Top Ideas from BMO Capital Markets

As the second half of the year unfolds, there is much to keep an eye on, from the North American Free Trade Agreement ("NAFTA") negotiations to imposed and proposed tariffs. The BMO Nesbitt Burns Portfolio Advisory Team gathered highlights from the recent **2018 BMO Nesbitt Burns Research Conference**, which took place at the end of June, to provide an overview of what the panel of analysts from across BMO Capital Markets ("BMO CM") had to say. The following is a summary of the analysts' views on various market sectors, in no particular order. As a reminder, the views below are for informational purposes only, and it is important to consult with your BMO Financial Professional for advice specific to your needs and personal situation.

BMO Capital Markets analysts' sector views

Analysts at BMO CM admit that news headlines have derailed investors from fundamentals, causing a lot of volatility in the equity markets in 2018. However, they remain steadfast in their call that U.S. stocks are in the midst of a 20-25 year bull market. This view is backed by their analysis, which shows that earnings growth is strong and stable, cash flows are steady, interest rates (although rising) remain near historical lows, and gross domestic product ("GDP") growth is positive. In the U.S., they remain overweight the Financials, Industrials, and Materials sectors. In Canada, they think the near-term setup is positive, and following the June Research Conference, upgraded the Energy sector to overweight. This should drive the oil-heavy S&P/TSX Composite Index higher over the coming months.

In terms of the economic outlook for the U.S. and Canada, BMO Chief Economist, Douglas Porter, believes Canadian economic growth will level off to approximately 2.0% in 2018 (down from 3.0% in 2017), while U.S. economic growth is expected to increase to approximately 2.8% in 2018 (up from 2.3% in 2017), driven by the lower unemployment rate, which is sitting at multi-year lows. Mr. Porter discussed NAFTA, and the implications of the proposed and imposed tariffs on economic growth. The bottom line is that the impact is still quite manageable. Imposed tariffs on steel and aluminum could reduce GDP by less than 0.5% in Canada. Potential auto tariffs, however, could have a larger impact, in excess of 1%, which would then have an impact on the unemployment rate, given that underlying economic growth is expected to lie at 2% this year.

Commodities

Looking at commodities, BMO CM believes that oil prices will likely trade in a US$55 to US$70 range per barrel for West Texas Intermediate ("WTI") prices. BMO CM is positive on oil market fundamentals, but note that Canadian companies will face headwinds from oil price differentials between WTI and Western Canadian Select ("WCS") prices. Despite the headwinds, the majority of companies are expected to report strong free cash flow for 2018. They prefer large-cap companies with good production profiles, stable balance sheets, and operations that can withstand lower oil prices. Their top three picks in Canada are Suncor (SU), Canadian Natural Resources (CNQ) and EnCana (ECA).

Within the Energy sector, infrastructure stocks (such as pipelines and utilities) have been hurt in 2018, simply driven by sector rotation out of these high-yielding stocks that typically trade as bond alternatives. However, BMO CM sees attractive value here. Their top three-year idea is TransCanada (TRP), as most of TransCanada's projects are contracted (supporting the current yield of approximately 5%), and their backlog of $21 billion in projects supports their dividend growth guidance of 8-10% per year through 2020. BMO CM also views Enbridge (ENB) as an attractive stock at current levels, driven by the company's industry-leading 10% dividend growth through 2020, improving balance sheet, and competitive position in U.S.-bound crude oil. They also highlighted Algonquin Power & Utilities (AQN), which is a diversified utility and power company, with 100% contracted projects, and attractive dividend growth guidance of 10% through 2021.

Going up the risk curve, investors may take a look at energy services stocks. Within this group, BMO CM favours quality; the safest name in their coverage universe is Computer Modelling Group (CMG), which has a relatively stable maintenance revenue stream. The stock offers a yield of approximately 4%, and has limited correlation to commodity prices. Other names they highlight are Precision Drilling (PD) and STEP Energy Services (STEP), which they believe offer "torque at a reasonable price."

