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Equity Strategy

Still Loving Financials: Revisiting our Bullish Case for the Financial Sector

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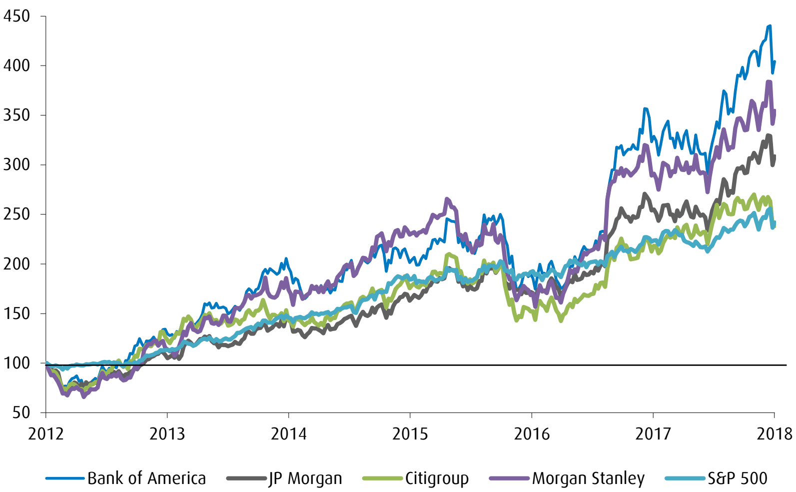
Back on February 21, 2012 we made a very bullish call on U.S. Mega Banks ("The Half of Book (Value) Club"), a most hated sector at the time. Since then, we have reiterated this stance several times and we continue to recommend many of the same stocks (Bank of America, Morgan Stanley, Citigroup and JPMorgan in particular) despite their very strong performance over the last six years. In this report, however, we broaden out the call to include other sub-sectors (such as life insurance) and geographies. European financials seem like great value investments right now given the continuing economic recovery for major European countries. The Euro-area unemployment rate is on a continued downtrend and positive structural reforms are making their economies more competitive (i.e labor and land reforms). The recent market pullback has made the entry point that much more timely for some of our favourite names listed in the pages below.

Figure 1: Large Cap U.S. Banks versus the Canadian Market



Source: FactSet

BAC, JPM, MS and C have shown total returns of 440%, 340%, 310% and 210% respectively over the last six years vs. 180% for the market (in Canadian Dollar Terms)

Figure 2: BMO Nesbitt Burns Investment Strategy Committee's Recommended Asset Allocation (%)

	Income		Balanced		Growth		Aggressive Growth	
	Recommended Asset Mix	Benchmark Weights	Recommended Asset Mix	Benchmark Weights	Recommended Asset Mix	Benchmark Weights	Recommended Asset Mix	Benchmark Weights
Cash	5	5	5	5	5	5	0	5
Fixed Income	70	70	40	45	20	25	5	0
Equity	25	25	55	50	75	70	95	95
Canadian Equity	15	15	25	25	35	35	40	40
U.S. Equity	10	5	25	15	25	20	35	30
EAFE Equity*	0	5	0	5	5	10	10	15
Emerging Equity	0	0	5	5	10	5	10	10

** Within EAFE, we specifically recommend Continental European equity. Source: BMO Nesbitt Burns Private Client Strategy Committee*

Key Reasons for Our Bullish Call

1) The credit outlook remains positive both in North America and Europe and the sector's capital ratio (their capacity to absorb losses) is very strong; 2) The synchronized global economic recovery remains strong, despite being in the later stages of the cycle, and increasing interest rates should boost earnings for the entire sector; 3) Lower regulation in the U.S. and recent tax cuts should boost earnings power; 4) Strong technicals; 5) Attractive valuations and risk/reward at current levels.

We elaborate on each of the above themes later in the report.

Below we highlight some of our favourite global financial stocks and key points behind the investment thesis. These stocks are all members of our Equity Guided Portfolios.

- **Bank of America (BAC):** Underappreciated earnings power; solid management team.
- **Citigroup (C)**: Great international assets, continued solid execution and earnings power; trades below book value.
- **Manulife (MFC)**: Strong execution and earnings potential from Asian assets; benefits from higher rates.
- **CIBC (CM)**: Much improved execution over the last two quarters; de-risking the mortgage portfolio; cheapest major Canadian bank with an attractive dividend yield.
- **ING Groep (ING)**: Strong retail footprint in the Netherlands and Belgium; solid balance sheet and management team; stock is underpriced given the quality of their asset base.
- **UBS (UBS):** Global leader in wealth management; will benefit from continued global wealth creation, especially in emerging markets. Improving results and solid management team.

In the fixed income space, please see page 10 for our bond picks, which include attractive TD and Manulife issues. In the Preferred Share space, see page 11 for details on attractive CIBC and Manulife preferred shares.

ETF picks include: iShares Global Financials ETF (IXG-US), Financial Select Sector SPDR (XLF)-US, BMO Equal Weight U.S. Banks Hedged to CAD Index ETF (ZUB-T), BMO Equal Weight U.S. Banks ETF (ZBK-T).

Why Are We Still Positive on Financials?

1) The credit outlook remains positive both in North America and Europe

This is crucial since increased loan loss provisions have historically been toxic to stock performance (since it crushes profitability). We take comfort from the fact that bond spreads in general and for the financial sector in particular are generally very well behaved which indicates that the fixed income market does not see any looming threats (as it did before the financial crisis). Capital ratios and risk management have improved substantially thereby lowering the potential downside risk.

BMO Capital Markets analyst James Fotheringham who covers U.S. Large-Cap Banks and Specialty Finance concludes that: "The fundamental credit quality should remain benign across the U.S. banking system until the end of 2019E (and perhaps beyond). We use seven macroeconomic factors (unemployment rate, car sales, Fed Funds Rate etc), to forecast benign credit quality trends for the U.S. banking system. We expect these benign credit conditions to endure for the next two years at least. Our updated credit forecasting model incorporates the anticipated effects of tax reform on the broader U.S. economy. Also, capital strength remains more than adequate across the U.S. banking system, despite its recent decline. At 8.1% tangible common equity/tangible assets (TCE/TA), the aggregate capital strength of U.S. banks is down 5% from its recent peak, but still ~20% above its previous quarter century high."

The forecast for benign fundamental credit quality is shown in Figure 3 (the light blue line is their forecast). Their system-wide fundamental credit quality is predicated on their proprietary seven macro-factor linear regression model, but the output of that model is determined by their quarterly estimates for those seven macroeconomic factors shown in Figure 4.

Figure 3: System Wide Fundamental Credit Quality: BMO Predicts that Credit Quality Will Remain Benign out to the end of 2019

Source: BMO Capital Markets

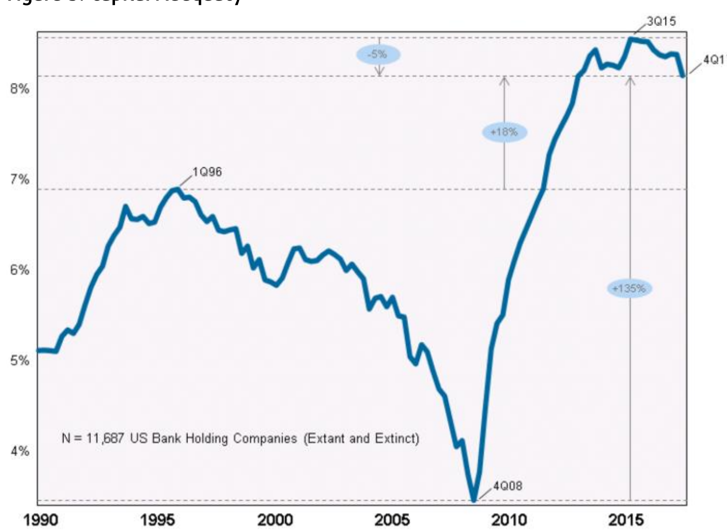
Figure 4: BMO Capital Markets' Macro-Factors that Influence their Views on Fundamental Credit Quality

