

## Canadian Strategy Snapshot

### Highlights From First-Quarter Earnings Season

#### Bottom Line:

The negative earnings headlines and results from Canadian banks dampened an otherwise strong first-quarter earnings season for the TSX. In fact, if we exclude the Financials sector, the S&P/TSX is beating expectations by 6% on average with the more cyclical areas of the market continuing to recover. However, the net miss by the big three sectors has been a key drag on S&P/TSX bottom-up 2023 EPS estimates which are now 3% below our 2023 EPS target. Furthermore, this negative surprise has pushed out the trough in broader S&P/TSX earnings growth to 3Q23 from 1Q23 that was beginning to take shape at the end of last quarter. While we continue to expect earnings to normalize in the back half of 2023, our models suggest the earnings contraction could be slightly deeper than initially expected. This could be exacerbated further if Financials and Resources continue to see net negative revisions, as these three sectors make up 59% of the index. Be that as it may, we continue to believe this is all part of a broader normalization process, as the depth and breadth of the earnings contraction and recovery will ultimately define the pace and sustainability of the price recovery in 2023. In our opinion, the earnings contraction in 2023 and subsequent recovery in 2024 will not be smooth and synchronized across sectors, which highlights the importance of a more selective investment approach and more emphasis on active portfolio management.

#### Overview:

- Financials Dampen Otherwise Strong Quarter**
  - While the TSX first-quarter earnings season is only posting a modest 2.1% positive surprise, if we exclude the Financials sector the S&P/TSX is beating expectations by a much stronger 6% on average.
- Risks to Our S&P/TSX EPS Target as Broad Revision Trends Remain Downward**
  - The weaker first-quarter earnings season for the big three sectors (Energy, Financials and Materials) has put renewed downward pressure on our 2023 EPS outlook. In fact, bottom-up 2023 EPS estimates are now 3% below our 2023 target.
- Earnings Turn Negative, but Sector Dispersion Remains Elevated = Opportunities**
  - Despite this earnings contraction being pushed deeper into 2023, it is important to remind investors that there are many opportunities in the S&P/TSX. Overall, the recovery has not been smooth and synchronized across sectors, which in our opinion highlights the importance of a more active approach.

2023 Institutional Investor All-America & All-Canada Research Teams

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If our research has been helpful, we appreciate your consideration.

#### Investment Strategy

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#### CDN Strategy – S&P/TSX Targets

S&P/TSX Price Target	
2023 Calendar Year End	22,500

S&P/TSX EPS Target	
2023 Calendar Year End	\$1500

Source: BMO Capital Markets Investment Strategy.

#### CDN Strategy – Recommended S&P/TSX Sector Weightings

Sector	Opinion	Tgt. Wgt.
Communication Services	OW	5.5%
Consumer Discretionary	MW	4.0%
Consumer Staples	UW	2.5%
Energy	MW	17.5%
Financials	OW	31.5%
Health Care	UW	0.0%
Industrials	MW	13.5%
Information Technology	MW	7.5%
Materials	OW	14.0%
Real Estate	MW	2.0%
Utilities	UW	2.0%

Source: BMO Capital Markets Investment Strategy.

OW: Overweight

MW: Market Weight

UW: Underweight

## Financials Dampen Otherwise Strong Quarter

### Strong 1Q23 Earnings Season Outside the Big Three Sectors

S&P/TSX 1Q23 Earnings Surprise Table

	% Surprise	.vs 31 Mar 2023 Estimates	% reported
S&P/TSX	2.1%	-2.2%	85.8%
<b>S&amp;P/TSX ex FINL</b>	<b>6.0%</b>	<b>-0.1%</b>	
TSX ex ENRG, MATR & FINL	11.5%	11.7%	
Positive Surprise	57%	54%	
No Surprise	2%	1%	
Negative Surprises	41%	45%	

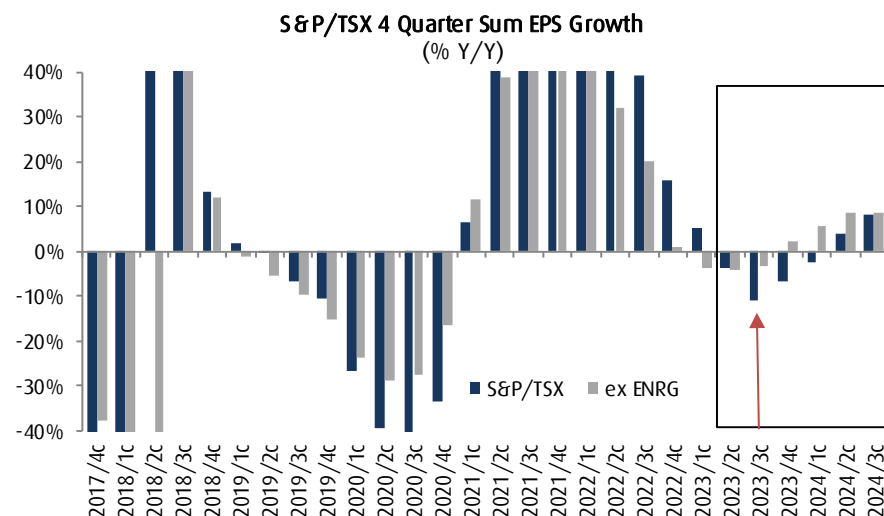
Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

