Equity Income Guided Portfolio

Quarterly report

Wealth Management
Dominion Securities

September 3, 2024 | Portfolio Advisory Group – Equities

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All values in Canadian dollars and priced as of Aug. 30, 2024, market close, unless otherwise noted.

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Central bank rate cuts are on the way

Lower rates tend to be positive for dividend portfolios, as long as we avoid a recession

According to RBC Economics, surging population growth has prevented outright declines in Canadian gross domestic product, but per person output continues to fall and the unemployment rate is rising like it usually only would during a recession. Interest rate cuts from the Bank of Canada will eventually alleviate some of the pressure on households. As purchasing power is restored, RBC Economics expects per capita growth to turn positive in 2025.

The Bank of Canada started its rate cutting cycle with interest rate reductions of 25 basis points (bps) in June and July. RBC Economics believes the Canadian economy remains weaker than most, while inflation continues to come down towards the target rates, and expects the Bank of Canada to cut rates by an incremental 25 basis points (bps) in both September and October.

We are cognisant that the Canadian economy feels the pain of higher mortgage payments. If bond yields remain high, the risk of reduced consumer discretionary income will be amplified, especially for the tranches of mortgages that originated in 2020 and 2021 and are set to mature in 2025 and 2026. We believe the Canadian equity market partially reflects this risk. We have noted a slowdown in dividend growth expectations from management teams in all sectors (with the possible exception of the oil patch as well as a few names in the Consumer Staples and Financials sectors), and have striven to balance the Portfolio between higher-dividend-yielding stocks and those that we think have the potential to increase their dividends over the near term.

RBC Economics believes that easing U.S. inflation data coupled with an ongoing slowdown in the labour market suggest downside economic risks may be gathering momentum. While the market is pricing in 100 bps of rate cuts in the U.S. for the balance of the year, RBC Economics believes that solid domestic demand backed by strong government spending will result in only two rate cuts of 25 bps each, one in September and one in December.

We have maintained our holdings in companies that have operations in the U.S. and international markets to offset the risk of a slowing Canadian economy.

In our opinion, a falling interest rate environment should benefit dividend portfolios. As interest rates fall, we expect the traditional defensive sectors (Consumer Staples, Utilities, Communication Services, and Real Estate) to outperform the broader S&P/TSX Composite Index.

We have maintained our exposure to interest-rate-sensitive sectors to take advantage of falling interest rates and to reduce our exposure to slowing consumer spending. However, we continue to balance the Portfolio to benefit from an eventual recovery in the economy while not being overly exposed to high-growth stocks that are usually accompanied by higher valuations.

Performance

The Equity Income Guided Portfolio generated a total return of 5.95% for the quarter, outperforming the S&P/TSX High Dividend Index and the S&P/TSX Composite Index by 122 and 30 basis points, respectively.

From an attribution point of view, Utilities, Energy and Materials were the best-performing sectors during the quarter. On the flip side, the Industrials, Communication Services, and Real Estate sectors were relative laggards.

Total return for the summer quarter (6/1/24–8/31/24)

	Total return
Equity Income Guided Portfolio	5.95%
S&P/TSX Composite Index	5.65%
S&P/TSX High Dividend Index	4.73%