	1Q18E	2Q18E	3Q18E	4Q18E	1Q19E	2Q19E	3Q19E	4Q19E
Unemployment Rate	4.0%	3.9%	3.9%	3.8%	3.7%	3.7%	3.7%	3.6%
Nominal GDP (YOY)	5.5%	4.3%	4.3%	4.1%	4.2%	3.8%	3.8%	3.8%
Car Sales (millions of units)	17.2	16.6	16.4	16.4	16.3	16.2	16.2	16.2
Consumer Spending (YOY)	2.6%	2.9%	2.5%	2.2%	2.2%	2.1%	1.9%	1.8%
Fed Funds Rate	1.46%	1.71%	1.96%	2.21%	2.46%	2.71%	2.88%	2.88%
Housing Starts (thousands of units)	1,300	1,290	1,270	1,260	1,260	1,260	1,270	1,270
Mortgage Purchase Originations ($ billions)	218	345	350	270	255	365	360	270

Source: BMO Capital Market

Capital supporting the U.S. banking system has recently declined from quarter-century highs; however, at more than 8% TCE/TA (tangible common equity divided by tangible assets) in aggregate, BMO Capital Markets believes that capital is still more than adequate.

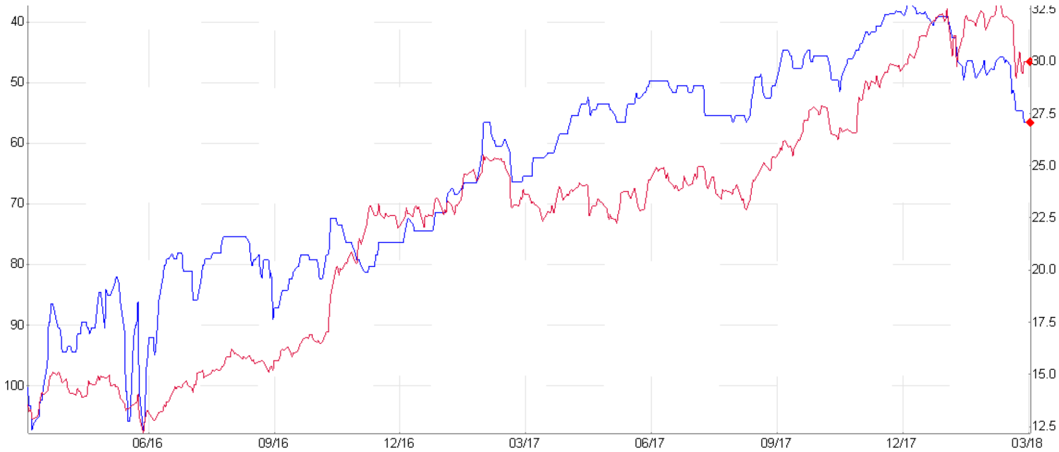
Figure 5: Capital Adequacy



Source: BMO Capital Markets

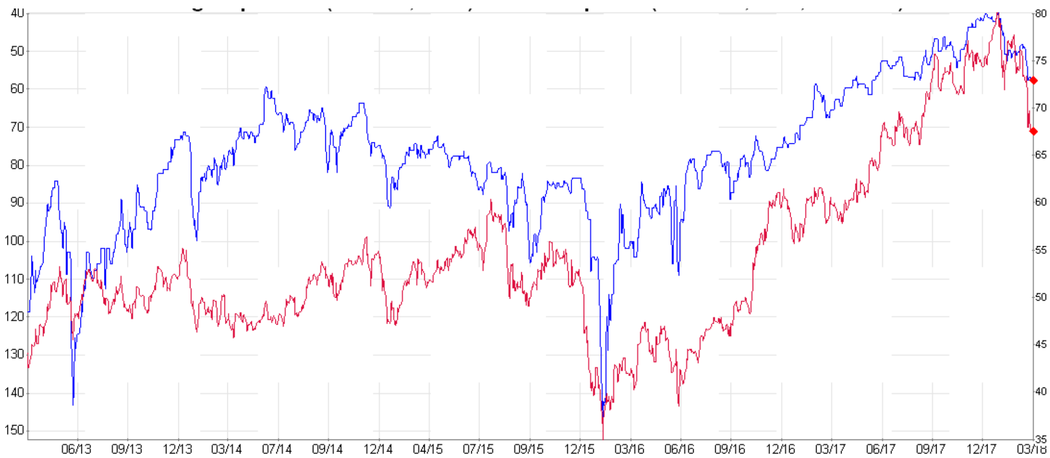
The fixed income market continues to constructive for the global banking system. This is very important, as the bond and Credit Default Swap (CDS) markets have tended to lead equities since the financial crisis, and particularly for bank stocks. As Figures 6 and 7 below show, there is a very strong inverse relationship between CDS spreads and stock prices. While spreads have widened a little recently, they remain very well behaved looking back several years. In other words, when CDS spreads tighten (go down), stocks typically go up and vice-versa – but often with some lag. Looking at Citigroup for example, a simplistic historical relationship implies the stock should be somewhere in the mid-seventy dollar range. We see similar stories with other favourite stocks such as Bank of America, CIBC, Manulife, AIG, ING and UBS.

Figure 6: Bank of America Stock (red line, right-hand-side) versus CDS Spread (blue line, left hand side, inverted)



Source: Credit Suisse

Figure 7: Citigroup Stock (red line, right-hand-side) versus CDS Spread (blue line, left hand side, inverted)



Source: Credit Suisse

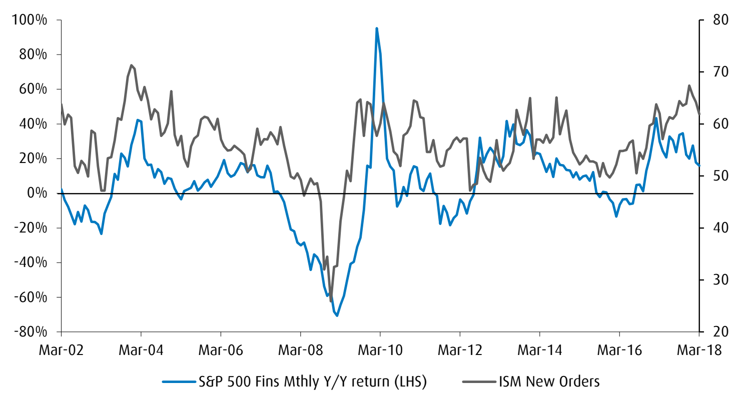
2) The synchronized global economic recovery –although we are later in the cycle- remains strong which helps earnings momentum for the entire sector

The biggest potential risk to these stocks is a recession. Our models show that recession risks remain quite low over the next year in North America. This is important given the economic/market sensitivity of these stocks.

Diversified financials should perform strongly if U.S. economic momentum holds up. Specifically, since 2001, the S&P has performed best when the ISM New Orders index is above 50 and rising. This could be the prelude to another strong up move, similar to the 2002-2003 experience.

Increasing long term interest rates are generally a positive for financial stocks, particularly for life insurers whose long term liabilities decrease and generate higher investment income in this environment. For banks, a steeper yield curve (i.e. long term rates rising faster than short term rates) tends

Figure 8: S&P 500 Financial Sector versus ISM New Orders Index



Source: Bloomberg

to increase the net interest margin and thus profitability. Our historical work supports this argument and has shown that financials have performed especially strongly in periods when long term (i.e. 10 year yields) interest rates are rising. Going back to the 1990s, average annualized returns for the financial sector has been 20% and 17% in the U.S. and Canada respectively when 10 year yields were rising versus less than 2% when rates were declining. Since we expect rates to continue rising over the next few years, this should be a solid tailwind for bank and insurance stocks.