### Cyclical Areas Show Strong Positive Surprises

	1Q23 EPS % Surprise	.vs 31 Mar 2023 Estimates	2023 EPS % Revision (post report date)
Communication Services	8%	4%	1%
Consumer Discretionary	14%	12%	2%
Consumer Staples	-3%	-4%	-2%
Energy	4%	-7%	-2%
Financials	-2%	-4%	-2%
Diversified Banks	-5%	-8%	
Health Care	-32%	-32%	-7%
Industrials	20%	20%	3%
Information Technology	17%	25%	13%
Materials	-2%	-7%	-3%
Gold	21%	13%	
Real Estate	-3%	-3%	-1%
Utilities	20%	22%	3%

Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

### Trough in Quarterly Earnings Growth Has Been Pushed Out to 3Q23



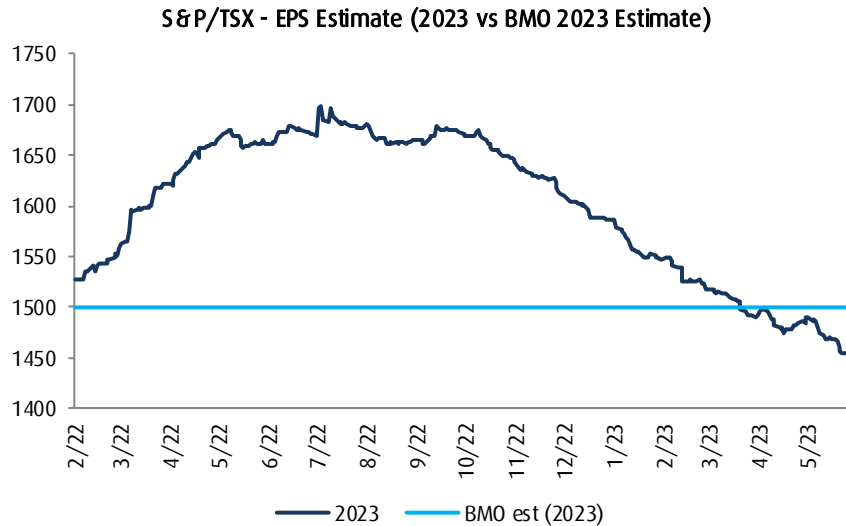
Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

While the TSX first-quarter earnings season is only posting a modest 2.1% positive surprise, if we exclude the Financials sector the S&P/TSX is beating expectations by a much stronger 6% on average. Indeed, the negative earnings surprise from banks this quarter significantly dampened the strong underlying positive surprises from the more cyclical areas of the market. From our perspective this highlights the unsynchronized earnings recovery in 2023, where the early cyclical areas (like Consumer Discretionary and Technology) which posted negative surprise in 2022 are recovering, while other areas are beginning to adjust. Overall, this negative surprise from the big-three sectors has pushed out the broad S&P/TSX quarter earnings growth trough to 3Q23, from 1Q23 seen at the end of last quarter.

- Consumer Discretionary, Industrials, Technology and Utilities beat estimates by double digits this quarter.
- Energy was able to beat downwardly revised estimates.
- Financials missed downwardly revised estimates, driven by a 5% miss by the Canadian Banks.
- Materials missed downwardly revised estimates, however, the gold sub-industry posted solid earnings this quarter.