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

Source - FactSet

Portfolio positions

						EPS/AFFO/CFPS			Price to earnings/ AFFO/CFPS				Payout ratio				
Symbol	Company name	Weight	Market cap (M)	Price 8/28/24	52-wk range	2023A	2024E	2025E	2023A	2024E	2025E	Div. yield	2023A	2024E	2025E	Forecast growth in EPS/ AFFO or CFPS	Forecast dividend growth rate to 2025
Interest sensitive																	
BMO	Bank of Montreal	2.5%	$80,067	$110.37	134 - 103	11.81	10.84	11.66	9.3x	10.2x	9.47	5.62%	49%	56%	55%	-8%	3%
CM	Can. Imp. Bank of Commerce	5.0%	$68,889	$73.50	75 - 47	6.73	7.22	7.51	10.9x	10.2x	9.79	4.86%	51%	50%	49%	7%	3%
BNS	Bank of Nova Scotia	2.5%	$81,078	$65.94	70 - 55	6.48	6.59	7.46	10.2x	10.0x	8.84	6.43%	65%	64%	58%	2%	1%
RY	Royal Bank of Canada	5.0%	$225,924	$159.98	162 - 108	NA	NA	NA	NA	NA	NA	3.55%	NA	NA	NA	NA	NA
TD	Toronto-Dominion Bank	2.5%	$140,024	$80.11	87 - 74	7.91	8.04	8.90	10.1x	10.0x	9.00	5.09%	49%	51%	49%	2%	7%
NA	National Bank of Canada	2.5%	$43,198	$126.91	127 - 84	9.46	10.44	11.02	13.4x	12.2x	11.52	3.47%	42%	41%	42%	10%	4%
MFC	Manulife Financial	5.0%	$65,457	$36.81	37 - 24	3.47	3.66	3.99	10.6x	10.1x	9.23	4.35%	42%	44%	44%	9%	9%
SLF	Sun Life Financial	5.0%	$41,995	$72.67	75 - 62	6.36	6.65	7.97	11.4x	10.9x	9.12	4.46%	47%	49%	44%	20%	7%
BAM	Brookfield Asset Mgmt.^	5.0%	$17,246	$41.11	44 - 28	1.37	1.50	1.93	30.0x	27.4x	21.30	3.55%	93%	101%	91%	29%	21%
IFC	Intact Financial**	2.5%	$44,812	$251.24	264 - 188	11.70	14.32	16.10	21.5x	17.5x	15.60	1.93%	38%	34%	33%	12%	8%
FCR.UN	First Capital REIT*	5.0%	$3,685	$17.36	18 - 12	0.95	1.11	1.08	18.3x	15.6x	16.07	4.98%	91%	77%	80%	-3%	0%
T	TELUS	5.0%	$32,347	$21.68	26 - 20	0.95	0.97	1.07	22.8x	22.4x	20.26	6.94%	153%	161%	156%	10%	11%
BIP.UN	Brookfield Infr. Partners^	5.0%	$21,202	$32.52	33 - 21	2.95	3.17	3.42	11.0x	10.3x	9.51	4.98%	52%	51%	50%	8%	6%
FTS	Fortis	5.0%	$29,222	$59.01	60 - 50	3.09	3.32	3.46	19.1x	17.8x	17.05	4.00%	73%	71%	71%	4%	5%
ALA	AltaGas	2.5%	$10,079	$33.89	34 - 25	2.59	2.96	3.27	13.1x	11.4x	10.36	3.51%	43%	40%	39%	10%	6%
Consumer																	
QSR	Restaurant Brands Int'l^**	2.5%	$31,181	$69.11	83 - 62	3.77	3.44	3.91	18.3x	20.1x	17.68	3.36%	58%	68%	62%	14%	5%
CTC.A	Canadian Tire**	2.5%	$8,819	$153.86	161 - 126	10.42	11.01	13.30	14.8x	14.0x	11.57	4.55%	67%	64%	53%	21%	0%
Industrial																	
CNR	Canadian National Railway**	2.5%	$99,486	$158.04	181 - 143	7.28	7.79	8.89	21.7x	20.3x	17.78	2.14%	43%	43%	41%	14%	7%
TIH	Toromont Industries**	2.5%	$9,856	$120.31	136 - 101	6.38	6.21	6.59	18.9x	19.4x	18.26	1.60%	27%	31%	29%	6%	0%
EFN	Element Fleet Management**	2.5%	$11,132	$27.58	28 - 19	1.29	1.52	1.69	21.4x	18.1x	16.32	1.74%	33%	41%	41%	11%	46%
Resources																	
CNQ	Canadian Nat. Resources#	5.0%	$104,474	$49.22	56 - 40	6.93	7.28	8.82	7.1x	6.8x	5.58	4.27%	27%	29%	25%	21%	5%
SU	Suncor Energy#	5.0%	$69,534	$54.75	57 - 40	10.17	11.43	13.40	5.4x	4.8x	4.09	3.98%	21%	19%	16%	17%	0%
ENB	Enbridge*	5.0%	$115,577	$53.08	54 - 43	5.48	5.51	5.69	9.7x	9.6x	9.33	6.90%	65%	66%	66%	3%	3%
TRP	TC Energy	5.0%	$63,546	$61.25	62 - 45	4.52	4.40	4.41	13.6x	13.9x	13.89	6.27%	82%	87%	90%	0%	3%
PPL	Pembina Pipeline*	5.0%	$31,204	$53.78	55 - 39	4.81	5.45	5.54	11.2x	9.9x	9.71	5.13%	56%	51%	52%	2%	4%
NTR	Nutrien^**	2.5%	$23,691	$47.79	66 - 45	4.70	3.90	4.33	10.2x	12.3x	11.04	4.52%	45%	55%	51%	11%	2%

^ In U.S. dollars.
* Adjusted funds from operations (AFFO) instead of earnings per share (EPS).
# Cash flow per share (CFPS).
** FactSet estimates.

Payout ratios based on earnings per share, except as noted above. Dividend growth rate is based on RBC Capital Markets' or FactSet's 2025 forecast dividend compared to the current annualized dividend. Growth in EPS/AFFO/CFPS are based on the RBC Capital Markets' 2025 forecast compared to 2024.

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Source - RBC Capital Markets, FactSet

Sector commentary

Banks and Insurance

An attractive source of income despite a challenging operating environment

The operating environment for the Canadian banks remains challenging, due in part to rising unemployment and the potential for greater credit losses. However, we acknowledge that the banks have been proactive in building reserves and interest rates have already begun their descent. Overall, we are maintaining a cautious stance on the banks and believe those with fewer idiosyncratic risks should outperform over the near term.

With regard to the insurance companies, we believe fundamentals are generally healthy, supported by solid underwriting, strong capital ratios, and attractive dividend growth potential. All-in, we believe volatility should be expected within Financials, but we continue to view this sector as a solid source of income generation for dividend portfolios.

We are maintaining **Royal Bank of Canada (RY)** at a 5% weight.

We are decreasing our position in **Bank of Montreal (BMO)** to 2.5%. The bank's credit quality has deteriorated in recent quarters, causing upward pressure on credit provisions for the balance of the year. Put differently, this represents a headwind to earnings, and thus we expect the stock to trade at a discount to peers on a price-to-book (P/B) basis over the near-to-medium term. Conversely, RBC Capital Markets expects the dividend to increase by approximately 3% through 2025.

We are increasing our position in **Canadian Imperial Bank of Commerce (CM)** to 5.0%. Solid execution has allowed the bank to benefit from positive operating leverage, and a declining rate environment should ease consumer pressures. Due to Canadian Imperial's sensitivity to the Canadian economy, we believe this could be a tailwind in the year ahead. We also believe shares could outperform if an economic soft landing scenario materializes. RBC Capital Markets is forecasting a 3% dividend growth rate through 2025.

We are maintaining our 2.5% position in **The Bank of Nova Scotia (BNS)**. In an effort to increase its exposure to developed markets, the bank announced its intention to acquire a 14.9% stake in KeyCorp (KEY). The deal is expected to be accretive to earnings in year one and the bank plans to eliminate its dividend reinvestment program, suggesting management is comfortable with the current positioning of its capital base. Bank of Nova Scotia generates an above-average dividend yield and trades at a valuation discount relative to peers. RBC Capital Markets is forecasting a 1% dividend increase through 2025.

We are maintaining our 2.5% position in **Toronto-Dominion Bank (TD)**. A resolution of the bank's anti-money-laundering challenges is expected by the end of the calendar year, and the bank estimates its financial fines will total approximately US$3.1 billion. Visibility is improving, but we admit clarity around non-financial penalties such as an asset cap (i.e., slower growth) and/or monitorship (i.e., higher expenses) is still required. Until these issues become clearer, we believe upside may be muted. RBC Capital Markets expects the dividend to grow by approximately 7% through 2025.