Figure 9: Market Returns When the 10 Year Treasury Yield is Rising

10 Year Rising				U.S. Market							
Period	Dates	10 Year Starting Level	10 Year Ending Level	No. of Months	S&P Price Return	Annualized Price Return	S&P Financials Price Return	S&P Financials Annualized Price Return	TSX Price Return	Annualized Price Return	TSX Financials Price Return
1	Jan 62 - Dec 69	4.1	7.9	96	33.7%	3.7%			49.3%	5.1%	
3	Apr 71 - Sep 75	6.1	8.5	54	-19.3%	-4.7%			-2.4%	-0.5%	
5	Sept 77 - Sept 81	7.4	15.8	49	20.4%	4.6%			88.3%	16.8%	
7	May 83 - Jun 84	10.8	13.8	14	-5.7%	-4.9%			-8.3%	-7.1%	
9	Mar 87 - Mar 89	7.5	9.3	25	1.1%	0.5%			-4.3%	-2.1%	
11	Oct 93 - Nov 94	5.4	7.9	14	-3.0%	-2.6%	-9.0%	-7.7%	-3.8%	-3.3%	-1.9%
13	Jan 96 - Mar 97	5.6	6.9	15	19.0%	15.0%	30.6%	23.8%	17.7%	14.0%	51.0%
15	Oct 98 - Jan 00	4.6	6.7	16	26.9%	19.6%	7.6%	5.6%	36.6%	26.4%	-10.4%
17	Jun 03 - Jul 07	3.5	5	49	54.3%	11.2%	47.1%	9.9%	99.1%	18.4%	89.4%
19	Apr 09 - Mar 10	3.1	3.8	12	34.0%	34.0%	47.7%	47.7%	29.1%	29.1%	39.5%
21	Aug 12 - Dec. 13	1.6	3	17	31.4%	21.3%	44.9%	29.9%	14.0%	9.7%	27.6%
23	Aug 16 - Jan 18	1.5	2.7	18	30.1%	19.2%	49.4%	30.7%	9.3%	6.1%	21.8%
				379							
Average					**18.6%**	**9.7%**	**31.2%**	**20.0%**	**27.1%**	**9.4%**	**31.0%**
Median					**23.6%**	**7.9%**	**44.9%**	**23.8%**	**15.9%**	**7.9%**	**27.6%**

Source: Bloomberg, BMO Nesbitt Burns

Figure 10: Market Returns When the 10 Year Treasury Yield is Declining

10 Year Declining											
Period	Dates	10 Year Starting Level	10 Year Ending Level	No. of Months	S&P Price Return	Annualized Price Return	S&P Financials Price Return	S&P Financials Annualized Price Return	TSX Price Return	Annualized Price Return	TSX Financials Price Return
2	Jan 70 - Mar 71	5.5	7.8	15	18.0%	14.1%			3.4%	2.7%	
4	Oct 75 - Aug 77	7.9	7.1	23	8.7%	4.4%			7.8%	4.0%	
6	Oct 81 - Apr 83	14.6	10.3	19	34.9%	20.8%			27.0%	16.3%	
8	Jul 84 - Feb 87	12.9	7.2	32	88.6%	26.9%			63.5%	20.2%	
10	Apr 89 - Sept 93	9.1	5.4	54	48.2%	9.1%			10.0%	2.1%	1.2%
12	Dec 94 - Dec 95	7.8	5.6	13	34.1%	31.1%	49.6%	45.1%	11.9%	10.9%	14.0%
14	Apr 97 - Sept 98	6.7	4.4	18	26.9%	17.2%	17.7%	11.5%	-6.1%	-4.1%	9.4%
16	Feb 00 - May 03	6.4	3.4	40	-29.5%	-9.9%	19.1%	5.4%	-24.9%	-8.2%	57.1%
18	Aug 07 - Mar 09	4.7	2.7	21	-45.2%	-29.1%	-73.4%	-53.0%	-37.1%	-23.3%	-45.2%
20	Apr 10 - Jul 12	3.7	1.5	28	16.2%	6.7%	-9.2%	-4.1%	-4.5%	-1.9%	-4.2%
22	Jan 14 - July 16	2.6	1.5	30	21.9%	8.3%	12.4%	4.8%	6.5%	2.5%	14.0%
				293							
Average					**20.3%**	**9.1%**	**2.7%**	**1.6%**	**5.2%**	**1.9%**	**6.6%**
Median					**21.9%**	**9.1%**	**15.0%**	**5.1%**	**6.5%**	**2.5%**	**9.4%**

Source: Bloomberg, BMO Nesbitt Burns

3) The current U.S. congress and administration appears intent on lowering regulation and the recently passed tax cut will have a material positive impact on earnings power for the sector. Operating results generally continue to improve and the credit environment is still constructive.

As noted by BMO Capital Markets analyst Lana Chan who covers U.S. Regional Banks: “The Senate (recently) passed a bipartisan regulatory reform bill (S. 2155) by a wide margin… we believe that regulatory reform will pass in some form and will be positive for our regional and small and mid-cap banks… Regulatory reform will also be a positive for mid-sized banks as they have been cautious on crossing over the US$50 billion asset threshold given the significantly higher regulatory costs.” The key advantages for the sector at large is that this should slow regulatory/compliance expense growth meaningfully and increase flexibility to return excess capital through dividends, buybacks and mergers and acquisition activity.

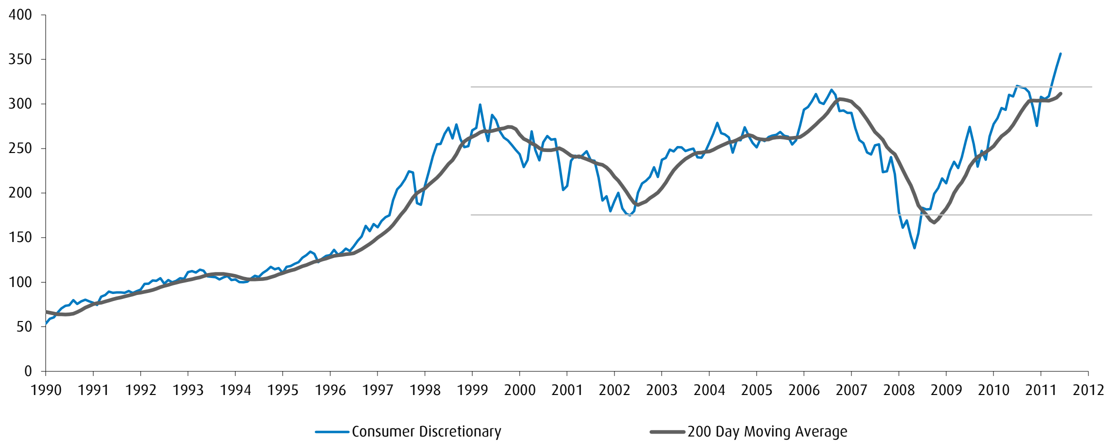
As we noted in January, the impact of the tax cut will vary greatly by industry but generally speaking, profitable and U.S. focused companies will benefit most. In our view, financials will be one of the top beneficiaries. This continues to be one of our favourite sectors and it has been for years.

BMO Capital Markets analyst James Fotheringham very recently raised his estimates and targets meaningfully. He writes: "we estimate direct and indirect effects of tax reform, when considered altogether, to be 19% accretive to our two-year- forward core earnings per share (EPS) forecasts and 2% accretive to our two-year-forward book value per share (BVPS) forecasts, on average (unweighted) across our coverage universe of 26 large-cap banks and specialty finance stocks."