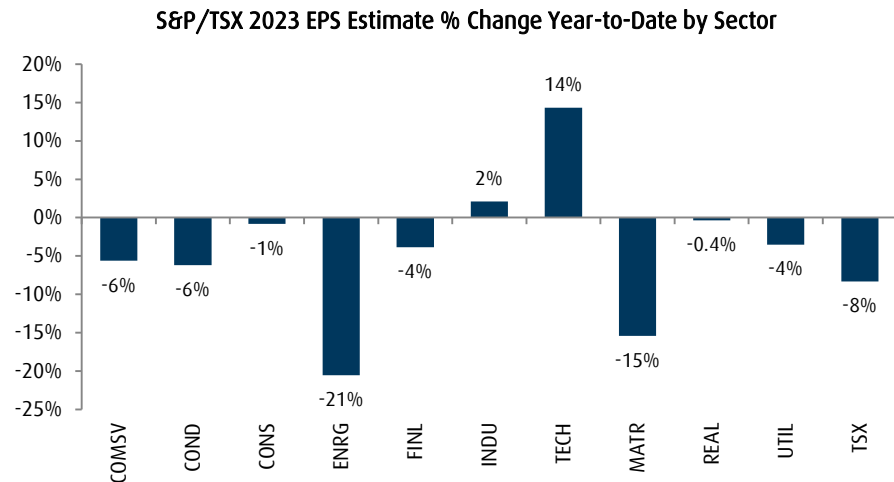
## Risks to Our S&P/TSX EPS Target as Broad Revision Trends Remain Downward

Bottom-Up 2023 EPS Estimates Now 3% Below Our Target



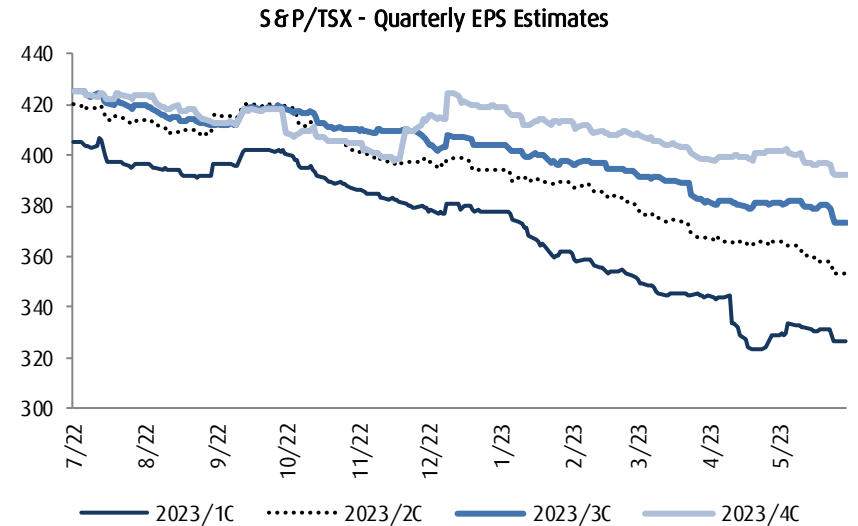
Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

Energy and Materials Lead the Broad Downward Revisions to 2023 Estimates, While Technology Bucks the Trend



Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

While 1Q Is Likely the Low in EPS, Quarterly Estimates Revisions Remain Downward



Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

As we stated in our 2023 Market Outlook, earnings revisions will be key to the TSX's price recovery. While there have been some positive developments in the more cyclical areas of the market, the weaker first-quarter earnings season for the big three sectors (Energy, Financials and Materials) has put renewed downward pressure on our 2023 EPS outlook. In fact, bottom-up 2023 EPS estimates are now 3% below our 2023 target. While we continue to expect earnings to normalize around these levels, the trend suggests the earnings contraction could be slightly deeper than initially expected. This could be exacerbated further if Financials continues to see net negative revisions, as these three sectors make up 59% of the index.

- Yes, the first quarter is likely to market the low for absolute EPS, however, we would need to see revision trends stabilize for the market to become more confident in the earnings recovery.
- Industrials, which started the year with net negative revisions, has turned positive, while Technology has seen net positive revisions nearly triple since mid-March.
- Energy and Materials have seen the sharpest downward revisions to 2023 estimates year to date.

## Earnings Turn Negative, but Sector Dispersion Remains Elevated = Opportunities

### Negative Earnings Growth in 2023, but Some Sectors Already Recovering

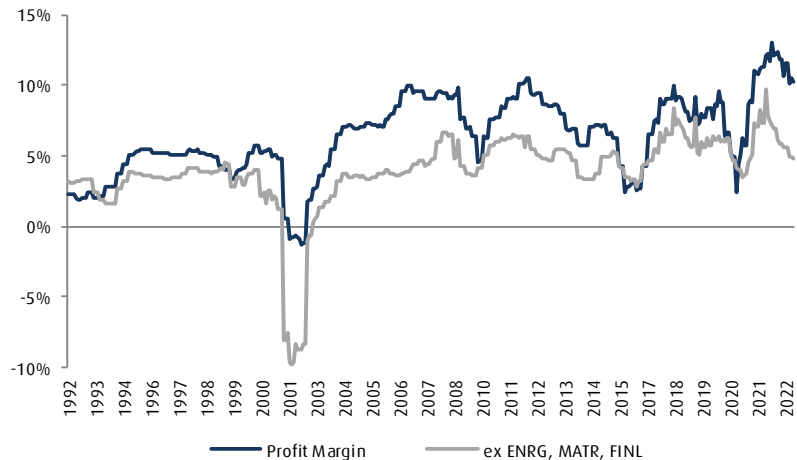
S&P/TSX Annual Bottom-Up Estimated EPS and Sales Growth

