth opportunities through retail tuck-in acquisitions. RBC Capital Markets believes this strategy will significantly improve FCF and expects the company to subsequently return cash to shareholders through a combination of share repurchases and dividend increases. Its pending merger with Potash Corp, expected to close mid-2017, should generate $500M in synergies, according to Agrium.

AGU 2015 revenue by geography

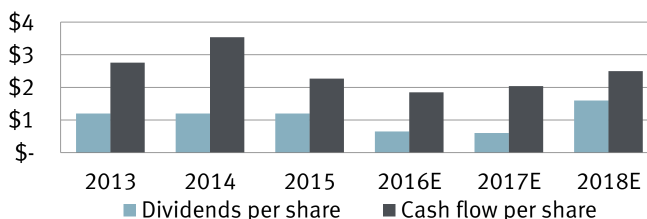


Source - Bloomberg, Company reports

ARC Resources (ARX) – 2.5%

- ARC's management team takes a long-term perspective and has been in the process of selling non-core assets to fund a more-focused growth strategy in the Montney. This should allow ARC to deliver further capital efficiencies and keep operating costs low while delivering strong multi-year production growth rates. The balance sheet is also among the strongest of its peers.
- Lower natural gas prices previously forced ARC to lower its dividend; however, estimates have been moving higher based on tightening supply/demand fundamentals. And if prices continue to be weak, 45% of ARC's production is hedged. RBC Capital Markets forecasts a payout ratio of about 30%, and for the dividend to be maintained in 2017.

ARX dividends & cash flow per share

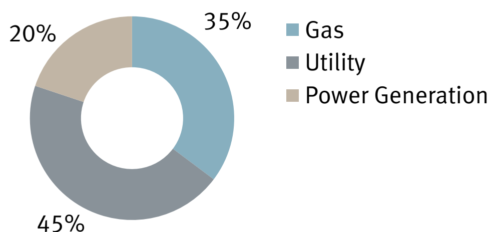


Source - Bloomberg, Company reports, RBC Capital Markets estimates

AltaGas (ALA) – 2.5%

- AltaGas is an integrated energy infrastructure and services organization exposed to natural gas production volumes and demand for electricity.
- RBC Capital Markets believes the company has ample liquidity via its bank lines and capital markets access to fund its growth program. However, we believe the share price may remain under pressure until more clarity is provided on the potential impact following S&P's decision to assign a "negative outlook" to the company's investment-grade rating.
- RBC Capital Markets forecasts a 6% increase for 2017. This results in an AFFO payout ratio of approximately 77%.

ALA 2015 revenue by segment

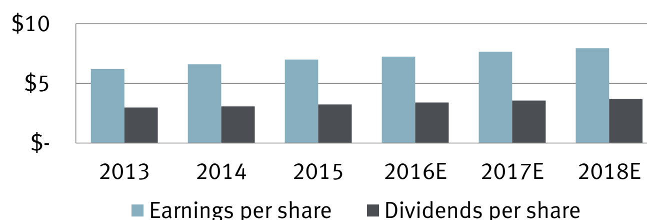


Source - Bloomberg, Company reports

Bank of Montreal (BMO) – 5.0%

- Compared to most Canadian banks, Bank of Montreal should benefit from ongoing U.S. economic growth. RBC Capital Markets believes that the U.S. business is poised for mid-single-digit earnings growth for 2016–17 due to strong loan growth and a weaker Canadian dollar.
- RBC Capital Markets forecasts a small dividend increase for 2017 for a payout ratio of 47%, near the upper end of BMO's stated 40%–50% range.

BMO earnings & dividends per share



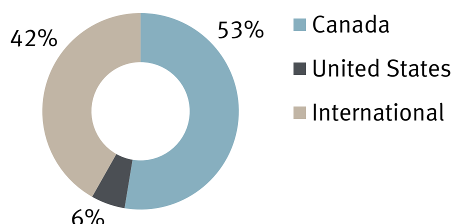
Source - Bloomberg, Company reports, RBC Capital Markets estimates

Some exhibits in the report may not add to 100% due to rounding.

The Bank of Nova Scotia (BNS) – 5.0%

- We believe the Bank of Nova Scotia's international banking division should grow faster than domestic franchises over time, although near-term growth has been held back by slow economic growth in the Caribbean.
- While Scotia expects the cumulative energy-related loan loss ratio since 2015 of 1.9% to rise to roughly 3% in 2017, energy-related loan losses have now moderated from the peak levels recorded in Q2; and problem loan formations have also declined. The company has also guided towards high cost savings and efficiency improvements this quarter.
- RBC Capital Markets forecasts a 3% dividend increase for a 2017 payout ratio of 49%, near the upper end of BNS' stated 40%–50% range.

