

## Canadian Strategy Snapshot

### Divergent Growth Outlook Is Oversold

#### Bottom Line:

Based on our interactions with clients, one of the primary concerns and rationales for the steep valuation discount of the TSX is the perception that Canada faces significantly higher growth headwinds relative to its neighbour to the South. There is no denying that the higher debt loads of Canadian households and the maturity structure of the mortgage market dampens confidence, let alone buying power of the Canadian consumer over the next few years. However, we believe these growth concerns are largely overstated. Yes, retail sales are likely to be more sluggish in Canada versus the US as the Canadian consumer adjusts to higher rates. However, Canadian economic activity is highly correlated with the US and is unlikely to significantly decouple. As such, we believe Canadian investors should remain focused on the leading nature of US economic activity when looking at the broader growth trajectory of Canadian equity markets. Furthermore, our work also suggests much of this divergent economic activity has been priced in, with domestic-oriented companies significantly underperforming year to date, helping in part to position the TSX to trade at a near-record valuation discount. Overall, we remain steadfast in our view on Canada...As interest rate AND US recession fears continue to fade, investors will become more confident and forthcoming in their earnings outlook. Therefore, when mindsets begin to change and adjust, so too will forecasts, providing the key catalyst for Canadian valuation expansion and broadening market performance as we head into next year.

Please see our recent [Canadian Strategy Snapshot: Cash Generation Key Source of Strength & Stability](#) and [Canadian Strategy Snapshot: The Canadian Value Proposition](#) for details on our Canadian market outlook.

#### Key Points:

- **Relative Economic Growth Concerns Have Been Key Headwind for the TSX**
- **Growth Divergence Has Been Largely Priced In**
- **Domestic-Oriented Companies Have Lagged, but Momentum May Be Shifting**

#### Implementation Strategies:

[Canadian Equity PLUS](#), [US Equity PLUS](#), [Canadian ex MEF](#), [Canadian GARP](#) and [North American Dividend Growth portfolio](#);

#### Investment Strategy

**Brian G. Belski** Chief Investment Strategist  
brian.belski@bmo.com (416) 359-5761

**Ryan Bohren, CFA\*** Head of Canadian Equity Strategy  
ryan.bohren@bmo.com (416) 359-4993

Dillon Suresh, CFA\* Investment Strategy Associate  
dillon.suresh@bmo.com (416) 728-5108

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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	31.0%
Health Care	UW	0.0%
Industrials	MW	13.5%
Information Technology	OW	9.0%
Materials	OW	13.0%
Real Estate	MW	2.0%
Utilities	UW	2.0%

Source: BMO Capital Markets Investment Strategy.