We are maintaining our 2.5% position in **National Bank of Canada (NA)**. In a move to expand its Canadian exposure, National Bank announced its intention to acquire Canadian Western Bank in an all-stock deal valued at approximately C$5 billion, and management has stated the bank expects the transaction to be accretive to earnings. However, we note that the acquisition is still subject to regulatory approval. If given a green light, the deal is expected to close in late 2025. Overall, we view National as a high-quality bank with strong credit quality, capital, cost control, and attractive returns on equity. RBC Capital Markets thinks the dividend could grow by roughly 4% through 2025.

We are reducing our position in **Intact Financial Corporation (IFC)** to 2.5%. Shares of Intact Financial have performed well on the back of solid income from underwriting and investment. We also believe IFC will continue to hold up well in a risk-off environment; however, we are cognisant that valuation is above average at approximately 2.9x P/B. Dividend growth is projected to be in the high single digits through 2025, according to consensus estimates.

We are increasing our position in **Sun Life Financial (SLF)** to 5.0%. The company's shares currently trade at a premium to peers on a P/B basis, which we believe is warranted given its ability to generate an above-average return on equity. Improving financial market conditions should also benefit Sun Life, given that asset and wealth management accounts for roughly half of its overall business. RBC Capital Markets forecasts the dividend to grow by 7% through 2025.

We are maintaining our 5.0% position in **Manulife Financial (MFC)**. We believe the underlying business is benefiting from a favourable rate of change, driven in part by the sale of lower-yielding assets at fair value. As a result, Manulife is seeing an improvement in profitability metrics that should lead to a rerating over the medium-to-long term, in our view. Shares trade at a discount to peers on a P/B basis, and RBC Capital Markets expects the dividend to grow by approximately 9% through 2025.

We are maintaining our 5.0% position in **Brookfield Asset Management (BAM)**. Company management believes it will raise US$90–US$100 billion in 2024, in line with 2023 levels. The company also plans to grow its fee-bearing capital to approximately US$1 trillion by 2027 from US$514 billion at the end of Q2 2024. As a result, RBC Capital Markets believes the company can grow its dividend by approximately 21% through 2025. Its shares trade at a discounted valuation relative to its closest peer.

Real Estate

Easing interest rates, partially offset by a softening economic outlook, should provide a valuation floor

Momentum has been building within the S&P/TSX Real Estate sector, driven in part by easing inflationary pressure, and we think this is setting the stage for greater rate cuts from the Bank of Canada during the balance of the year. In general, property fundamentals have been healthy, supported by a 5% average year-over-year increase in same-property net operating income. But not all real estate investment trusts (REITs) are created equal; we're still seeing pockets of weakness, particularly in office and retail. The former's challenges have been primarily a function of slower economic activity, hybrid/remote working conditions, and rising unemployment, while the latter is being impacted by shrinking consumer wallets. The sector is trading at a 22% discount to net asset value according to RBC Capital Markets.

We are increasing our position in **First Capital Real Estate Investment Trust (FCR.UN)** to 5.0%. The company is making good progress on its $1 billion asset disposition program, in our view, monetizing lower-yielding assets—in many cases at valuations above book value. The majority of sale proceeds are being directed towards debt reduction, and RBC Capital Markets estimates leverage will decline to the low 8x range by late 2026. Overall, we believe there is a credible plan to drive a rerating in the units. We view the distribution as sustainable, supported by a payout ratio of roughly 80% based on RBC Capital Markets' 2025 estimate.

Energy and Materials

Softening demand may lead to weaker commodity prices

RBC Capital Markets is of the view that compression in refining margins, pockets of demand softness, and risks of oversupply in 2025 could place a ceiling on global oil prices. As a result, we could see some weakness in commodity prices in the months ahead. Conversely, we acknowledge that producer balance sheets are healthy and the Canadian Trans Mountain Expansion Project is now in service. The latter would be supportive of tighter spreads between heavy and light oil prices, in our view—a positive for Canadian oil producers. Net-net, we believe oil producers are well positioned to increase dividends and conduct share buybacks in the year ahead. Elsewhere, weaker crop prices and tepid demand will likely remain an overhang for the agriculture industry.

We are maintaining our 5% weight in **Canadian Natural Resources (CNQ)**. The company has achieved its net debt target of $10 billion, and is returning 100% of excess free cash flow via share repurchases and dividend increases. The company's shares trade at a premium to peers, but we believe this is warranted due to its strong balance sheet, return of capital plan, and long-life/low-decline portfolio. RBC Capital Markets is projecting the dividend to grow by approximately 5% through 2025.

We are maintaining our 5% weight in **Suncor (SU)**. The company's net debt stands at approximately $9 billion and management aims to achieve its $8 billion target by the end of 2024. When this has been accomplished, Suncor plans to increase its return of capital to 100% of excess free cash flow, from the current 75%. Furthermore, the company has stated it is on pace to improve its cost of production to US$43 per barrel (vs. US$53 per barrel currently) by 2026. Overall, we acknowledge that refining margins may compress in a weaker demand environment, but we are encouraged by the favourable rate of change in the business on a longer-term basis.

We are maintaining our 2.5% position in **Nutrien (NTR)**. Weaker crop prices have resulted in diminishing demand for fertilizer products. However, RBC Capital Markets believes the company's shares have already priced in a weaker economic scenario, and therefore sees limited downside at current levels. Furthermore, RBC Capital Markets expects Nutrien to deliver nearly US$2 billion in free cash flow in 2025, which would be supportive of its current dividend. Overall, we believe the dividend is sound but the share price could be range-bound due to limited near-term catalysts.