BNS 2015 revenue by geography

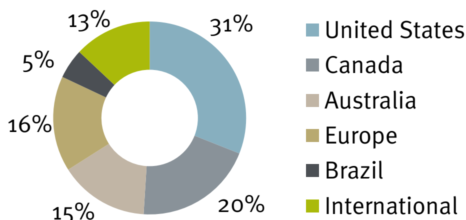


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Brookfield Asset Management Inc. (BAM'A) – 2.5%

- Brookfield Asset Management is a global alternative asset manager focused on property, power, and infrastructure with over $200B under management (approximately $100B fee-bearing).
- Given its solid track record of identifying long-term opportunities, we believe BAM should be able to generate significant returns over and above what is reflected in its share price.
- BAM continues to grow its asset management business, which we believe will provide the company with a steadier source of earnings. We expect the company will increase its dividends based on a portion of the growth rate in cash flow from operations.

BAM'A 2015 revenue by geography

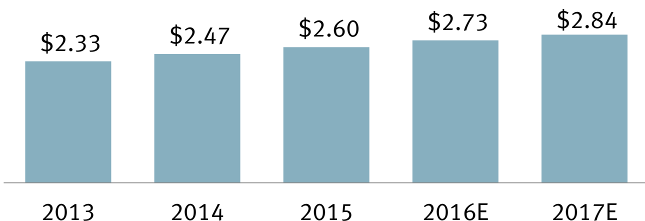


Source - Bloomberg, Company reports

BCE Inc. (BCE) – 5.0%

- BCE, Canada's largest telecom services company by market cap, provides local, long distance, wireless, satellite, and internet services across Canada. Bell Canada also owns Bell Media.
- Despite emerging wireline revenue pressure, positive ARPU growth and cost-efficiencies should continue to translate to positive wireline EBITDA growth, underpinning overall NAV growth and continued dividend growth.
- RBC Capital Markets forecasts a 4% increase for 2017, for a payout ratio of approximately 77%.

BCE dividends per share

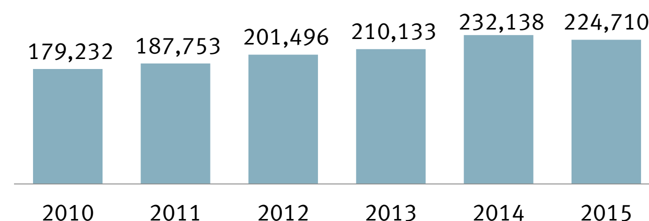


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Canadian National Railway (CNR) – 5.0%

- We view CN Railway as a best-in-class railroad based on its industry-leading operating record and commitment to delivering superior service. The company's pursuit of strong service and superior operations has fueled volume growth ahead of the peer group, which has driven margins, earnings, and free cash flow to record levels.
- Despite a low dividend yield, CN Railway meets our investment goal of increasing exposure to U.S. and global markets.
- CN Railway's annual dividend has increased for 19 successive years. RBC Capital Markets expects the company to hike its dividend 9% in 2017.

CNR revenue ton miles

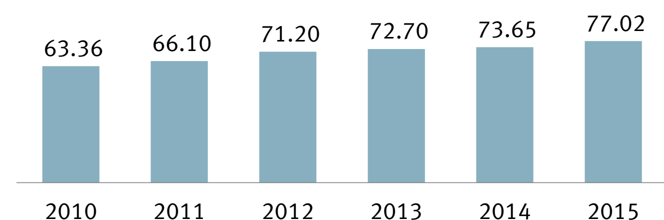


Source - Bloomberg, Company reports

Cineplex Inc. (CGX) – 2.5%

- Cineplex is a leader in the Canadian media industry with nearly 80% of Canadian movie box office share.
- Despite a challenging advertising environment and rising structural headwinds across the media sector, RBC Capital Markets likes Cineplex's high-quality/defensive attributes. The counter-cyclical nature of box office attendance makes Cineplex a key component to a diversified income portfolio as its share price tends to provide strong relative performance during market downturns.
- RBC Capital Markets is forecasting a 2% increase in the Cineplex dividend for 2017, which would translate into a 2017 free cash flow payout ratio of approximately 82%.

CGX movie attendance (in millions)



Source - Company reports

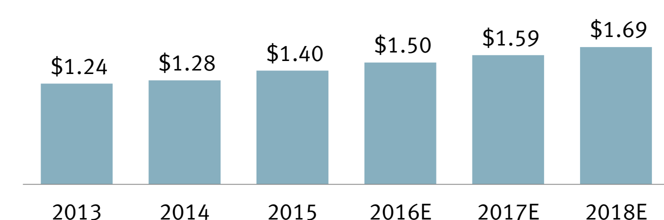
Enbridge (ENB) – 2.5%

This security is restricted pursuant to RBC Capital Markets policy and, as a result, its continued inclusion in the Equity Income Guided Portfolio has not been reviewed or confirmed as of the date hereof.

Fortis Inc. (FTS) – 5.0%

- Fortis is a utility holding company with regulated utilities in Canada, the U.S., and the Caribbean. The company also has non-regulated operations in power and real estate.
- The company is entering a period of significant organic growth, with the five-year CAGR in rate base through 2020 expected by RBC Capital Markets to be 6%, which should be supportive of dividend increases. We also like the upside optionality from potential LNG-related infrastructure.
- FTS has increased its dividend for 42 consecutive years. RBC Capital Markets forecasts an approximate 70% payout ratio for 2017.