4) The Technicals are Supportive

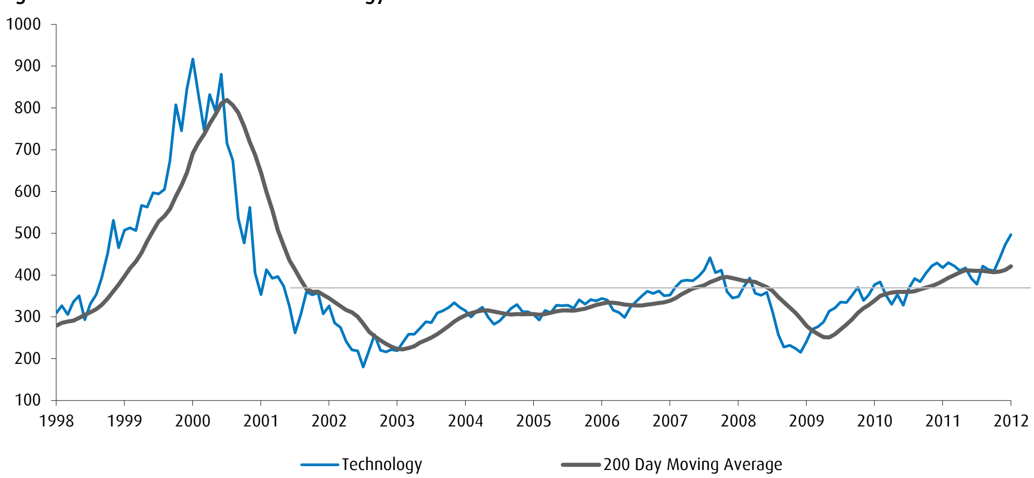
In 2012, BMO Nesbitt Burns technical analyst Russ Visch wrote a report titled "Out With the Old, In With the New" which highlighted the end of the secular bull market in commodities and the emergence of new leadership. At the time, he focused on the breakouts occurring in consumer discretionary and technology stocks and what made the charts so compelling were the size of the patterns they were breaking out of. The reason for this is that there's a concept in technical analysis called "proportionality" which means the bigger the pattern a security or index breaks out of, the greater the implications. Each sector and dozens upon dozens of individual companies within them were breaking out of 5, 10, and in some cases 20 year base patterns which, while not entirely unheard of, was extremely rare.

Figure 11: S&P 500 Consumer Discretionary Index – 1990 to 2012



Source: BMO Nesbitt Burns Technical Research, FactSet

Figure 12: S&P 500 Information Technology Index – 1998 to 2012

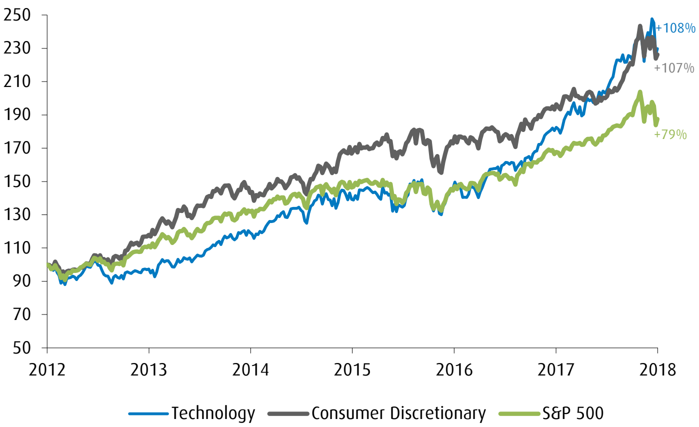


Source: BMO Nesbitt Burns Technical Research, FactSet

Those sectors subsequently went on 100%+ runs in the intervening 5 years, eclipsing the gains of the S&P 500.

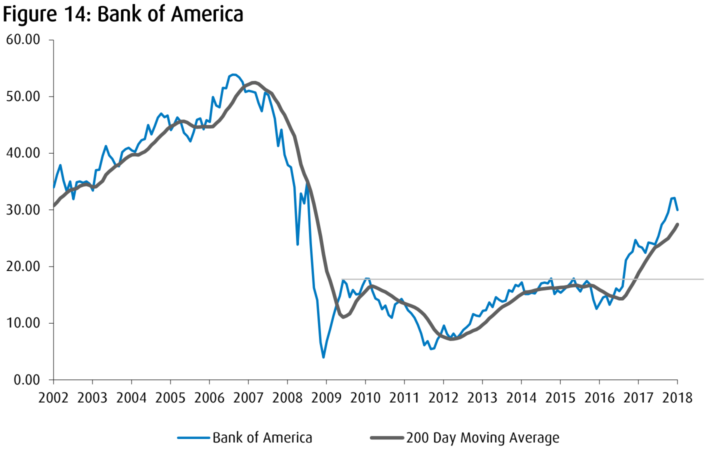
Why is this important? In early 2017, we saw similar-sized breakouts in large-cap U.S. financials. For example, Bank of America and Citigroup have broken out of extremely large eight-year base patterns. The initial upside targets for these breakouts measure to US$38 for Bank of America and US$110 for Citigroup. Given the size of the patterns they broke out of though, much higher targets are likely on a 2-4 year basis. Even more astounding are the twenty year trading range breakouts in companies like J.P. Morgan and U.S. Bancorp. Initial upside targets are US$120 and US$67 respectively but they too will go significantly higher within this emerging secular (multi-year/multi-decade) bull market. These are only some examples of the many stocks with similar charts.

Figure 13: S&P 500 versus Technology and Consumer Discretionary



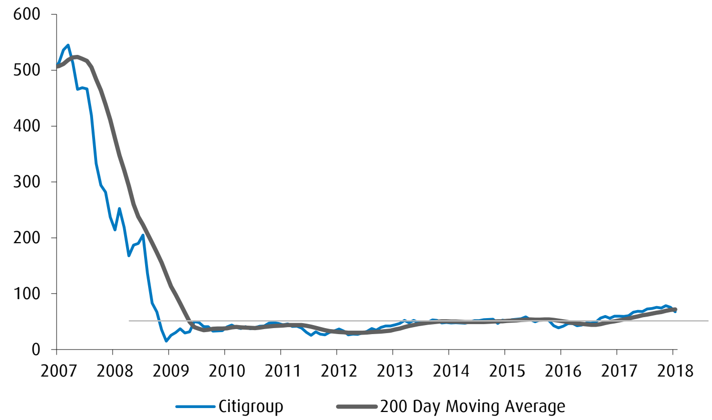
Source: BMO Nesbitt Burns Technical Research, FactSet

Figure 14: Bank of America



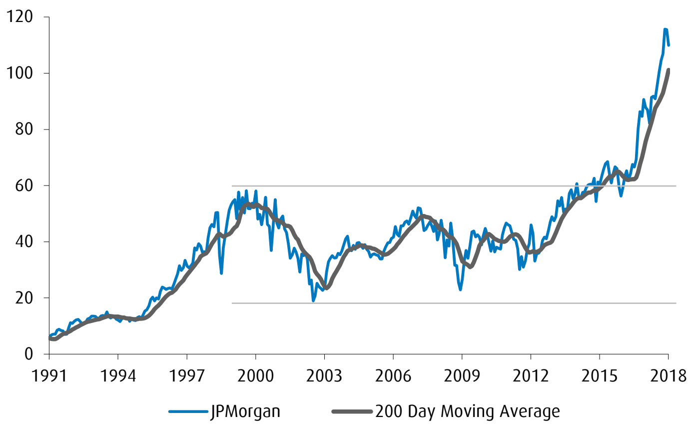
Source: BMO Nesbitt Burns Technical Research, FactSet