Retail and consumer products

BMO CM believes that certain consumer stocks look attractive in this environment, given their lower volatility and stable characteristics. In Canada, they highlight Canadian Tire (CTC.A): Canadian Tire shares have delivered stable returns over the last two calendar years, and the company has delivered impressive same store sales growth in a challenging retail environment. Among the Canadian grocers, BMO CM highlights Loblaw (L), as they believe the main challenges they faced in the last year or so (grocery deflation, higher minimum wage costs, and higher drug prices) have now passed. The company's valuation is reasonable, and Consumer Staples stocks should be safe total return vehicles without significant volatility. This sentiment was echoed by BMO CM's U.S. analysts who cover Food Retail, Food and Beverages and Household Products sectors that exhibit stable and defensive characteristics. In the U.S., a name of interest includes Sysco (SYY), which BMO CM believes is becoming "the Consumer Staples stock to own."

Financials

BMO CM believes that the Canadian banks, as a group, are attractive total return vehicles. With strong balance sheets, healthy dividend payout ratios, good capital allocation, and benign credit conditions, they believe that these stocks should continue to perform well on a total return basis. In addition, the valuations seem reasonable; trading in line with other periods of similar economic growth. The Canadian banks have a winning track record of outperformance. Over the past 25 years, the Bank Index has outperformed the market 84% of the time by an average of 6.6% per year.

U.S. Financials have underperformed so far this year, but BMO CM believes this underperformance has led to an interesting buying opportunity. With benign credit conditions, solid loan growth, higher interest rates and shareholder-friendly corporate actions (such as increasing dividends and share buybacks), the sector looks attractive. For long-term investors, BMO CM's best ideas are Capital One Financial (COF) and Morgan Stanley (MS).

U.S. technology

Technology and internet stocks were arguably some of the best performing companies in 2017, and so far in 2018. BMO CM addressed Amazon.com, believing there is still room left in the stock to go higher (they have a price target of US$2,000), driven by their thesis in Amazon's advertising business. In technology equipment, BMO CM sees interesting opportunities in Motorola Solutions (MSI) for their stable organic growth prospects. At the June Research Conference, they touched on their concerns about Apple (AAPL), which they believe could face a challenging iPhone product cycle. In technology services and software, BMO CM views the following three stocks as core portfolio holdings: Microsoft (MSFT), Adobe (ADBE), and Salesforce.com (CRM).

Industrials and transportation

BMO CM notes that the backdrop for Industrials stocks both in Canada and in the U.S. remains positive, despite the rhetoric around cyclical peaks. In Canada, the current environment is strong across all freight segments, both in terms of pricing and demand. While the rails have performed quite well most recently, and come off some weakness due to macro concerns, BMO CM believes there is more room to go. In particular, they view Canadian Pacific Rail (CP) as their best idea among the rails for its strong pricing and volume outlook, in addition to improved productivity.

In the U.S., the team notes that while concerns of a cyclical peak have hurt the stocks, their work shows that we are still a long way off from this point. Based on the length of the past three cycles, the next peak is unlikely to hit before 2024-2025. In addition, the companies today are very different from prior cycles, as they've undergone significant cost-cutting to stay profitable during lower-sales environments. BMO CM views Caterpillar (CAT) as one of the best ways to benefit from a cyclical recovery, and they believe that the company's operational excellence is underappreciated by investors.

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2018 and beyond

While uncertainty regarding global trade and tariffs, and news headlines may cause some concern among investors, many industries do continue to experience growth. At the time of publication, economic momentum remains strong, as noted by BMO Economics. The overall sentiment at the 2018 BMO Nesbitt Burns Research Conference was generally positive, and views should remain optimistic for the remainder of the year.

If you have any questions about the information in this article, or would like to discuss your investments, please contact your BMO Financial Professional.

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