FTS dividends per share

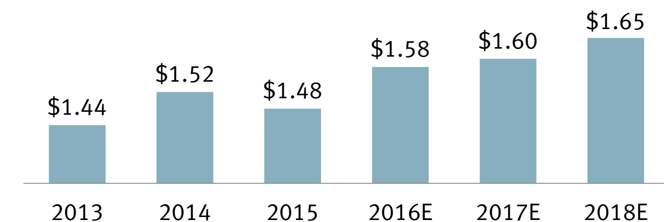


Source - Bloomberg, Company reports, RBC Capital Markets estimates

H&R REIT (HR.UN) – 2.5%

- H&R is one of Canada's largest diversified commercial property REITs with a $14B portfolio of office, industrial, and retail properties in Canada and in the U.S. Recently, H&R began to acquire U.S. multi-family properties in order to continue to diversify its portfolio.
- H&R has a highly predictable cash flow stream given its high percentage of triple-net leases on its non-retail properties combined with its high occupancy rates.
- H&R has increased its distribution 14% since 2012. At the current level, RBC Capital Markets expects a payout ratio of approximately 84% of the 2017 AFFO per-unit estimate.

HR.UN trailing 12-mo adj. funds from operations per unit

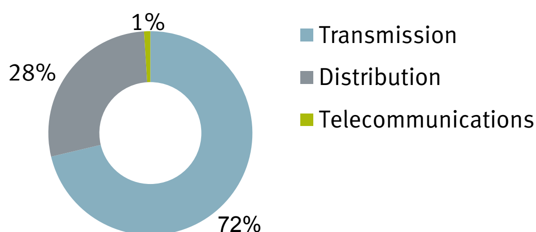


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Hydro One Ltd. (H) – 2.5%

- Hydro One has two primary business segments in Ontario, electric transmission and electric distribution, and a very small telecommunications division.
- RBC Capital Markets expects a baseline 5% EPS CAGR through 2020 driven by utility rate base additions, with upside potential from further transmission investment, operational efficiencies, or the possibility of additional acquisitions of smaller Ontario-based electric local distribution companies. Including the yield, this equates to a high single-digit total-return plus upside into the low-double digits, and the stock has a below-average risk profile. RBC Capital Markets expects Hydro One will increase its dividend by about 5% in 2017, for a payout ratio of 70%.

H 2015 net income by segment

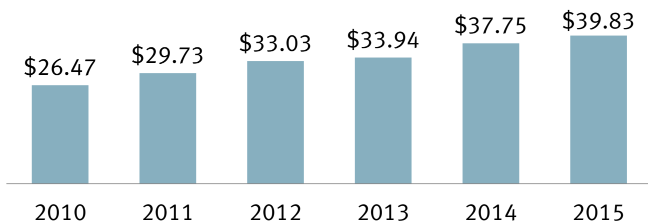


Source - Bloomberg, Company reports

Intact Financial Corp. (IFC) – 5.0%

- Intact Financial is one of the largest property and casualty insurance companies in Canada.
- We believe the company's defensive nature, coupled with its leading market position and operating metrics will likely continue to provide valuation support as a "safer haven" within the Financials sector. Further share price upside may also come from acquisitions or growth in book value per share.
- Earlier this year, Intact increased its quarterly dividend by 9%. RBC Capital Markets forecasts an increase of 3% in 2017, for a payout ratio of approximately 35%.

IFC book value per share

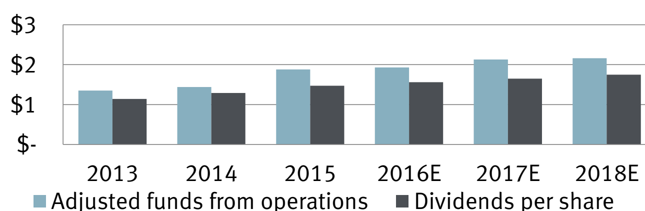


Source - Bloomberg, Company reports

Inter Pipeline Ltd. (IPL) – 2.5%

- Inter Pipeline holds interests in crude oil pipeline systems and natural gas liquid extraction facilities in Western Canada as well as liquids storage businesses in Europe.
- We continue to view Inter Pipeline as an attractive way to gain exposure to oil sands volume growth. The company's underutilized capacity could propel the share price higher; however, the challenging oil environment may limit near-term upside. The recent acquisition of the Williams Canada assets provides upside potential if NGL prices recover.
- RBC Capital Markets forecasts a 6% dividend increase in 2017, for an AFFO payout ratio of approximately 80%.

