

# North American Focus List

Quarterly report



Wealth Management  
Dominion Securities

June 1, 2023

Portfolio Advisory Group – Equities

## What's inside:

- 2 Focus List changes
- 2 Performance
- 3 Focus List positions
- 4 Methodology

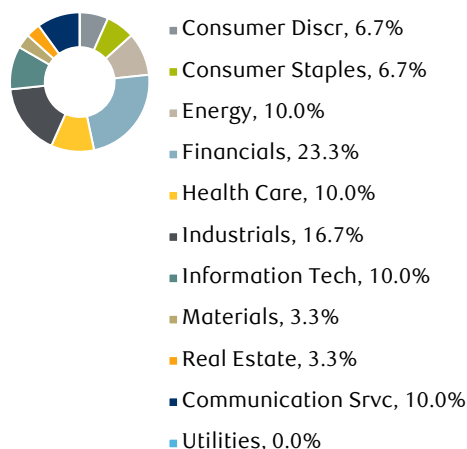
## Waiting for the next move

For the better part of the quarter ended May 31, Canadian and U.S. bond and equity markets were rangebound. Investors awaited further economic signals to determine whether the well-anticipated recession was upon us. Labour conditions remain stubbornly tight and inflation pressures elevated, though we recently started to see clearer signs of improvement in both. Throughout the quarter we saw the failure of several large U.S. banks, a direct consequence of the recent sharp increase in interest rates. The issues were rapidly addressed by regulatory bodies and, besides a brief panic, markets stabilized quickly and remain stable for now.

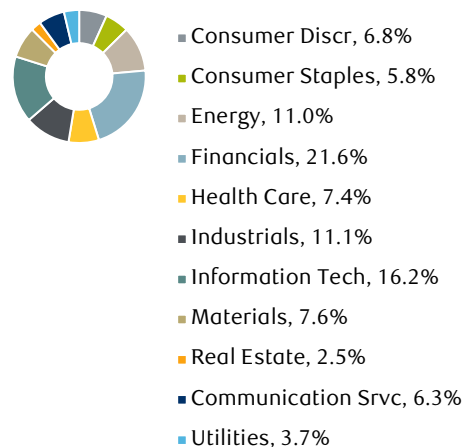
Despite the speedbump, the Federal Reserve again raised interest rates by 25 basis points (bps) at its March 22 Federal Open Market Committee meeting and again at its May 3 meeting. The Bank of Canada was more dovish and held rates unchanged at its March and April meetings. Both central banks grapple with the trilemma of concurrent sticky inflation, weakening economic backdrop, and financial system turbulence. As a result, economists are split on whether a soft landing or hard landing will take place. On the equity side, we have seen brisk changes in narratives and sector leadership since the beginning of the year.

### Sector weightings: North American Focus List vs. benchmark

North American Focus List



Benchmark



For an overview of the Portfolio, please [click here](#).

All values in Canadian dollars and priced as of May 31, 2023, market close, unless otherwise noted.

For important disclosures and authors' contact information, see [page 5](#).

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Percentages may not total 100% due to rounding. Source - RBC Wealth Management, FactSet; data as of market close 5/26/23

We believe the recent stresses in the U.S. regional banking system differ from the 2008–2009 Global Financial Crisis. That crisis was a culmination of highly leveraged financial institutions selling complex and esoteric securities (particularly those backed by home mortgages). In an environment of lax lending standards, the securities ultimately proved to be mispriced, bringing the interconnected financial system to its knees. We are now seeing a handful of regional banks which, under an extraordinary set of circumstances, find themselves underprotected from the Fed’s aggressive interest rate hiking cycle. This resulted in a classic bank run on deposits due to widespread liquidity concerns. The issues were smoothed over by governmental bodies providing emergency liquidity to stem further contagion in the system. So far, it seems to be working.

The Canadian banking sector fared better than its U.S. counterpart. That is partially because the Canadian landscape is more concentrated in larger, more diversified banks, but also because Canadian regulators have been more vigilant about risks. Collectively, the Big Six banks hold 90% of Canada’s deposits, providing them with a sturdy base of deposits and inherent profitability. That being said, Canadian banks are not immune to cyclical risks. They could face tightening conditions if funding rates rise or if households fail to service their debt due to rising interest rates. At this juncture, the Investment Committee is cognizant of recession risks in the broader economy that could cause loan defaults among households.

As we look out over the next 12 months, we think sluggish economic growth will be a prominent theme. Canadian and U.S. consumers are starting to feel the pinch as inflation takes a bigger bite out of everyone’s wallets, household savings rates fall, and credit card debt rises. Corporate revenue growth is likely to decelerate as broader economic activity slows and last year’s price increases reach a ceiling. At the same time, margins are set to contract as wage and raw material inflation catch up and borrowing costs are higher. All this points to earnings per share of the broader indices having some more room to fall.