Utilities, Pipelines, and Midstreams

Attractive yields and steady dividend growth

Pipelines and midstreams continue to be important components of dividend portfolios, in our view, given their above-average dividend yields and steady dividend growth profiles. Midstream and pipeline valuations continue to trade at a discount to regulated utility stocks. We believe this is a function of investors having lower dividend growth expectations, higher leverage profiles for midstreams and pipelines, and the perceived cushion that Utilities stocks can provide during periods of economic uncertainty.

We think the regulated utility sector remains attractive due to stable cash flows and attractive dividend growth. The previously elevated valuations have eased, presenting attractive opportunities, in our view.

We are maintaining our 5% position in **TC Energy (TRP)**. The company has predictable cash flows, with approximately 95% of its EBITDA (earnings before interest, taxes, depreciation, and amortization) stemming from regulated and long-term contracted assets. It will be spinning off its liquid business in the second half of the year. Overall, we think TC Energy's dividend is sustainable, but the price of TRP shares is likely to remain range-bound. However, we believe investors' appetite for RemainCo entities (i.e., the remaining business after the spinoff) will be solid given their strong EBITDA growth profile, lower financial leverage compared to the current structure, and attractive dividend growth in the 3% range.

We are maintaining our 5% position in **Enbridge (ENB)**, given management's projected capital allocation framework that aims to right-size the balance sheet alongside capital deployment supporting growth initiatives and shareholder returns. Enbridge addressed its funding gap by issuing equity in Q2, and management noted the company will return to a self-funding strategy on a forward basis. Looking ahead, the company will be focused on optimizing its existing business, integrating U.S. utility assets, and reaching its targeted leverage of approximately 4.5x–5.0x. RBC Capital Markets estimates the dividend will grow by approximately 3% through 2025.

We are maintaining our 5.0% position in **Pembina Pipeline (PPL)**. We believe the company is well positioned to benefit from growing natural gas and natural gas liquids volumes in the Western Canadian Sedimentary Basin, alongside further infrastructure opportunities. The company's EBITDA is supported by 85% fee-based revenues, primarily take-or-pay or cost-of-service contracts, which underpin the steady dividend. RBC Capital Markets forecasts the dividend will increase by about 4% through 2025. Finally, Pembina noted it plans to operate under a self-funding model and to maintain a balance sheet leverage around the 3.5x level.

In the Utilities sector, we are maintaining our 5% position in **Brookfield Infrastructure Partners L.P. (BIP.UN)**, given its resilience to an uncertain economic environment and healthy, growing dividend yield. We believe the company has multiple avenues of growth for funds from operations, largely through its inflation-indexed contracts and capital recycling program. We continue to favour Brookfield Infrastructure amongst other Canadian Utilities companies as we believe it has more global assets with revenues tied to economic activity. Additionally, more than 90% of its debt is fixed, with an average maturity of seven years. The company targets distribution increases of 6%–9% per annum over the long term.

We are maintaining our 5% weight in **Fortis (FTS)**. The company has reiterated its rate-based growth plan of approximately 6% per annum from 2024 to 2028, supporting a dividend growth profile of roughly 5% per year. We continue to view Fortis as a steady dividend payer with attractive dividend growth and a supportive balance sheet.

We are maintaining our 2.5% position in **AltaGas (ALA)** to provide more defensive characteristics. AltaGas has a dividend yield of approximately 3.5%, which we view as attractive, supported by a 2025 AFFO payout ratio of roughly 55% according to RBC Capital Markets' estimate. Furthermore, RBC Capital Markets believes the strength and stability of the utility business will allow the company to grow its dividend by approximately 6% through 2025.

Consumer

The Canadian consumer is still not out of the woods, but lower rates should provide some relief

The health of the consumer remains top of mind in the current environment of rising unemployment, shrinking disposable incomes, and elevated household leverage. As a relative positive, we expect interest rates to trend lower for the rest of the year due to softening inflation. Overall, we believe our consumer-oriented holdings can provide the Portfolio with a source of income as well as upside participation once economic growth starts to reaccelerate.

We are maintaining our 2.5% weight in **Canadian Tire (CTC.A)**. We believe the company's skew towards discretionary items will drive revenue growth in the current environment. Fortunately, the present economic situation appears to be well understood by the company, and management is focusing its efforts on cost minimization. As a result, we are of the view that Canadian Tire will be better positioned coming out of the economic downcycle and should benefit from stronger margins going forward. Valuation is inexpensive, in our view, and we are comfortable collecting the dividend yield of approximately 4.5%.

We are maintaining our 2.5% weight in **Restaurant Brands International (QSR)**. The company guided to same-store sales growth of 3% or more and unit growth of 5% or more per annum through 2028. We believe the former is achievable, partly driven by menu refreshes and a step-up in targeted promotional offerings. However, the latter would likely require a reacceleration in the Asian economy, in our view. With respect to the dividend, we believe the company can grow its distribution by approximately 5% through 2025. Shares trade at a discount to highly franchised peers.

Industrials

Cash flows are supportive of attractive dividend growth

The Canadian Industrials sector is not among the higher-yielding sectors in the S&P/TSX Composite Index, but it encompasses high-quality businesses with proven histories of consistent shareholder returns. In our view, the Industrials companies within the Portfolio have strong track records of strategic execution, healthy balance sheets, and quality management teams.

We are initiating a 2.5% position in **Element Fleet Management (EFN)**. The company continues to benefit from strong originations, which in turn should be supportive of continued growth in services and syndication income. Due to its balance sheet strength and its growing cash flows, we believe the company has plenty of options for the return of capital. The dividend is projected to grow by double digits through 2025, according to consensus estimates.

We are maintaining our 2.5% position in **Toromont Industries (TIH)**. The company has a long history of dividend increases, and we expect more increases and share buybacks in the future as Toromont is in a net cash position (i.e., its cash holdings exceed its debt). We believe it will opt to maintain its balance sheet strength but will be opportunistic if an acquisition target does appear. The company's consolidated backlog exiting Q1 was $1.3 billion, of which approximately 90% of the Equipment Group's backlog is expected by management to be delivered within the next 12 months. Toromont shares trade at a premium valuation relative to peers, but we believe this is warranted given the company's consistent history of strong execution and the fact that it has no financial leverage.