IPL dividends & adjusted funds from operations

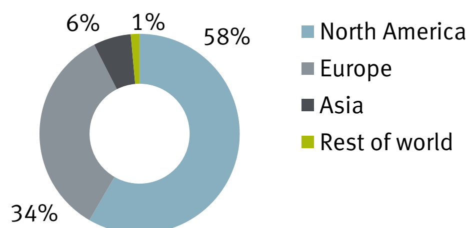


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Magna International Inc. (MG) – 2.5%

- MG is one of the world's leading auto parts suppliers with a diversified product suite. It also has the capability to design and integrate complete systems, including the assembly of an entire vehicle. It operates over 300 plants in 28 countries.
- North American auto sales have approached the long-term trend line while RBC Capital Markets projects global production to grow at a 2% CAGR through the end of the decade. We expect higher utilization rates to drive higher margins. The shares trade at a meaningful discount to the peer group despite the potential for dividend increase and share buybacks.
- RBC Capital Markets expects MG will increase its dividend by 10% in 2017, for a payout ratio of approximately 25%.

MG 2015 revenue by geography

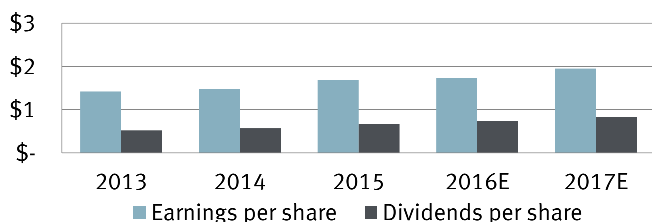


Source - Bloomberg, Company reports

Manulife Financial Corp. (MFC) – 5.0%

- Manulife is Canada's largest insurer and a leading global provider of wealth management products and services.
- Manulife believes it can deliver $4B in core earnings in 2016, mainly driven by volume contribution and, to a lesser extent, by higher margins. Going forward, we believe the share price should benefit from lower earnings volatility because sensitivities to movements in equity markets and interest rates have declined significantly.
- Manulife recently increased its annual dividend by 9%. RBC Capital Markets forecasts a dividend payout ratio of 43% in 2017.

MFC earnings & dividends per share

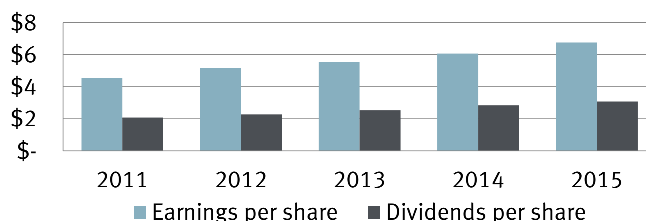


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Royal Bank of Canada (RY) – 5.0%

- Royal Bank is Canada's largest bank by assets and market capitalization, offering a full range of personal, commercial, and corporate banking services. Earnings are split between Canadian Banking, Capital Markets, Wealth Management, and U.S. & International Banking.

RY earnings & dividends per share

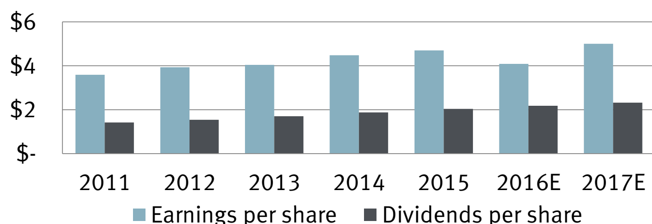


Source - Bloomberg, Company reports

National Bank of Canada (NA) – 5.0%

- National Bank is the smallest of the Big Six Canadian banks and operates mainly in Canada. Slower economic growth in Canada means NA's valuation discount should remain for the medium term.
- Slower investment banking earnings growth and higher loan losses are likely to temper 2016 EPS growth. NA was the first Canadian bank to record a general provision equivalent to approximately 8% of its oil & gas loans.
- RBC Capital Markets forecasts a 3% dividend increase for 2017, for a payout ratio of 45%, near the mid-point of National's stated 40%–50% range.

NA earnings & dividends per share

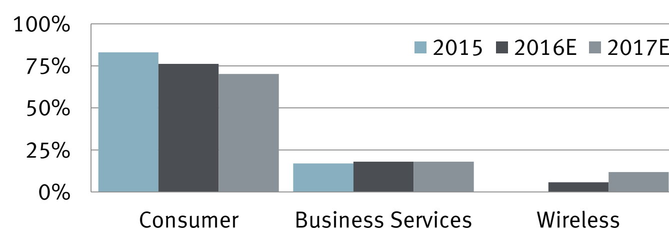


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Shaw Communications (SJR'B) – 5.0%

- SJR'B is one of Canada's largest telecom operators offering cable, internet, and telephony services in Western Canada. With the 2015 acquisition of WIND Mobile, Shaw has boosted the revenue and EBITDA growth profile of the stock. It has already spent millions of dollars upgrading its network and plans to roll out its LTE network in Toronto and Vancouver under the rebranded Freedom Mobile.
- There will be capex requirements and spectrum outlays within the wireless segment in the near future, so management is likely to defer dividend growth until after the LTE upgrade. RBC Capital Markets believes the dividend is sustainable, but notes the payout ratio will remain over 100% in FY2017, before easing to 70%–80% longer term.