In this limited visibility environment, perplexing economic crosswinds, signs of a looming recession, and potential financial instability, we think it makes sense to maintain defensive positioning. We continue to recommend high-quality companies that have a track record of execution, strong balance sheets, ample free cash flow generation, robust competitive moats, and secular growth tailwinds. As interest rates decline from today’s elevated levels, we would expect secular-growth-oriented stocks to outperform, especially as the broader economy decelerates. Such stocks, in our view, can be purchased now at attractive valuations.

## Focus List changes

There were no changes for the quarter ending May 31, 2023.

## Performance

The North American Focus List was down 0.03% for the quarter ending May 31, underperforming the blended benchmark by 160 basis points (bps). The underperformance was driven by Information Technology, Financials, and Real Estate sectors, partially offset by Consumer Discretionary, Consumer Staples, and Industrials sectors.

### Total return for the spring quarter (3/1/23–5/31/23)

	Total return
North American Focus List	-0.03%
Blended benchmark	1.57%
Relative	-160 bps

Note: Past performance is no guarantee of future results and should not be viewed as an indicator of future results.

Source - FactSet

# Focus List positions

Symbol	Company name	Price 5/26/23	52-wk range	EPS (calendar year)			P/E		Div. yield	Market cap (B)
				2022A	2023E	2024E	2023E	2024E		
Communication Services										
GOOG*	Alphabet Class C	\$125.43	127 - 83	\$4.56	\$5.38	\$6.40	23.3x	19.6x	0.0%	\$736.78
T	TELUS	\$26.34	32 - 26	\$1.19	\$1.04	\$1.26	25.4x	20.9x	5.5%	\$37.88
DIS*	Walt Disney	\$88.29	126 - 84	\$3.64	\$4.31	\$5.67	20.5x	15.6x	0.0%	\$161.33
Consumer Discretionary										
AMZN*	Amazon.com	\$120.11	147 - 81	\$0.27	\$1.58	\$2.66	NM	45.2x	0.0%	\$1,232.37
HD*	Home Depot	\$292.83	347 - 265	\$16.59	\$15.18	\$15.86	19.3x	18.5x	2.9%	\$294.40
Consumer Staples										
STZ*	Constellation Brands Class A	\$232.88	261 - 208	\$10.58	\$11.41	\$12.99	20.4x	17.9x	1.5%	\$42.67
COST*	Costco Wholesale	\$507.26	565 - 443	\$13.55	\$14.72	\$16.00	34.5x	31.7x	0.8%	\$224.96
Energy										
CNQ	Canadian Natural Resources	\$75.82	88 - 59	\$11.19	\$7.48	\$8.86	10.1x	8.6x	4.7%	\$83.60
SU	Suncor Energy	\$38.86	54 - 36	\$8.44	\$5.63	\$6.17	6.9x	6.3x	5.4%	\$50.89
TRP	TC Energy	\$54.11	74 - 51	\$4.30	\$4.29	\$4.17	12.6x	13.0x	6.9%	\$54.11
Financials										
BMO	Bank of Montreal	\$114.74	139 - 112	\$13.13	\$12.75	\$13.37	9.0x	8.6x	5.1%	\$81.83
BN	Brookfield Corp.	\$42.87	56 - 39	\$3.60	\$3.21	\$3.66	13.4x	11.7x	0.9%	\$70.21
IFC	Intact Financial	\$202.59	210 - 172	\$11.88	\$13.04	\$13.87	15.5x	14.6x	2.2%	\$35.51
MA*	Mastercard Class A	\$374.37	392 - 277	\$10.65	\$12.29	\$14.60	30.5x	25.6x	0.6%	\$351.98
RY	Royal Bank of Canada	\$123.08	140 - 117	\$11.22	NA	NA	NA	NA	4.4%	\$170.54
TD	Toronto-Dominion Bank	\$78.26	97 - 76	\$8.36	\$8.38	\$8.62	9.3x	9.1x	4.8%	\$142.57
USB*	U.S. Bancorp	\$30.67	53 - 27	\$4.32	\$4.61	\$4.78	6.7x	6.4x	6.3%	\$47.01
Health Care										
JNJ*	Johnson & Johnson	\$154.35	183 - 150	\$8.53	\$10.65	\$10.98	14.5x	14.1x	3.1%	\$401.11
TMO*	Thermo Fisher Scientific	\$522.02	611 - 476	\$23.24	\$23.69	\$26.59	22.0x	19.6x	0.3%	\$201.35
UNH*	UnitedHealth Group	\$481.52	558 - 450	\$21.44	\$23.72	\$26.95	20.3x	17.9x	1.4%	\$448.31
Industrials										
CP	Canadian Pacific Kansas City Limited	\$104.92	112 - 86	\$3.77	\$4.31	\$5.11	24.3x	20.5x	0.7%	\$97.69
HON*	Honeywell International	\$193.75	221 - 167	\$8.76	\$9.16	\$10.08	21.2x	19.2x	2.1%	\$128.97
TRI	Thomson Reuters	\$169.14	181 - 122	\$3.43	\$4.49	\$5.05	37.6x	33.5x	1.6%	\$79.81
TIH	Toromont Industries	\$107.15	115 - 93	\$5.47	\$5.61	\$5.68	19.1x	18.9x	1.6%	\$8.81
WCN	Waste Connections	\$188.48	197 - 148	\$5.14	\$5.75	\$6.49	32.8x	29.1x	0.7%	\$48.54
Information Technology										
AAPL*	Apple	\$175.43	176 - 124	\$6.08	\$6.14	\$6.68	28.6x	26.3x	0.5%	\$2,759.29
CSU	Constellation Software	\$2,688.93	2783 - 1748	\$60.09	\$80.70	\$98.83	33.3x	27.2x	0.2%	\$56.98
MSFT*	Microsoft	\$332.89	333 - 213	\$9.41	\$10.31	\$11.85	32.3x	28.1x	0.8%	\$2,475.20
Materials										
CCL.B	CCL Industries Class B	\$65.61	72 - 56	\$3.48	\$3.74	\$3.93	17.5x	16.7x	1.6%	\$10.84
Real Estate										
CCI**	Crown Castle International	\$111.76	194 - 110	\$7.38	\$7.64	\$7.55	14.6x	14.8x	5.6%	\$48.47