We are keeping our 2.5% position in **Canadian National Railway (CNR)**. The company reduced its 2024 EPS guidance to mid- to high-single-digit growth (from 10%) in light of a weaker demand environment and labour disputes. The Canadian rail industry also went through a historic strike that we believe will result in a temporary headwind to earnings. Overall, we view the high barriers to entry in the railroad industry as a positive for the company and continue to favour the stock for long-term growth. Canadian National Railway has a long history of returning capital to investors, and FactSet estimates point to a 7% dividend increase by the end of 2025.

Communication Services

Margins being pressured by increased competition

We expect wireless margins to remain under pressure, driven in part by continued promotional intensity, restrictive interest rates, and softer immigration. On the flip side, the industry has been successful in expanding its wireline market share, specifically within Internet. All-in, RBC Capital Markets expects the industry to modestly grow its revenues through 2025. We believe significant upside is unlikely until we see improvements in balance sheets and payout ratios.

We are maintaining our 5% position in **TELUS (T)**. A challenging demand backdrop has placed downward pressure on TELUS International (TIXT) and in turn, caused TIXT to reduce its fiscal 2024 guidance. We view this as an incremental drag on TELUS, but in the bigger picture, capital intensity should decline and free cash flow generation should inflect higher. As a result, RBC Capital Markets expects the leverage to improve to approximately 3.5x and the payout ratio to improve to approximately 66% by 2025. Simultaneously, RBC Capital Markets expects the dividend to grow by 11% through 2025.

Element Fleet Management Corporation

(TSX: EFN; $27.58)

We are adding a 2.5% position in Element Fleet Management

- **Strong growth:** The company has multiple catalysts including the normalization of OEM production and accelerated customer wins. Recent earnings per share (EPS) reports have been ahead of consensus estimates, and the company raised its 2024 guidance due to strong growth in the first half of the year. The company also announced the acquisition of Autofleet Solutions, which should augment and accelerate the modernization of Element's digital capabilities, in our view.
- **Increase in return of capital to shareholders a potential catalyst:** We believe the company's solid free cash flow generation profile could lead to a meaningful dividend increase and/or share buyback activity. The consensus dividend growth estimate for 2025 is 13%. The dividend is projected to grow by double digits through 2025, according to consensus estimates.

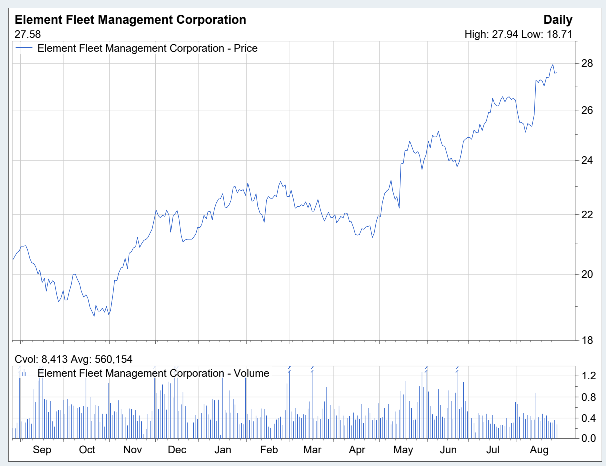
Risks

Risks include, but are not limited to: an economic recession that could negatively impact originations/portfolio growth; credit and/or equity market volatility that could reduce the ability to access capital on profitable terms to fund the current portfolio or future growth opportunities; and increased competition leading to customer losses.

Company description

Element Fleet Management is the largest player in the North American fleet leasing and management industry, and also has a large presence in the Australia-New Zealand market. In addition, the company offers customers global fleet management capabilities via its Element-Arval strategic partnership. Element Fleet was formed through the acquisition and integration of three leading fleet management companies (TLS, PHH Fleet, and GE Fleet Services) from 2012 to 2015.

1-year pricing chart



Source - FactSet; data through 8/28/24

Allied Properties REIT

(TSX: AP.UN; $17.55)

We are removing the 2.5% position in Allied Properties

- **Challenging operating environment and rising leverage:** The office market has remained challenged due to the adoption of hybrid/remote working conditions and rising unemployment. All else equal, we expect office demand to remain soft. Additionally, the company converted an outstanding loan into equity. As a result, leverage increased to nearly 11x debt-to-EBITDA, and this has reduced the company's financial flexibility.
- **Elevated payout ratio:** While we acknowledge that Allied Properties generates an attractive yield, we are also cognisant that the payout ratio is elevated and this leaves a limited margin for error for the distribution on a forward-going basis. RBC Capital Markets estimates the payout ratio should remain in the mid-90% range through 2025.

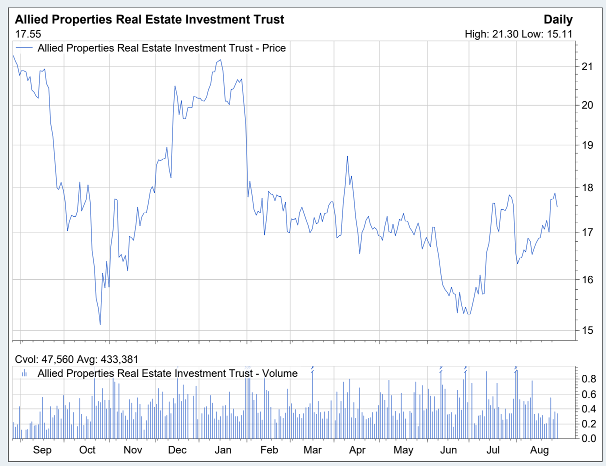
Risks

Risks include, but are not limited to: Allied Properties' concentration in major Canadian cities; rising adoption of hybrid and remote working environments; higher office supply; and increased unemployment.