SJR'B revenue per division

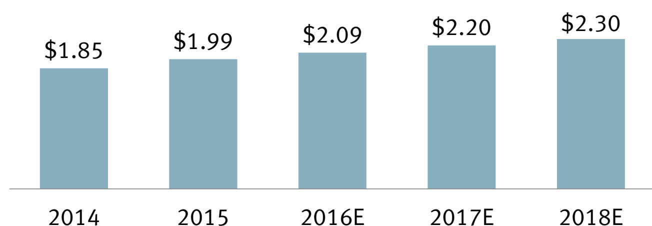


Source - Bloomberg, Company reports, RBC Capital Markets estimates

SmartREIT (SRU.UN) – 2.5%

- SmartREIT owns interests in approximately 150 predominately Wal-Mart-anchored shopping centres, comprising more than 30 million square feet of gross leasable area (GLA) across all 10 Canadian provinces.
- Its property expansion and development pipeline encompasses almost five million square feet of development potential, including the first phase of the Vaughan Metropolitan Centre. Wal-Mart represents approximately 27% of SmartREIT's gross revenue.
- RBC Capital Markets forecasts a 4% distribution increase in 2017, for an AFFO payout ratio of 78%.

SRU.UN adjusted funds from operations per unit

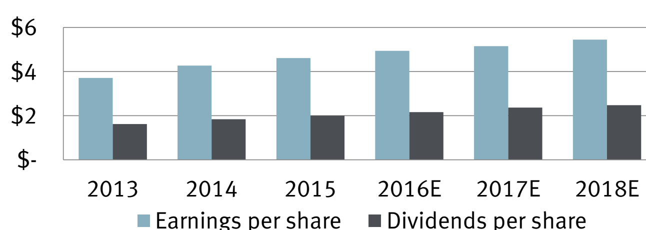


Source - Bloomberg, Company reports, RBC Capital Markets estimates

TD Bank (TD) – 5.0%

- TD Bank is well positioned to record above-average revenue growth in Canada and the U.S. TD's diversification outside of Canada should be viewed more positively, in our view, as the U.S. economy continues to improve.
- RBC Capital Markets continues to believe TD should grow EPS faster than should the Canadian peer group in 2016–17, driven by above-average loan growth in the U.S. and lower exposure to Alberta than peers.
- RBC Capital Markets expects an 8% hike to TD's 2017 dividend, for a 46% payout ratio.

TD earnings & dividends per share

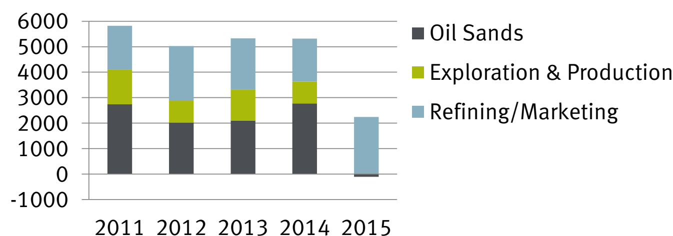


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Suncor Energy Inc. (SU) – 2.5%

- Suncor Energy has re-engineered itself into a best-of-breed global integrated oil producer that consistently provides upstream growth, capital discipline, and cost containment.
- Its downstream operations, which benefit from lower oil prices and a strong balance sheet, should allow it to weather current oil market conditions and still proceed with its oil sands and offshore development projects. It is also targeting $1.0–$1.5B of non-core asset sales by mid-2017 to potentially fund future upstream acquisitions.
- The company recently increased its dividend 4% and elected to renew its share buyback program, a testament to management's commitment to return capital to shareholders. We do not expect a dividend increase in 2017.

SU operating earnings by division

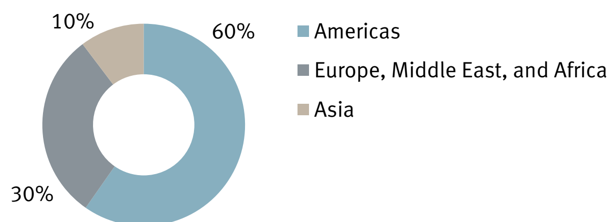


Source - Bloomberg, Company reports

Thomson Reuters Corporation (TRI) – 2.5%

- Thomson Reuters—an information provider for the world's businesses—should benefit from a global economic recovery.
- Thomson generates the majority of its revenue outside of Canada, which should be positive as we believe the Canadian dollar is likely to remain under pressure. Management has indicated that organic revenue growth remains the priority. We continue to see modest annual dividend increases as well as the current US$1.5B NCIB as the priority usage for excess free cash flow.
- It has raised the dividend annually for the past 22 years. RBC Capital Markets expects a small dividend increase for 2017.