Figure 15: Citigroup



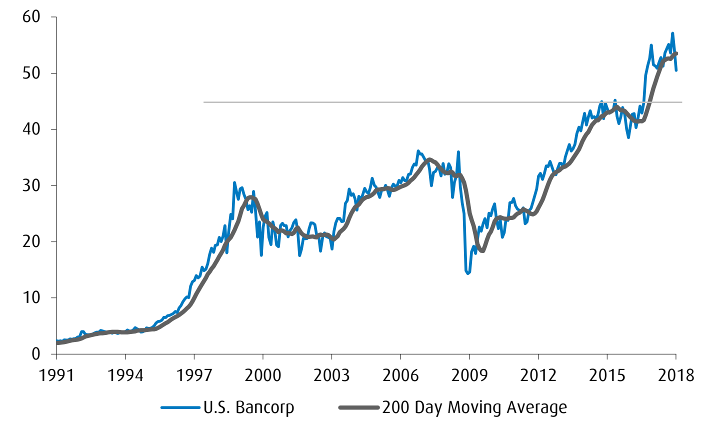
Source: BMO Nesbitt Burns Technical Research, FactSet

Figure 16: JP Morgan



Source: BMO Nesbitt Burns Technical Research, FactSet

Figure 17: U.S. Bancorp

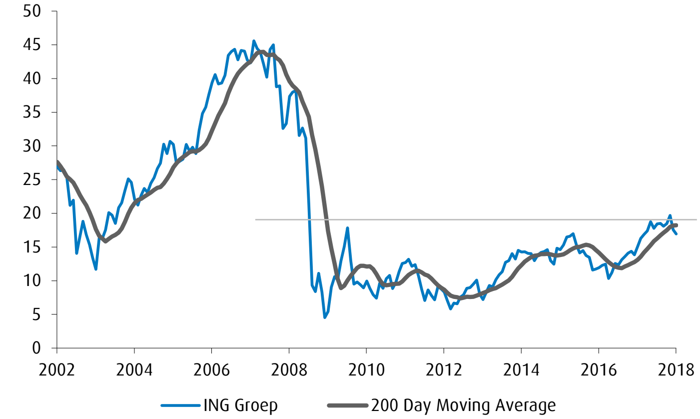


Source: BMO Nesbitt Burns Technical Research, FactSet

Finally, this trend is not limited to U.S. financials either. Many European financials have either broken out of similar-sized patterns or are poised to do so. ING Groep broke out of a base pattern virtually identical to those of Bank of America and Citigroup with an initial upside target that measures to US$32. UBS is also challenging the upper end of a massive multi-year base pattern. A break above resistance at US$23.25 would shift the secular trend to bullish and open an initial upside target that measures to

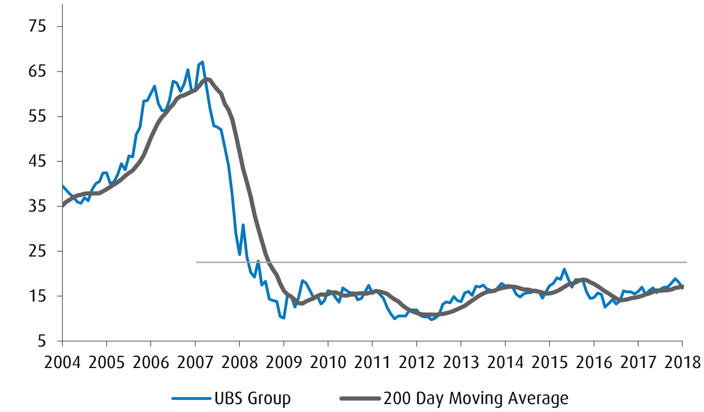
US$39.50. Like the other charts we have noted, that target is likely just the first stop in what should turn out to be a massive multi-year run.

Figure 18: ING Groep



Source: BMO Nesbitt Burns Technical Research, FactSet

Figure 19: UBS



Source: BMO Nesbitt Burns Technical Research, FactSet

5) Valuations Remain Attractive

Most of the names listed in the table trade at or just below book value. Also note also that Return on Equity (ROE) is projected to increase for most of the companies. This is very significant as an upward ROE trajectory has historically been a key stock driver. While we are very unlikely to return to the "artificially inflated" 20%+ ROE levels of 2002 – 2007, we think low double digit ROE is achievable over the next few years which implies continued strong EPS growth trajectory and Price/Book multiple expansion.

Name	Price (US$)	Market Cap (US $ billions)	Dividend Yield (%)	Return on Equity			Price to Book		Price to Earnings	
				2017	2018	2019	2018	2019	2018	2019
Bank of America Corporation	$29.99	$306,618	1.6%	7.7%	10.0%	10.9%	1.2x	1.1x	11.5x	10.1x
Citigroup Inc.	$67.50	$172,822	1.9%	7.5%	8.6%	9.3%	0.9x	0.8x	10.5x	9.1x
Manulife Financial Corporation	$18.58	$36,792	3.8%	11.7%	12.4%	12.0%	1.1x	1.0x	9.0x	8.6x
Canadian Imperial Bank of Commerce	$88.28	$39,195	4.9%	16.4%	16.0%	15.3%	1.5x	1.4x	9.4x	9.1x
ING Groep NV Sponsored ADR	$16.93	$65,474	3.9%	9.9%	9.9%	9.9%	1.0x	1.0x	10.1x	9.6x
UBS Group AG	$17.66	$67,596	3.7%	2.2%	10.5%	11.1%	1.2x	1.1x	11.0x	9.9x

Source: FactSet, as of March 30, 2018

Name	Business Description	Investment Thesis
Bank of America (BAC-US)	Bank of America is a multinational banking and financial services company. It is the second largest U.S. bank by assets.	BAC has 10% of U.S. retail deposits which represents a sustainable low cost funding advantage BAC is on an upward return on equity (ROE) trajectory (from virtually 0% to 10% in 2018) Continued improvement in profitability due to the ongoing U.S. recovery, cost cutting, higher interest rates and lower litigation expenses
Citigroup Inc. (C-US)	Citigroup is a multinational banking and financial services company that is globally established in emerging markets. Its consumer banking operations target high-net-worth individuals.	Continued long-term opportunities in emerging markets which offer higher growth potential Significant capital return prospects as Deferred Tax Assets (DTA) convert to excess capital over time One of the fastest dividend growth rates in the S&P 500 over the next five years given improvements in profitability and capital reserves

Manulife Financial (MFC-T)	Manulife is a leading global provider of financial protection and wealth management products and services. It is Canada's largest life insurer.	Improvement in interest rates and higher equity markets driving an improved earnings outlook Potential for multiple expansion given higher-growth and higher ROE Asian and wealth management businesses Realize benefits of recent acquisitions
CIBC (CM-T)	CIBC provides financial services to Canadian individuals and corporations across Canada and the U.S. CIBC also owns FirstCaribbean Int'l Bank	Exhibiting solid growth across all segments, on better operating leverage and lower overall credit expenses Substantial reduction in mortgage exposure, which should help de-risk the company's overall portfolio Diversification outside of Canada provides a tailwind if the Canadian economic expansion moderates
ING Groep (ING-US)	ING Groep N.V. is one of the world's largest banking and financial services companies. It has sizeable operations in Europe and the faster growing Emerging Markets.	Global banking franchise with good long-term growth opportunities in Europe and emerging markets (higher growth potential) Higher interest rates and cost savings opportunities should increase margins Opportunities to increase revenues by cross-selling products (investments) to new and existing clients which should increase share of wallet and earnings
UBS Group (UBS-US)	UBS Group AG is one of the leading global wealth management services providers. It also provides investment banking and trading services to corporate and institutional clients. It is headquartered in Switzerland and operations around the world.	Global leader in wealth management with great position in emerging markets Focused on increasing fee/managed accounts which should lead to higher revenue visibility and increasing margins Costs are expected to come down over the next few quarters which should increase profitability Expected to grow its dividend per share at mid-single digit rates for the next few years while executing sizeable buybacks

Source: BMO Nesbitt Burns, Company Reports

ETFs and Mutual Funds

Our ETF and Mutual Fund specialists provide the ETFs below as a way to gain exposure to the theme.