	Earnings Growth		Sales Growth	
	2023	2024	2023	2024
S&P/TSX	-5%	10%	-1%	4%
Communication Services	1%	13%	12%	5%
Consumer Discretionary	5%	18%	8%	6%
Consumer Staples	7%	13%	3%	5%
Energy	-29%	15%	-12%	2%
Financials	5%	6%	9%	4%
Health Care	-124%	52%	6%	3%
Industrials	27%	14%	-17%	5%
Information Technology	18%	31%	15%	12%
Materials	-24%	15%	-6%	3%
Real Estate	-6%	6%	5%	7%
Utilities	17%	0%	-6%	3%
S&P/TSX ex ENRG	5%	9%	3%	5%

Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

### Profitability Remains Strong Which Should Will Support During Rebound

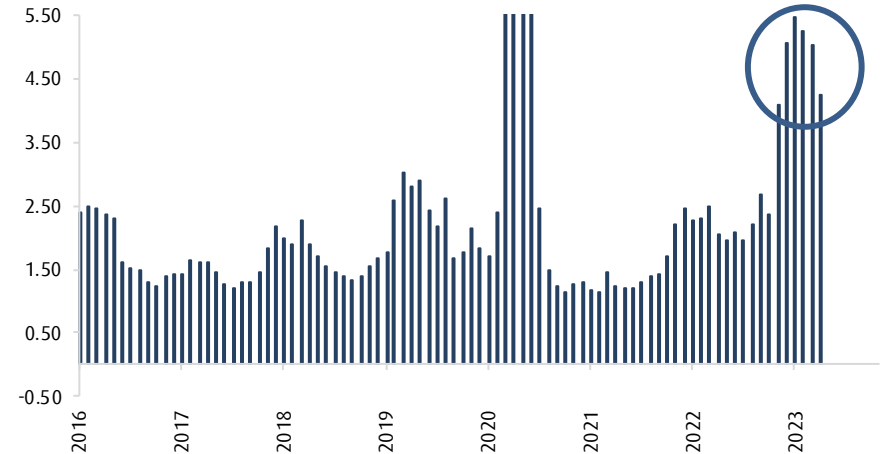
S&P/TSX LTM Profit Margin



Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

### Earnings Dispersion Remains Elevated = Remain Selective

S&P/TSX NTM EPS Growth Dispersion based on coefficient of variation



Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

As expected, the S&P/TSX 2023 earnings turned negative alongside sales growth. Yes, Energy, which meaningfully contributed to the TSX last year, has become a key headwind as it's entered an earnings recession. Despite this earnings contraction it is important to remind investors that there are many opportunities in the S&P/TSX outside Energy and the other resource sectors. In fact, looking at S&P/TSX ex ENRG, earnings growth and sales growth are expected to be 6% and 4% in 2023 versus -4% and -1% for the broad TSX. From a sector standpoint, Industrials and Technology are expected to see their earnings grow 27% and 18%, respectively, this year. Overall, the earnings contraction in 2023 and subsequent recovery in 2024 will not be smooth and synchronized across sectors, which in our opinion highlights the importance of a more selective investment approach and more emphasis on active portfolio management.

- 7 out of 10 sectors are still expecting positive earnings growth in 2023, and all 10 sectors are expecting positive earnings growth in 2024.
- Profit margins remain strong, suggesting companies continue to display strong profitability and operating efficiency, which will support earnings rebound as sales recover in 2024, in our opinion.

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<b>Canadian Strategy Snapshots</b>	
5/17/2023	<a href="#">Canadian Strategy Snapshot: Factor Performance Observations of the TSX</a>
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6/29/2022	<a href="#">Canadian Strategy Snapshot: Financials Remain Our Highest Conviction Overweight</a>
6/23/2022	<a href="#">Canadian Strategy Snapshot: Our Market Weight Industrials</a>
6/15/2022	<a href="#">Canadian Strategy Snapshot: TSX Positioning as US Enters Bear Market</a>
<b>Monthly Reports</b>	
5/4/2023	<a href="#">Canadian Strategy: Canadian Chartbook – May 2023</a>
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Hold	Market Perform	49.5 %	15.1 %	46.8 %	44.6 %	37.7 %	37.5%
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