TRI 2015 revenues by geography

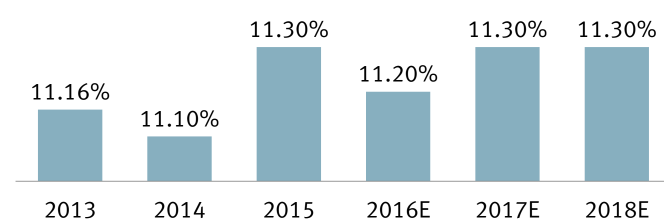


Source - Bloomberg, Company reports

Toromont Industries Ltd. (TIH) – 2.5%

- Toromont sells, rents, and services a broad range of Caterpillar mobile equipment and industrial engines in most of Eastern Canada. Toromont also runs Cimco, an industrial and recreational refrigeration business.
- We view Toromont as a "best-in-class" defensive firm with strong operating margins and balance sheet flexibility. We believe the valuation premium is warranted given its positive earnings growth outlook, solid balance sheet, and potential for acquisition growth.
- Despite Toromont's current dividend yield being below our target level, TIH has a 26-year history of increasing its dividend and payout ratio, and we are confident there is further room for growth.

TIH dividends & diluted earnings per share (adjusted)

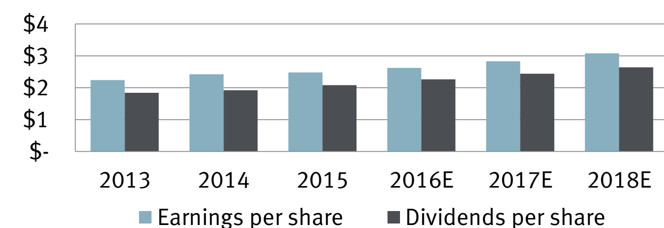


Source - Bloomberg, Company reports, RBC Capital Markets estimates

TransCanada Corporation (TRP) – 5.0%

- TransCanada's assets include natural gas pipelines, power generation, and natural gas storage. We think TRP shares offer an attractive entry point for investors seeking good value with a long-term investment horizon.
- There are a number of recent positive developments for TRP, including Keystone XL moving back on the radar. In addition, we believe the recent Columbia Pipeline Group (CGP) acquisition has provided meaningful EPS and DCF accretion through the end of the decade. TRP has reiterated its 8%–10% dividend per share CAGR to 2020.
- RBC Capital Markets forecasts an 8% distribution increase in 2017, for an EPS payout ratio of 87%.

TRP earnings & dividends per share

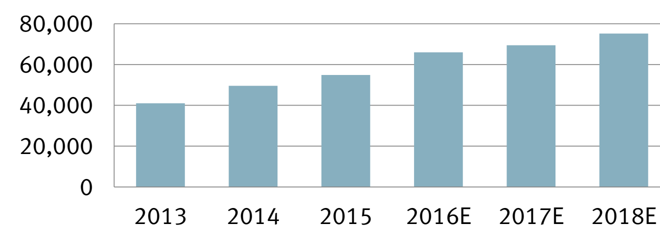


Source - Bloomberg, Company reports, RBC Capital Markets estimates

Vermillion Energy Inc. (VET) – 2.5%

- Vermilion's production base is internationally diversified and almost two-thirds oil-weighted. VET's production flows from Western Canada, France, Australia, Germany, and the Netherlands. VET's Corrib (18.5% working non-operated interest) gas development offshore Ireland achieved first gas at the end of 2015 and reached peak rates at the end of June 2016.
- Corrib is poised to provide free cash flow generation for the company given its European-linked gas pricing, no royalties, and low expected maintenance capex.
- According to RBC Capital Markets, the company's dividend is sustainable with forecasted simple and effective payout ratios of 44% and 87%, respectively, for 2017.

VET production in barrels per day



Source - Bloomberg, Company reports, RBC Capital Markets estimates

Portfolio companies risks

Agrium: Risks include, but are not limited to, unpredictable weather affecting agricultural inputs, foreign exchange impact on earnings and cash flows, volatile nature of input costs and realized prices, and fluctuations in sales of its retail division.

AltaGas: Risks include, but are not limited to, lower natural gas prices, declining frac spreads, lower Alberta power prices, reduced drilling activity in Western Canada, risk associated with changes in fees relating to services provided, and a credit downgrade to non-investment grade.

ARC Resources: Risks include, but are not limited to, changes in crude oil and natural gas prices, reservoir performance, lower production growth profile, replacement risks arising from other reservoirs that have a lower cost base, and the effect of foreign exchange and government legislation as it relates to royalties, income taxes, and environmental policy.

Bank of Montreal: Risks include, but are not limited to, the health of the overall economy, sustained deterioration in the capital markets environment, the U.S. and Canadian housing markets, and greater-than-anticipated impact from off-balance sheet commitments.

The Bank of Nova Scotia: Risks include, but are not limited to, the health of the overall economy, sustained deterioration in Latin America and the capital markets environment, greater-than-anticipated impact from off-balance sheet commitments, rising Canadian dollar, and increasing business loan losses.