Exchange Traded Fund	Ticker	AUM (C$)	Risk Rating	Management Expense Ratio (MER) (%)
iShares Global Financials ETF	IXG-US	$627.4 million	Medium Risk	0.46%

Investment Case: IXG provides a passive exposure to the S&P Global Financials Sector Index, which targets financial stocks from around the world. IXG holds companies that provide financial services to commercial to retail customers, including banks, investment funds, and insurance companies. IXG is market-cap weighted and holds about 190 names which currently includes Bank of America, Citigroup, JP Morgan, Manulife, CIBC, ING Groep, and UBS Group.

This ETF is a simple solution that gives you access and exposure to the global financials theme. It currently has about 52% in North America, 27% in Europe, 19% in Asia and 2% in Latin America.

This ETF is listed in the US, and for the Canadian Investor with Canadian dollars to invest, your currency exposure is CAD to the underlying currencies (i.e. USD, Euro, Pound, HKD, etc).

Exchange Traded Fund	Ticker	AUM (C$)	Risk Rating	Management Expense Ratio (MER) (%)
Financial Select Sector SPDR	XLF-US	$40,154 million	Medium Risk	0.14%

Investment Case: XLF provides passive exposure to the Financial Select Sector Index, which includes a diversified group of Financial names (i.e. more than just banks) from the S&P 500 at a very attractive cost. XLF holds about 70 U.S. names and is market-cap weighted with the top 10 holdings, which currently includes JPMorgan, Citigroup and Bank of America makes up over 55% of the assets.

This large ETF is very liquid and is designed to be low turnover to reduce cost and the impact of taxes. XLF is listed in the US and for the Canadian Investor with Canadian dollars to invest your currency exposure is CAD to the USD.

Exchange Traded Fund	Ticker	AUM (C$)	Risk Rating	Management Expense Ratio (MER) (%)
BMO Equal Weight U.S. Banks Hedged to CAD Index ETF	ZUB-TSX	$1,732 million	Medium Risk	0.39%
BMO Equal Weight U.S. Banks ETF	ZBK-T			

Investment Case: ZUB/ZBK aims to replicate the Solactive Equal Weight US Bank Index which consists of U.S. securities that fall within one of the following industry groups; Finance, U.S. Banks, U.S. Commercial Banks, or U.S. Commercial Savings Institutions. ZUB is the Canadian Dollar Hedged version whereas ZBK is the unhedged version. These ETF's provide an equally weighted exposure to US banks, and thus reduces the idiosyncratic risk from any one name. JPMorgan, Citigroup and Bank of America are all constituents of this 20 name portfolio.

Being fully hedged will contribute to performance when the CAD is rising and detract from performance when the CAD weakens. However, being hedged allows the investor to be exposed to US banks without being concerned about currency movements affecting the CAD return..

Source: BMO Nesbitt Burns, Prospectuses

Bond Recommendations

Fixed Income Strategist Richard Belley and Associate Portfolio Manager Kevan Hartford provide some bond recommendations.

TD: TD has the best balance sheet of any of the Big 6 Canadian banks and is the only one whose senior debt is still in the AA bucket in the Canadian Universe Index after last year's spate of downgrades by Moody's. Given the tendency of this group's issues to "cluster" in terms of performance, offers a better risk/reward profile than many of its peers. Legacy senior debt is expected to outperform due to scarcity as new bail-in regimes come into force this year, while its NVCC Sub-debt presents a way to capture some extra spread without assuming considerable risk.

Senior Debt

Term	Coupon	Maturity	Rating (DBRS/S&P/Moody's)	Yield	Price
3 Year	2.045%	03/08/2021	AA/AA-/Aa2	2.498%	$98.729
5 Year	1.909%	07/18/2023	AA/AA-/Aa2	2.715%	$96.051

NVCC Subordinate Debt

Term	Coupon	Maturity	Rating (DBRS/S&P/Moody's)	Yield	Price
3 Year	2.982%	09/30/2020*	A(L)/A-/A3	2.745%	$100.566
5 Year	3.224%	07/25/2024*	A(L)/A-/A3	3.402%	$98.994
10 Year	4.859%	03/04/2026*	A(L)/A-/A3	3.555%	$108.926

Manulife: Manulife is currently pressing up against the upper bands of its target leverage ratio, however this is poised to fall throughout 2018, all else equal. While there are risks of opportunistic issuance, we believe Manulife's preference to stick to its leverage targets will help keep spreads in check. Its well diversified funding and revenue bases should also act as stabilizers against any potential external shocks.

Term	Coupon	Maturity	Rating (DBRS/S&P/Moody's)	Yield	Price
3 Year	1.915%	09/01/2021	A(H)/A+/NR	2.606%	$97.761
5 Year	3.181%	11/22/2022*	A(H)/A+/A1	2.838%	$101.475

* These bonds are “Fixed-to-Floater” structures. The market prices them to their indicated maturity dates, as they are expected to be called on these dates by the issuer at par (effectively maturing). Investors do assume some extension risk in that the bonds could be extended to mature for another 5 years, paying floating-rate coupons. In practice, this extension risk is very small, as the floating rate coupons are generally quite punitive and the bonds forego their contribution towards financial capital required by the regulators.

Preferred Share Recommendations

Preferred Share Specialist Vince Sansalone provides the following financials recommendations. In general, preferred shares are also more tax efficient securities. Rate Reset preferred shares also benefit in a rising interest rate environment. BMO CM has forecasted the 5 year Canadian government bond yield to move from its current level of about 2.10% to 3.00% in Q4 2019. This should help support the price of this preferred share in the short term.

1) CIBC: CM.PR.R 4.40% Rate Reset, resets in 7/31/2022, with a reset spread of 338 bps

- The current yield and yield to call (YTC) (if called) offers investors an opportunity to pick up yield compared to a similar bond issue with a maturity in 2022. The current pref yield is 4.38% and the YTC is 4.24% vs a CM bond yield of about 2.64% maturing in 2022.

2) Manulife: MFC.PR.H 4.31% Rate Reset, resets in 3/19/2022, with a reset spread of 309 bps

- The current yield and yield to call (if called) offers investors an opportunity to pick up yield vs a similar bond issue with a maturity in 2022. The current pref yield is 4.29% and the YTC is 4.20% vs a bond yield of about 2.78%.

Both securities are callable in 2022 however the issuer(s) is not obligated to call the security for redemption. Both securities are also rated as Pfd-2.

Stock Fair Value Update

Our fair value discounted cash flow models for the S&P/TSX and S&P 500 yield fair values of ~18,000 and 2,850 to 2,900 respectively.

