From the Desk of the **Public Equities Team**

Canadian Equities Q&A as of September 26, 2024

By James Hunter, CFA. Edited by Jitesh Chauhan

Q1. You speak a lot about quality and diversification within portfolios. How do you find the right group of companies for a portfolio?

The Public Equities team (the "Team","we", "our") at TD Asset Management Inc., ("TDAM") is always looking for quality companies. We believe this means buying businesses that have a leading market share in its industry, a quality management team and where the customers stick with them over time. Part of our process is to rank businesses from best to worst in an industry. If the best is too expensive we're happy to be patient and invest in number two on the list; if that one is going through a rough patch that may not resolve soon, we'll go to number three and so on. However, we will not go into the bottom half of the list – we stay away from weaker companies.

Another part of my approach is to maintain a diversified portfolio. We believe this is important because as we progress through various business cycles there will naturally be market fluctuations. The market has gone through some rough drawdowns in the last several years and these periods can impair returns if a portfolio is too concentrated in one factor or industry group or stock. Our view is that portfolios with many quality businesses that add value at different times are better at weathering inevitable market turbulence.

Q2. What are some examples of industry leaders you prefer?

Some of our favourite companies are large holdings in the TD Monthly Income Fund and many other funds at TD Asset Management.

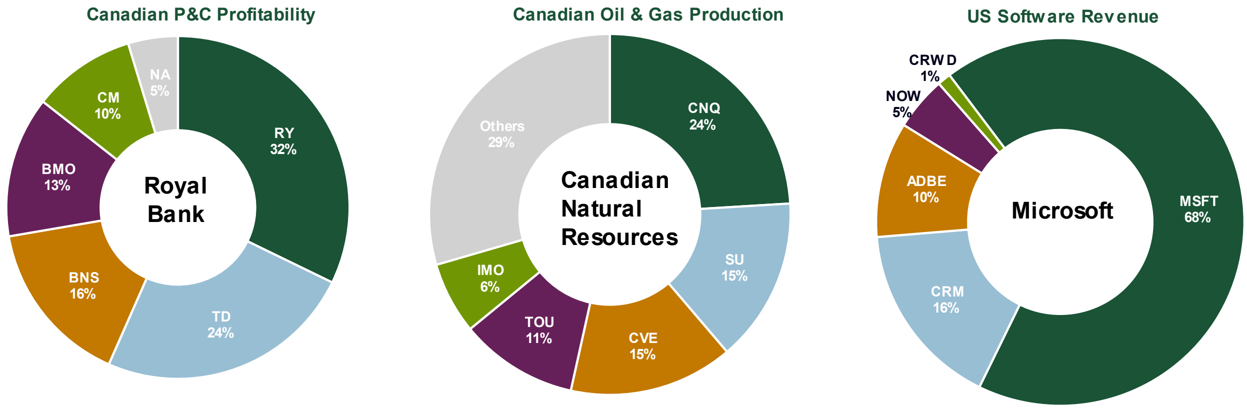
For example, Royal Bank of Canada (RBC), is the leading bank in Canada, with a 32% market share in Personal and Commercial (P&C) banking. In Canadian P&C banking RBC made an $8 billion profit in the last 12 months. That's more than the National Bank of Canada, Canadian Imperial Bank of Commerce and Bank of Montreal combined. With RBC, you basically have more revenue per unit of cost. Ultimately that drives higher returns on equity, which feeds dividends and book value growth. Management has also done a better job of deploying capital than other peers. While its valuation is on the higher side compared to other banks, we continue to view it as an attractive investment due to its industry leadership.

Canadian Natural Resources (CNQ) is another great company. CNQ produces over a million barrels per day of oil and oil equivalents, which is more than 50% bigger than the number two player, Suncor Energy. It's almost as big as the bottom 50 companies put together, which gives it a considerable cost advantage. While costs are important in banking and other industries, they are critical for oil and gas and other commodity producers because they have no control over commodity prices – they must take the market price. Being a low-cost producer in such an industry is vital for long-term success and CNQ is one of the lowest cost operators in this industry. CNQ is also one of the few producers that didn't cut their dividend during the pandemic.

Microsoft Corporation (MSFT) is another example of an industry leader. Its software-as-a-service revenues are larger than everyone else in their industry. MSFT has put up a 35% net profit margin, 40% return on equity and they doubled their free cash flow in the past 5 years. Despite this, it trades at a relatively small premium to its software peers, which we believe is underappreciated.

Investment Philosophy

Chart 1: Leadership in action – Royal Bank, Canadian Natural Resources, Microsoft



Note: RY = Royal Bank of Canada. TD = TorontoDominion Bank. BNS = Bank of Nova Scotia. BMO = Bank of Montreal. CM = Canadian Im perial Bank of Commerce. NA = National Bank of Canada. CNQ = Canadian Natural Resources Ltd. SU = Suncor Energy Inc. CVE = Cenovus Energy Inc. TOU = Tourmaline Oil Corp (Alberta). IMO = Imperial Oil Ltd. MSFT = Microso ft Corp. CRM = Salesforce Inc. ADBE = Adobe Inc. NOW = ServiceNow Inc. CRWD = Crowdstrike Holdings Inc.
Source: Company Reports, Bloomberg Finance L.P. As of Aug 31, 2024.

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Q3. What other trends are the portfolio management team monitoring right now?

Our primary focus is to orient our portfolios for the long term. In balanced mandates, we believe being overweight equities versus fixed income today is still optimal positioning, although during periods of market volatilty it is important to not concentrate the portfolios.

We are monitoring the surge in precious metals. Gold has been rallying due to a combination of factors including ongoing government budget deficits, geopolitical risks, and some weakness in the U.S. dollar. We are not bullish on the mining sector as it's a difficult business with many companies having operations in high-risk jurisdictions. We will continue to follow developments here to see if our investment positioning needs to evolve.

Q4. How do you view Canadian banks?

The Canadian banks are strong businesses. The stocks were cheap this summer, trading close to 10x earnings, and have had a great run in the last couple of months. Bank of Canada rate cuts have helped. Results have also been good, with most banks now reporting earnings growth and, other than the Bank of Montreal, their loan losses have come in as expected. Another positive for the banks is that capital requirements have peaked for the time being and all the banks have healthy capital buffers, so they should be able to continue increasing dividends. We believevthe outlook for Canadian bank stocks is positive.

For further information,
please contact your investment professional.