BCE: Risks include, but are not limited to, a sustained increase in wireless competition from new entrants resulting in higher churn and/or accelerated declines in post-paid ARPU, inability of Fibe TV and the internet to gain meaningful market share, higher capex associated with FTTH, and pricing war among incumbent Canadian telco companies.

Brookfield Asset Management: Risks include, but are not limited to, rising interest rates, hard cyclical downturn in the commercial property sector, and any economic shock that could cause lending spreads to widen and/or loan value ratios to decline.

Canadian National Railway: Risks 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-than-anticipated economic conditions.

Cineplex: Risks include, but are not limited to, the quality and success of new motion pictures, erosion in the appeal of premium theatrical offerings such as 3D, rollout of new theatres by competitors, competition from other distribution channels, and changes to the company's relationship with film distributors.

Enbridge: This security is restricted pursuant to RBC Capital Markets policy and, as a result, its continued inclusion in the Equity Income Guided Portfolio has not been reviewed or confirmed as of the date hereof.

Fortis: Risks include, but are not limited to, punitive regulatory or government decisions, deteriorating economic conditions in its service territories, ability to successfully close the ITC transaction, and quick rise in government bond yields.

H&R REIT: Risks include, but are not limited to, the ownership of real property, deteriorating economic conditions, competition, rise in bond yields, or a loss of a major tenant. Further weakness in the Energy sector could hamper the REIT's assets values in Alberta.

Hydro One: Risks include, but are not limited to, rising interest rates, government intervention, adverse regulatory intervention, and the inability to achieve meaningful cost synergies or complete growth initiatives.

Intact Financial: Risks include, but are not limited to, catastrophe-related losses, variable profitability, political uncertainty (especially in Ontario), acquisition and integration risk, reserve adequacy, and volatility in its investment portfolio.

Inter Pipeline: Risks include, but are not limited to, a material decline in throughput on the conventional oil gathering system where the impact cannot be offset via toll management, prolonged decline in frac spreads, inability to commission new projects on time and on budget, ability to secure new oil pipeline projects and acquisitions, or new projects that fail to gain investor confidence.

Magna International: Risks include, but are not limited to, deterioration in the outlook for auto sales, the financial performance of key customers, and pricing pressure.

Manulife Financial: Risks include, but are not limited to, persistently low interest rates, deteriorating equity markets, adequacy of actuarial assumptions, changes to accounting and regulatory rules, unfavourable political and/or economic developments in Asia, and appreciation in the Canadian dollar.

National Bank of Canada: Risks include, but are not limited to, the health of the overall economy, particularly Quebec's; sustained deterioration in the capital markets environment; integration risk of acquisitions; change in the competitive/political environment in Quebec; additional write-downs related to asset-backed commercial paper; and higher-than-expected loan losses in its energy loan portfolio.

Royal Bank of Canada: NA

Shaw Communications: Risks include, but are not limited to, greater-than-expected wireless capex, market share losses in Western Canada, and a pricing war among incumbent Canadian telco and cable companies.

SmartREIT: Risks include, but are not limited to, the ownership of real property, deteriorating economic conditions, competition, rise in bond yields, or loss of a major tenant.

Suncor Energy: Risks include, but are not limited to, an unexpected change in crude oil and natural gas prices, inability to replace production and reserves in a cost-effective manner, reservoir performance, profitability of its downstream operations, foreign exchange impact, and government legislation as it relates to royalties, income taxes, and environmental policy.

TD Bank: Risks include, but are not limited to, the health of the overall economy, sustained deterioration in the capital markets environment, a turndown in the Canadian and U.S. housing markets, failure of government programs, and greater-than-anticipated impact from off-balance sheet commitments.

Thomson Reuters: Risks include, but are not limited to, a stronger Canadian dollar, cyclical downturn in financial markets and/or major deterioration in the global economic outlook, further broker bankruptcies and/or major broker consolidation and restructuring, and inability to complete the Eikon rollout and migration.

Toromont Industries: Risks include, but are not limited to, lower demand for large equipment required for infrastructure, construction, or mining operations in Eastern Canada; replacement risks from new competitors in their area of operations; lower demand for its refrigeration division; negative macroeconomic trends; lower commodity prices; and strategy execution and labour relations.

TransCanada: Risks include, but are not limited to, reduced gas flows on the Canadian Mainline, inability to complete new projects, large disconnect between actual and forecast power and natural gas prices, and the ability to fund new growth projects at reasonable costs of capital.

Vermillion Energy Inc.: Risks include, but are not limited to, an unexpected change in crude oil and natural gas prices, inability to replace production and reserves in a cost-effective manner, reservoir performance, foreign exchange impact, and government legislation as it relates to royalties, income taxes, and environmental policy.