Figure 20: S&P 500 Fair Value

	Present value	% of value	Earnings per share growth	Discount rate	
Period 1 (2018-2021)	$535.49	18.7%	7%	9.0%	
Period 2 (2022-2026)	$582.64	20.3%	5%	9.0%	
Period 3 (2027 -)	$1,750.42	61.0%	3%	9.0%	
Rounded Fair Value	$ **2,870**	100.0%	Next 12 month consensus		140
			Implied terminal mult.		16.2 X
Current Price (March 31, 2018)	$ **2,641**		Long Bond		2.5%
			Historical Equity Risk Premium		4.5%
Upside Potential	**9%**		Additional Risk Premium		2.0%
			Total discount rate		9.0%

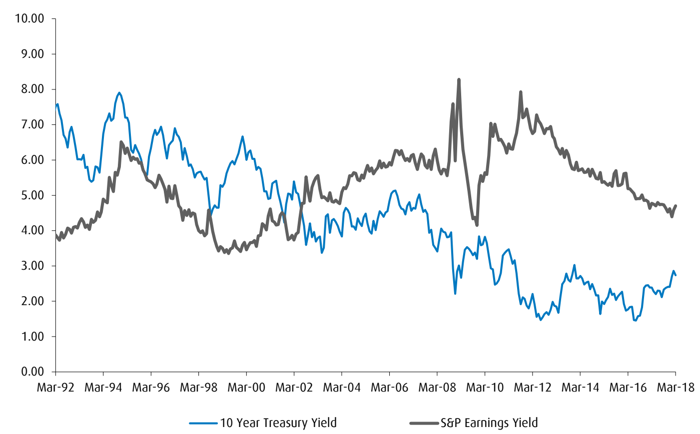
Source: Bloomberg, BMO Nesbitt Burns

Figure 21: S&P/TSX Fair Value

	Present value	% of value	Earnings per share growth	Discount rate	
Period 1 (2018-2021)	$3,424.30	19.0%	7%	9.0%	
Period 2 (2022-2026)	$3,725.80	20.7%	5%	9.0%	
Period 3 (2027 -)	$9,720.86	54.1%	2%	9.0%	
Rounded Fair Value	$ **18,000**	93.8%	Next 12 month consensus		970
			Implied terminal mult.		14,1 X
Current Price (March 31, 2018)	$ **15,367**		Long Bond		2.5%
			Historical Equity Risk Premium		4.5%
Upside Potential	**17%**		Additional Risk Premium		2.0%
			Total discount rate		9.0%

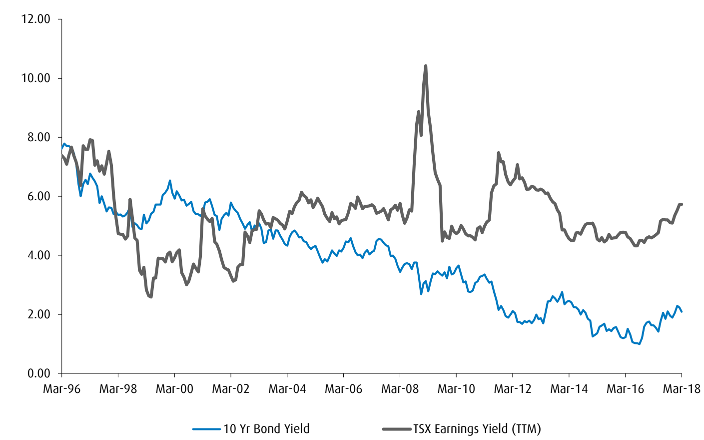
Source: Bloomberg, BMO Nesbitt Burns

Figure 22: S&P 500 Earnings Yield versus 10-year Treasury Yield



Source: Bloomberg

Figure 23: S&P/TSX Earnings Yield versus 10-year Canada Bond Yield



Source: Bloomberg

Figure 24: S&P 500 Index Sector Total Returns to March 2018

S&P 500 Index Sector Total Returns (%)	MTD	YTD
Info. Technology	-3.90	3.53
Cons. Discretionary	-2.33	3.10
S&P 500 Index	**-2.54**	**-0.76**
Financials	-4.31	-0.95
Health Care	-3.07	-1.22
Industrials	-2.68	-1.56
Utilities	3.76	-3.30
Materials	-4.24	-5.52
Real Estate	3.27	-5.79
Energy	1.66	-5.88
Consumer Staples	-0.88	-7.12
Telecom. Services	-1.00	-7.48

As of March 31, 2018

Source: Bloomberg

Figure 25: S&P/TSX Composite Sector Total Returns to March 2018

S&P/TSX Composite Index Sector Total Returns (%)	MTD	YTD
Info. Technology	-1.21	10.18
Real Estate	1.67	-0.67
Industrials	-2.10	-2.60
Cons. Discretionary	0.67	-2.87
Financials	-1.07	-3.49
Materials	0.31	-4.28
S&P/TSX Composite Index	**-0.16**	**-4.52**
Utilities	1.91	-5.85
Consumer Staples	-1.47	-5.92
Telecom. Services	-0.12	-6.69
Energy	1.89	-9.44
Health Care	0.25	-13.51

As of March 31, 2018

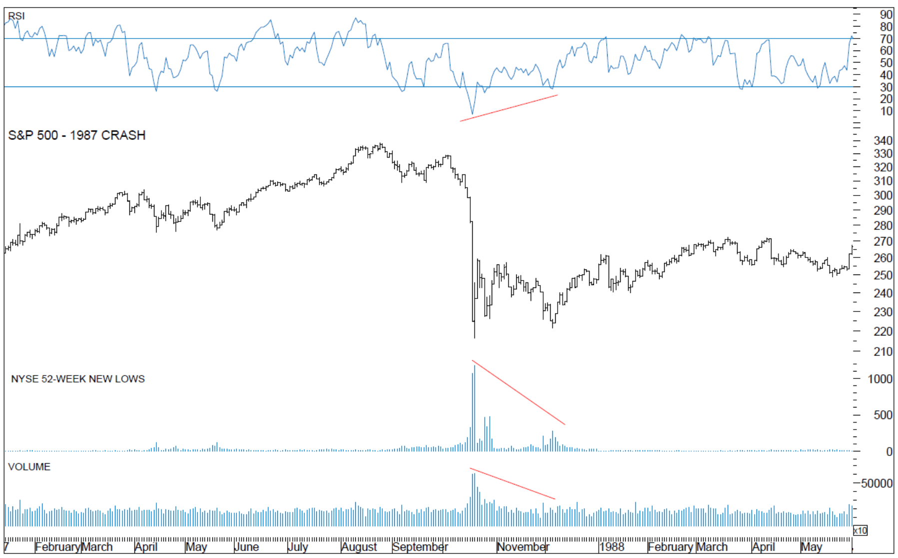
Source: Bloomberg

The Technical Picture— The “Low, Rally, Re-Test” Bottoming Sequence

Russ Visch, CMT, Technical Analyst

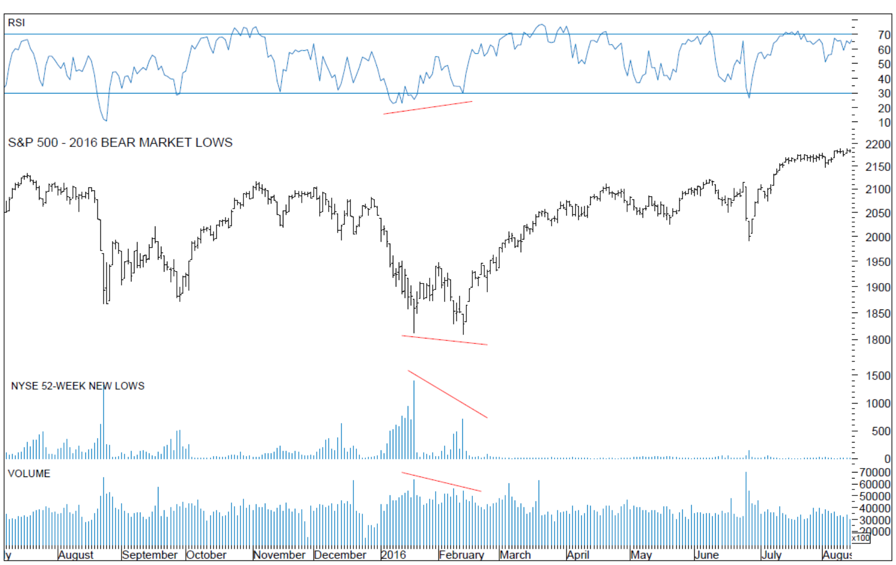
In last month’s report we wrote at length about the “low, rally, re-test” bottoming sequence, a fairly common development during medium-term corrections. Typically, corrections of this magnitude tend to play out in an A-B-C fashion where the “A wave” represents the initial sell-off, the “B wave” is an oversold bounce, and the “C wave” is a re-test of the lows made during the initial sell-off. The key to watch for during the “C wave” is that the “guts” of the decline are not as bad: price momentum doesn’t get nearly as oversold resulting in positive divergences, fewer individual stocks are making 52-week new lows, volume isn’t as heavy (reflecting a diminished desire/ability to sell) and overall volatility remains sedate. We see this set-up time and time again at major turning points all the way back to the 1987 crash and beyond as well as more recently at the early 2016 bear market low.