Company description

Allied Properties REIT is a leading owner, manager and developer of urban workspace in Canada's major cities. The portfolio's largest concentrations are in Toronto, Montreal, Calgary, and Vancouver, with clusters of properties also located in Ottawa, Kitchener, and Edmonton. Allied's portfolio consists of 216 properties (206 rental properties and 10 development properties), with the rental properties encompassing 15 million square feet of gross leasable area.

1-year pricing chart



Source - FactSet; data through 8/28/24

Thomson Reuters Corporation

(TSX: TRI; US$170.32)

We are removing the 2.5% position in Thomson Reuters

- **Fairly valued stock:** Thomson Reuters currently trades at an enterprise-value-to-EBITDA (EV/EBITDA) multiple of 25.7x, well above the recent historical range of 14x–27x and above its closest peer's multiple of 19x. The company recently increased its revenue growth guidance for 2024, but we believe the share price fully reflects the anticipated organic revenue growth of 7%–8% and strong return of capital to shareholders.
- **Low dividend yield:** TRI is expected to grow its dividend by 7% in 2025, well above the dividend growth of approximately 3% for the S&P/TSX Index; however, this dividend yield is the lowest in the Portfolio. We are therefore removing the position in favour of another growth company that trades at what we consider a more interesting valuation level while offering a higher dividend yield and similar dividend growth potential.

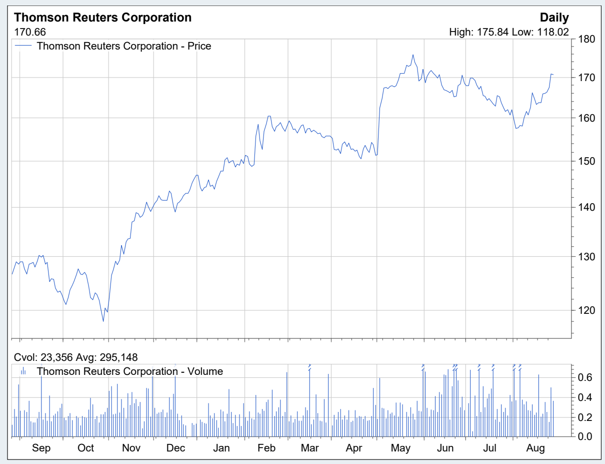
Risks

Risks include, but are not limited to: high valuation levels; lack of execution on the GenAI playbook; and an economic slowdown that could result in less end-user demand.

Company description

Thomson Reuters is a content-driven technology provider serving professionals in five business segments including legal professionals, corporates, tax professionals, Reuters News, and global print.

1-year pricing chart



Source - FactSet; data through 8/28/24

Canadian Imperial Bank of Commerce

(TSX: CM; $73.50)

We are increasing the position in Canadian Imperial Bank of Commerce to 5.0% (from 2.5%)

- **Maintaining economic sensitivity in a falling rate environment:** Canadian Imperial Bank derives approximately 70% of its revenues from Canada, and therefore is highly sensitive to the health of Canadian consumers and businesses. RBC Economics expects the Canadian overnight interest rate to decline by another 150 basis points from mid-2024 through the end of 2025. All else equal, lower rates should provide a tailwind for the economy and reduce the risk of growing delinquencies heading into next year. Additionally, we believe the bank has done a solid job in controlling expense growth, which in turn has allowed it to benefit from positive operating leverage.
- **Healthy capital and attractive dividend yield:** We believe Canadian Imperial Bank is well positioned in an environment where credit risk is still biased upward due to its Common Equity Tier 1 (CET1) ratio of approximately 13%. The bank also recently suspended the discount on its dividend reinvestment program, reinforcing the health of its capital position. Additionally, we believe Canadian Imperial Bank provides an attractive and sustainable yield, supported by a payout ratio of approximately 49% according to RBC Capital Markets' 2025 estimate. Heading into 2025, RBC Capital Markets is also projecting the dividend to grow by roughly 3%.
- **Reasonable valuation:** While the stock has rerated to approximately 10.2x forward price-to-earnings, this is still a discount to the peer group average of 10.7x. As a result, we believe we're receiving decent value in a favourable rate of change thesis.

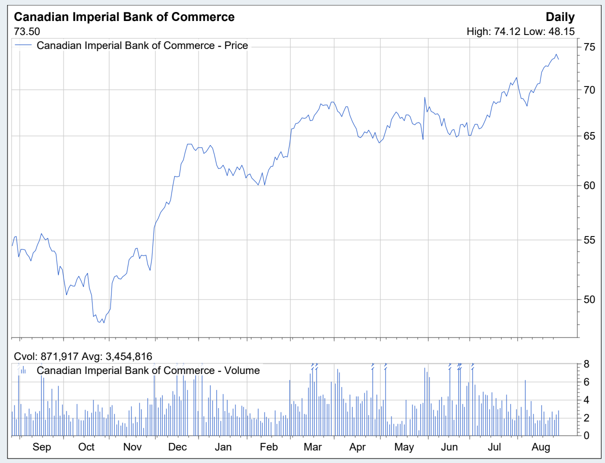
Risks

Risks include, but are not limited to: a slowdown in the Canadian economy; sustained deterioration in capital markets activity; weakening retail credit quality; loss of domestic market share; and regulatory changes.

Company description

Canadian Imperial Bank of Commerce is Canada's fifth-largest bank as measured by loans, assets, and market capitalization.

1-year pricing chart



Source - FactSet; data through 8/28/24

First Capital REIT

(TSX: FCR.UN; $17.36)

We are increasing the position in First Capital Real Estate Investment Trust to 5.0% (from 2.5%)

- **Executing well on the optimization plan:** First Capital set a goal of monetizing approximately $1 billion in asset sales as a means to strengthen its balance sheet. Importantly, the company has been prioritizing the sale of non-core assets (e.g., assets that generate lower yields) and has generally been able to sell these assets for valuations in excess of their book values. Overall, we believe these initiatives place First Capital on a stronger financial footing and should allow for a rerating in the units over time.