Methodology

The objective of the Equity Income Guided Portfolio (EIGP) is to provide investors with an attractive rate of current income with the potential for growing cash flow plus long-term capital appreciation by investing in a diversified Portfolio of higher-yielding Canadian securities, such as common stocks, Real Estate Investment Trusts (REITs), and income trusts that trade on the S&P/TSX Composite Index. This Portfolio consists of approximately 20–30 stocks and may be appropriate for investors who have a moderate risk tolerance in relation to an equity investment. Because of its focus on income and income growth, this Portfolio would ordinarily exhibit greater defensive characteristics relative to the broad equity market during bear markets and may underperform during bull markets.

The top-down strategy process employed by RBC Capital Markets plays a different role in the EIGP process than with our other Guided Portfolios. While the recommended sector "overweights" and "underweights" are taken into consideration, the Investment Committee aims to diversify the Portfolio adequately across the four broader economic sectors (interest sensitive, consumer, industrial, and resources), even though dividends may be modest. In this way, we address one of the most common pitfalls inherent in income investing: investors who focus too narrowly on the size of the dividend will more than likely find themselves heavily concentrated in the Financials and Utilities sectors, which tend to react negatively to rising interest rates.

Once the "sector weights" are established, an eligible universe of securities is determined. Careful consideration is given to identifying a pool of fundamentally preferred companies that have the potential to return, on a sustainable basis, a significant amount of cash flow to investors. The resulting universe will consist of securities with either an attractive dividend yield or a yield that may appear less attractive, but that we believe have strong potential for growth. In addition, companies that, in our view, pay out too high a percentage of their cash flows in dividends or distributions will be excluded.

Additional factors analyzed include a company's financial strength and debt levels, the amount of cash generated by the business relative to capital expenditure requirements, its longer-term return on capital, the proportion of income paid out versus reinvested, historical and forecast dividend growth rates, and trading liquidity.

The current dividend yield for the S&P/TSX Composite Index is approximately 2.79%; the EIGP currently offers investors a yield of approximately 3.70% plus the potential for capital appreciation and an inflation hedge.

Disclosures and disclaimers

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Required Disclosures

RBC Capital Markets Distribution of Ratings

For purposes of ratings distributions, regulatory rules require member firms to assign ratings to one of three rating categories –Buy, Hold/Neutral, or Sell– regardless of a firm's own rating categories. Although RBC Capital Markets' ratings of Top Pick/Outperform, Sector Perform and Underperform most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis (as described below).

Distribution of Ratings - RBC Capital Markets, LLC Equity Research
As of September 30, 2016

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	848	50.62	255	30.07
Hold [Sector Perform]	719	42.93	133	18.50
Sell [Underperform]	108	6.45	10	9.26

Explanation of RBC Capital Markets, LLC Equity Rating System

An analyst's "sector" is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst's view of how that stock will perform over the next 12 months relative to the analyst's sector average. Although RBC Capital Markets, LLC ratings of Top Pick (TP)/Outperform (O), Sector Perform (SP), and Underperform (U) most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis (as described below).

Ratings

Top Pick (TP): Represents analyst's best idea in the sector; expected to provide significant absolute total return over 12 months with a favorable risk-reward ratio. **Outperform (O):** Expected to materially outperform sector average over 12 months. **Sector Perform (SP):** Returns expected to be in line with sector average over 12 months. **Underperform (U):** Returns expected to be materially below sector average over 12 months.

Risk Rating:

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Agrium Inc. (AGU; Outperform; $135.39)
AltaGas Ltd. (ALA; Sector Perform; $32.64)
ARC Resources Ltd. (ARX; Outperform; $23.52)
Bank of Montreal (BMO; Sector Perform; $88.53)
The Bank of Nova Scotia (BNS; Outperform; $74.14)
BCE Inc. (BCE; Outperform; $57.89)
Brookfield Asset Management Inc. (BAM'A; Top Pick; $44.73)
Canadian National Railway Company (CNR; Outperform; $89.81)
Cineplex Inc. (CGX; Sector Perform; $50.31)
Enbridge Inc. (ENB; Restricted; $56.50)
Fortis Inc. (FTS; Outperform; $40.04)
H&R Real Estate Investment Trust (HR.UN; Sector Perform; $21.81)
Hydro One Ltd. (H; Outperform; $23.08)
Intact Financial Corp. (IFC; Outperform; $93.50)
Inter Pipeline Ltd. (IPL; Outperform; $27.31)
Magna International (MG; Outperform; $54.28)
Manulife Financial Corporation (MFC; Outperform; $23.39)
National Bank of Canada (NA; Outperform; $50.32)
Shaw Communications Inc. (SJR'B; Sector Perform; $26.29)
SmartREIT (SRU.UN; Outperform; $31.12)
Suncor Energy Inc. (SU; Outperform; $42.78)
Thomson Reuters Corporation (TRI; Sector Perform; $57.99)
Toronto-Dominion Bank (TD; Outperform; $63.57)
Toromont Industries Ltd. (TIH; Outperform; $44.04)
TransCanada Corporation (TRP; Outperform; $60.33)
Vermillion Energy Inc. (VET; Sector Perform; $54.49)

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