^ Adjusted funds from operations (AFFO) instead of earnings per share (EPS)

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# Methodology

The North American Focus List (the List) provides exposure to some of the highest-quality companies across the continent, allowing greater flexibility to add exposure within sectors where either the Canadian or U.S. market independently may lack adequate breadth or depth of quality investment opportunities.

The North American Focus List was formerly called the Global Equity Focus List from inception up to May 31, 2021.

The model will be largely based on a bottom-up search for quality companies trading at attractive valuations, with considerable flexibility around sector allocations. This point is particularly important to help determine the suitability of this List for specific investors. We have chosen a quality- and value-oriented strategy focused on long-term absolute returns best-suited for patient investors who are not particularly concerned with short-term fluctuations relative to a benchmark.

That being said, we recognize that a thorough understanding of underlying macro conditions is a necessary component of any portfolio management framework, and are committed to ensuring that the companies we choose are well positioned in the current environment and diversified reasonably across sectors.

The List will have 30 stocks that are assumed to be equally weighted positions. Typically half will be Canadian and half will come from the U.S.

Each constituent must meet certain criteria to be eligible, including: (1) minimum fundamental research coverage ratings from RBC Capital Markets and/or our third-party research providers and (2) minimum liquidity requirements to ensure investors can easily buy and sell shares without having any significant impact on pricing.

We expect turnover to remain low in typical market conditions, which reflects the nature of the companies included on the List (well-established, quality businesses with solid track records of creating value for shareholders). Changes will be communicated on a dynamic basis, while quarterly updates on the List will be published.

The List is compiled, monitored, and updated by the Investment Committee that includes members of the Portfolio Advisory Group's Canadian and U.S. equity teams within Canada.

NOTE: Past performance is no guarantee of future results and should not be viewed as an indicator of future results.

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Rating	Count	Percent	Investment Banking Services Provided During Past 12 Months	
			Count	Percent
Buy [Outperform]	824	56.05	236	28.64
Hold [Sector Perform]	591	40.28	132	22.34
Sell [Underperform]	55	3.74	4	7.27

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Brookfield Corporation (BN; Outperform; \$42.87)

Canadian Natural Resources Limited (CNQ; Outperform; \$75.82)

Canadian Pacific Kansas City Limited (CP; Outperform; \$104.92)  
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 Constellation Brands, Inc. Class A (STZ; Outperform; \$232.88)  
 Constellation Software Inc. (CSU; Outperform; \$2,688.93)  
 Crown Castle International Corp. (CCI; Outperform; \$111.76)  
 Honeywell International Inc. (HON; Sector Perform; \$193.75)  
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 Mastercard Incorporated Class A (MA; Outperform; \$374.37)  
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 Toromont Industries Ltd. (TIH; Outperform; \$107.15)  
 Toronto-Dominion Bank (TD; Outperform; \$78.26)  
 UnitedHealth Group Inc. (UNH; Outperform; \$481.52)  
 U.S. Bancorp (USB; Outperform; \$30.67)  
 Waste Connections, Inc. (WCN; Outperform; \$188.48)

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 Costco Wholesale Corporation (COST; Overweight; \$507.26)  
 Home Depot, Inc. (HD; Overweight; \$292.83)  
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 Walt Disney Company (DIS; Overweight; \$88.29)

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