- **Attractive yield:** While RBC Capital Markets expects the distribution to remain unchanged heading into 2025, we believe the units are providing an attractive yield at approximately 5%. Furthermore, we see this yield as sustainable, supported by an 80% payout ratio according to RBC Capital Markets' 2025 estimate.

- **Discounted valuation:** Units are trading at a discount of approximately 20% to net asset value. All else equal, a falling interest rate environment and an improved economic outlook should help narrow the valuation gap. Units are also trading at an implied capitalization rate of roughly 6.5%, which is adequate compensation relative to current fixed income yields in our opinion.

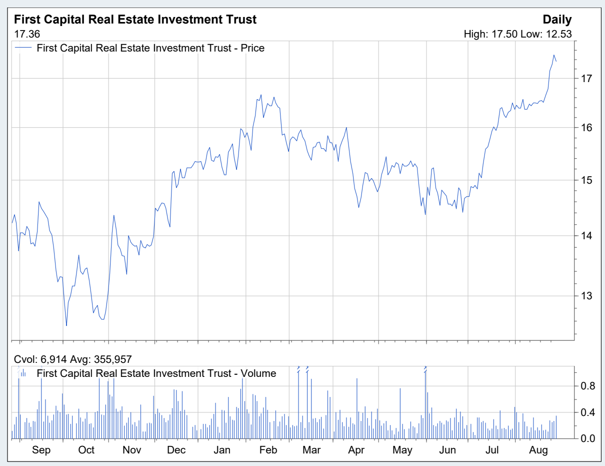
Risks

Risks include, but are not limited to: competition for tenants; supply of new retail space; interest rate fluctuations; financial strength of tenants; and broader economic weakness.

Company description

First Capital REIT is a fully integrated Canadian real estate investment trust, with a focus on the ownership, management, acquisition, and development of necessity-based real estate located in Canada's most densely populated urban centres. The portfolio is characterized by urban neighbourhood and community shopping centres and mixed-use properties. First Capital's properties are most commonly anchored by grocery stores and drug stores.

1-year pricing chart



Source - FactSet; data through 8/28/24

Sun Life Financial Inc.

(TSX: SLF; $72.67)

We are increasing the position in Sun Life Financial to 5.0% (from 2.5%)

- **Solid business fundamentals:** Sun Life Financial remains a high-quality business, in our view, supported by its industry-leading return on equity (ROE). The company is also well capitalized and should benefit from improving financial market conditions. RBC Capital Markets expects ROE to improve by nearly 200 basis points year-over-year to 19.2% in 2025. Importantly, we acknowledge that consumer risks remain top of mind; thus, the increased exposure to lifecos should limit the Portfolio's direct exposure to credit risk.
- **Well capitalized:** Sun Life's LICAT (Life Insurance Capital Adequacy Test) ratio stood at 150% as of Q2 2024, which is well above regulatory requirements. As a result, we believe the company would be in a strong financial position if higher-than-expected insurance claims were to materialize. This, in combination with the company's attractive ROE profile, should allow for solid dividend growth, in our view. RBC Capital Markets is forecasting the dividend to grow by approximately 7% through 2025.
- **Paying for quality:** Sun Life trades at a premium relative to peers on a price-to-book basis. We believe this is warranted due to the company's track record of delivering on its objectives and its above-average profitability metrics.

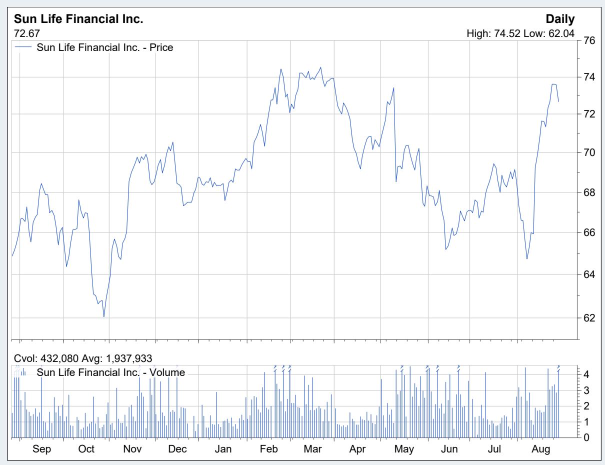
Risks

Risks include, but are not limited to: a prolonged economic downturn; larger-than-expected credit losses; changes in actuarial assumptions; appreciation in the Canadian dollar; and unfavourable economic developments in Asia.

Company description

Sun Life Financial is one of Canada's Big Three lifecos and has operations in Canada, the U.S., Asia, and the UK. The company has a substantial wealth management presence through majority-owned MFS, a large U.S. asset management company.

1-year pricing chart



Source - FactSet; data through 8/28/24

Bank of Montreal

(TSX: BMO; $110.37)

We are reducing the position in Bank of Montreal to 2.5% (from 5.0%)

- **Credit losses elevated relative to peers:** Bank of Montreal reported higher-than-expected provisions for credit losses for two consecutive quarters, and management commentary suggests that losses in the commercial lending portfolio may remain elevated for several more quarters. Of note, the spike in credit losses at BMO is substantially higher than those reported by its peers, and this raises questions around risk management and medium-term profitability at the bank. A potential monetary policy easing cycle in the U.S. and Canada could provide some relief on credit, but the lagged effect of these rate cuts may keep losses elevated for several quarters.
- **Underlying operating results remain stable:** Outside the weak credit performance, all segments reported positive pre-provision pre-tax (PPPT) growth, driven by lower-than-forecast expenses. Much of this expense outperformance was driven by Bank of the West expense synergies and restructuring charges announced last year, and this resulted in positive operating leverage for the bank. However, top line growth remains sluggish due to weak demand for commercial and real estate loans.
- **Strong capital position:** BMO remains very well capitalized, with a Common Equity Tier 1 (CET1) ratio of 13.0%, which positions the bank well to address stresses in its lending portfolio, in our view. Positive internal capital generation over next several quarters could also enable the bank to deploy excess capital towards share buybacks, which could support the stock.