Figure 26: S&P 500: 1987 Crash



Source: BMO Nesbitt Burns Technical Analysis

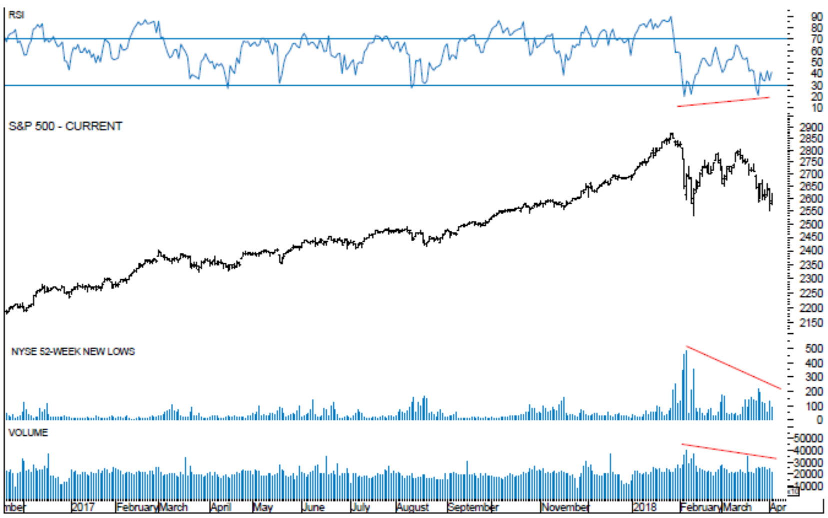
Figure 27: S&P 500: 2016 Bear Market Low



Source: BMO Nesbitt Burns Technical Analysis

While major averages such as the S&P 500 and Dow Jones Industrials ended the month of March very near to their early February lows, as we expected, the quality of this latest decline is nowhere near as bad as they were eight weeks ago. For example, the number of stocks making 52-week new lows on the NYSE is a fraction of what we saw in early February, volume is 60% lighter, and volatility (as measured by the VIX index) remains contained. Most short-term breadth and momentum oscillators are also not nearly as oversold, which has set up major positive divergences that are also typical of these "low, rally, re-test" bottoming sequences. In short, the current environment is a significant improvement over what we saw in early February and that's exactly what we'd expect to see at a major trading low. That, along with short-term breadth and momentum oscillators that are already improving from at/near oversold extremes, suggest we are very close to a sustainable low being put in place.

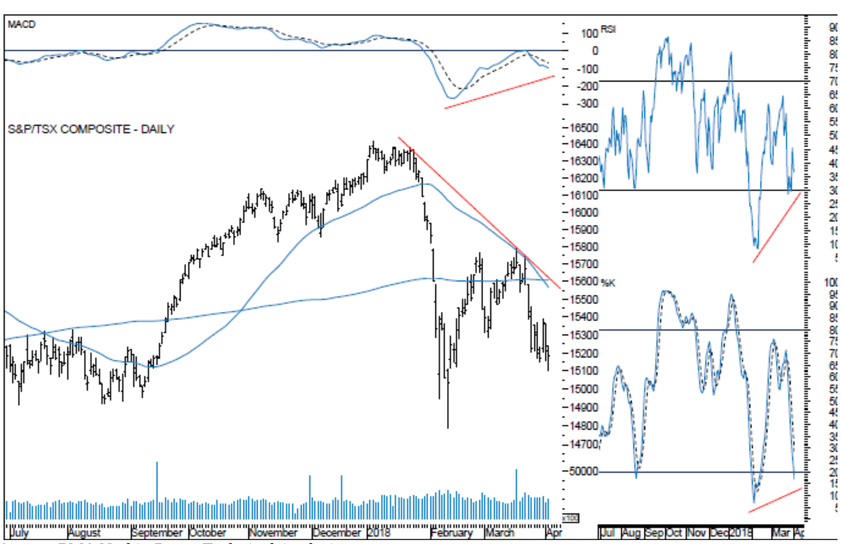
Figure 28: S&P 500: Current



Source: BMO Nesbitt Burns Technical Analysis

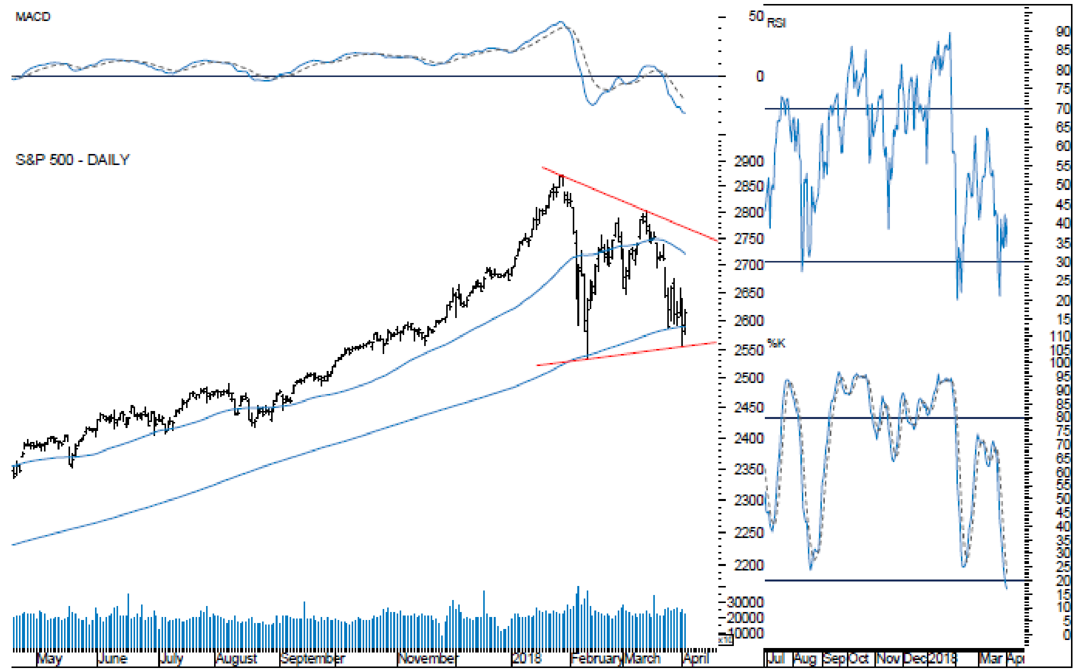
As equity markets accelerate from these lows, key resistance for the S&P/TSX Composite is a declining trendline drawn from the late January peak currently at 15,550. A reversal of that trendline would signal an end to the correction and clear the way for a challenge of the all-time high at 16,421. All of the price action in the S&P 500 since late January can now be defined as a large triangular consolidation pattern. A reversal of the upper trendline at 2745 would signal a resumption of the uptrend and clear the way for a challenge of its all-time high at 2872. (Traditional technical analysis methodology will tell you that such a reversal would automatically open a new upside target of 3212. We don't want to be putting the cart before the horse though, and prefer to see what the markets look like when the S&P gets to 2872.)

Figure 29: S&P/TSX Composite



Source: BMO Nesbitt Burns Technical Analysis

Figure 30: S&P 500



Source: BMO Nesbitt Burns Technical Analysis

General Disclosure