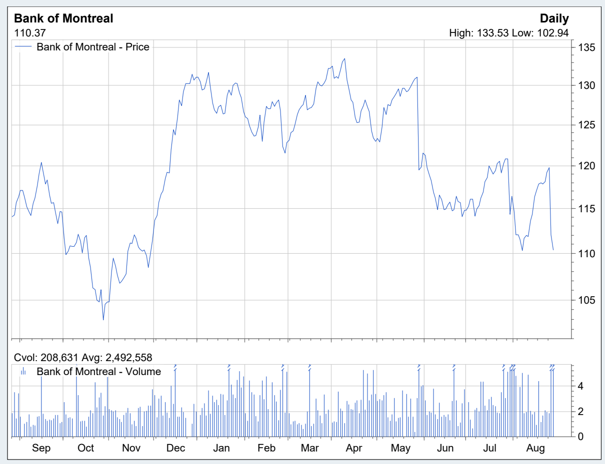
Risks

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.

Company description

Bank of Montreal is Canada's fourth-largest bank by market capitalization. Its group of companies include Chicago-based BMO Harris Bank, BMO Nesbitt Burns, and BMO Capital Markets.

1-year pricing chart



Source - FactSet; data through 8/28/24

Intact Financial Corporation

(TSX: IFC; $251.24)

We are reducing the position in Intact Financial Corporation to 2.5% (from 5.0%)

- **Fairly valued stock:** While we view Intact Financial as a core holding reflecting positive fundamentals and strong defensive attributes, the shares appear fully valued with a price-to-book (P/B) valuation multiple of 2.9x, compared to the five-year average of 2.5x.
- **Strong dividend growth:** The company is expected to grow its dividend in the high single digit range in each of the next two years, which is attractive in our view, and therefore we are maintaining a 2.5% position in the Portfolio.

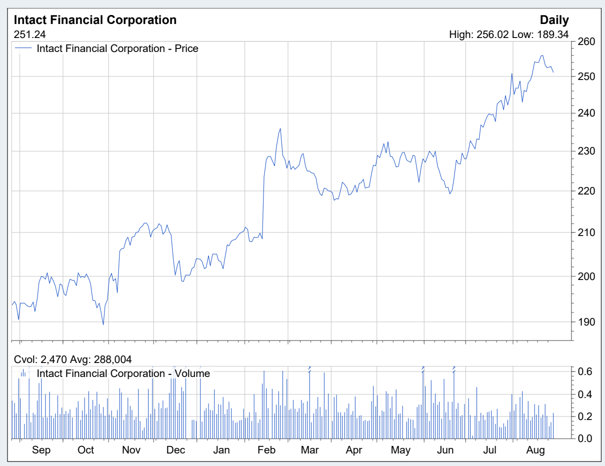
Risks

Risks include, but are not limited to: negative regulatory developments; a significant increase in catastrophes; deteriorating combined ratios; and integration/execution risks related to the recent acquisition of RSA.

Company description

Intact Financial is the largest property and casualty insurance company in Canada, holding an approximately 20% market share of premiums written in Canada. Business growth has come primarily through 18 acquisitions since 1988. The company writes personal and commercial insurance for individuals and small to medium-sized enterprises in all provinces and territories, within four key operating segments: personal auto, personal property, commercial auto, and commercial P&C.

1-year pricing chart



Source - FactSet; data through 8/28/24

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 2.89%; the EIGP currently offers investors a yield of approximately 4.45% plus the potential for capital appreciation and an inflation hedge.

Disclosures and disclaimers

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Distribution of ratings – RBC Capital Markets Equity Research
As of June 30, 2024

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Outperform]	857	57.44	271	31.62
Hold [Sector Perform]	588	39.41	146	24.83
Sell [Underperform]	47	3.15	5	10.64

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RBC Capital Markets has fundamental research of the following companies:

Allied Properties REIT (AP.UN; Sector Perform; $17.55)
AltaGas Ltd. (ALA; Outperform; $33.89)
Bank of Montreal (BMO; Sector Perform; $110.37)
Bank of Nova Scotia (BNS; Sector Perform; $65.94)
Brookfield Asset Management Ltd. (BAM; Outperform; $41.11)
Brookfield Infrastructure Partners L.P. (BIP; Outperform; $32.52)

Canadian Imperial Bank of Commerce (CM; Sector Perform; $73.50)

Canadian National Railway Company (CNR; Sector Perform; $158.04)

Canadian Natural Resources Ltd. (CNQ; Outperform; $49.22)

Canadian Tire Corp. (CTC.A; Outperform; $153.86)

Enbridge Inc. (ENB; Outperform; $53.08)

First Capital REIT (FCR.UN; Outperform; $17.36)

Fortis Inc. (FTS; Sector Perform; $59.01)

Manulife Financial Corp. (MFC; Outperform; $36.81)

National Bank of Canada (NA; Sector Perform; $126.91)

Nutrien (NTR; Outperform; $47.79)

Pembina Pipeline Corp. (PPL; Outperform; $53.78)

Restaurant Brands International Inc. (QSR; Outperform; $69.11)

Sun Life Financial Inc. (SLF; Outperform; $72.67)

Suncor Energy Inc. (SU; Outperform; $54.75)

TC Energy Corp. (TRP; Outperform; $61.25)

TELUS Corp. (T; Outperform; $21.68)

Thomson Reuters Corp. (TRI; Sector Perform; US$170.32)

Toromont Industries Ltd. (TIH; Outperform; $120.31)

Toronto-Dominion Bank (TD; Outperform; $80.11)

Our third-party research providers have fundamental research of:

Element Fleet Management Corp. (EFN; Reduce; $27.58)

Intact Financial Corp. (IFC; Reduce; $251.24)

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