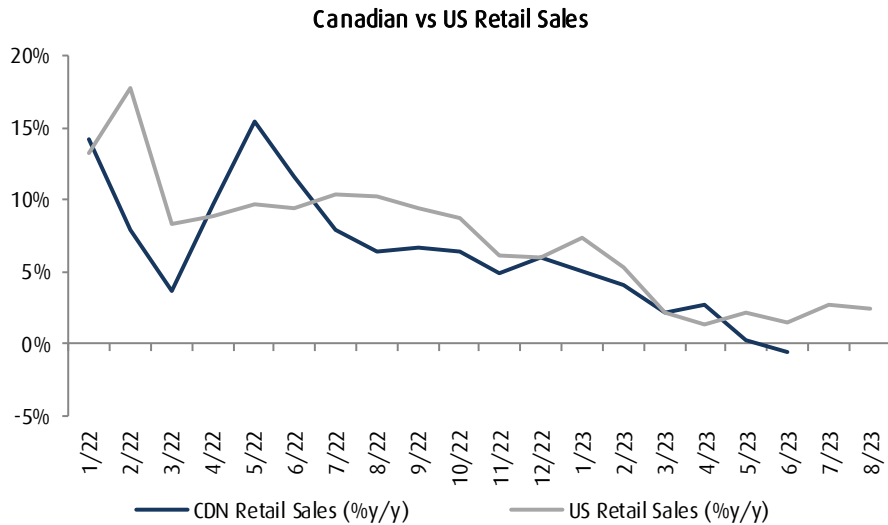
OW: Overweight

MW: Market Weight

UW: Underweight

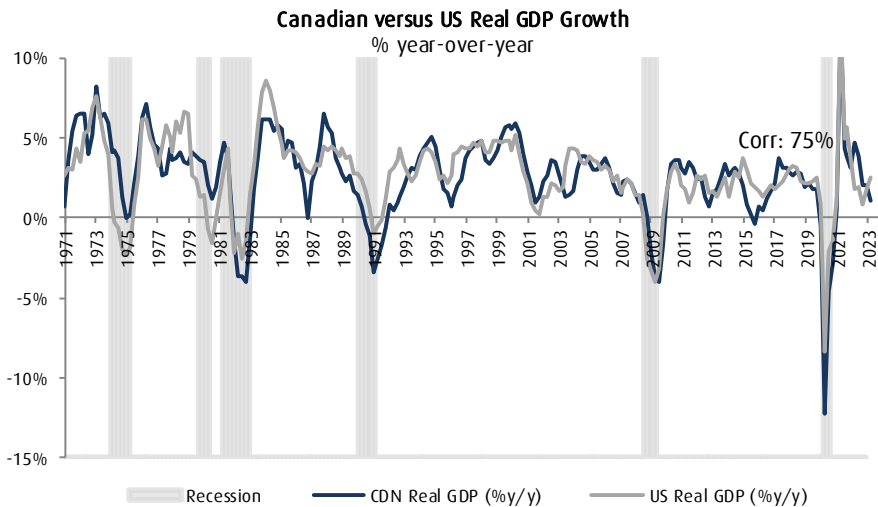
## Relative Economic Growth Concerns Have Been Key Headwind for the TSX

### Yes, Canadian Consumer Is Facing Stronger Headwinds Than the US



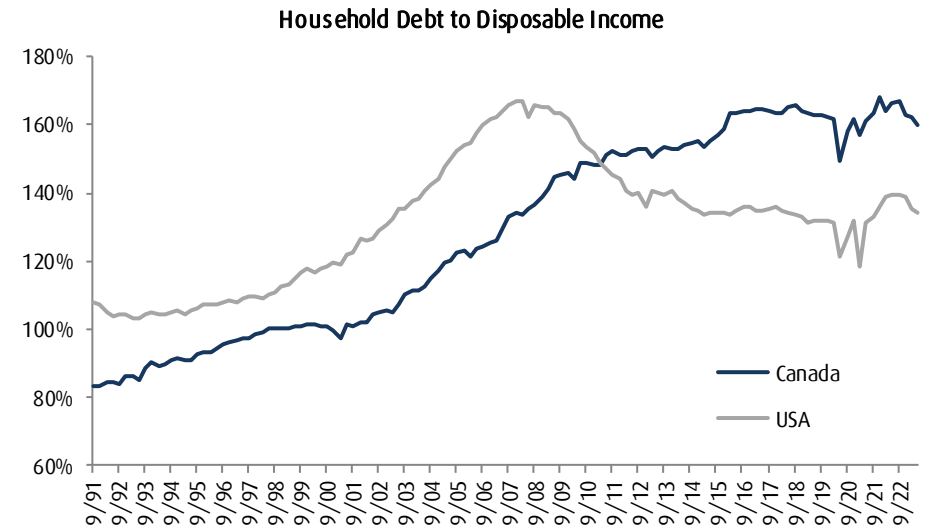
Source: BMO Capital Markets Investment Strategy Group, Haver, StatCan, Census Bureau

### Ultimately Canadian Growth Is Highly Correlated With Its Neighbour to the South



Source: BMO Capital Markets Investment Strategy Group, Haver, StatCan, BEA

### Canadian Household Debt Remains Key Long-Term Challenge



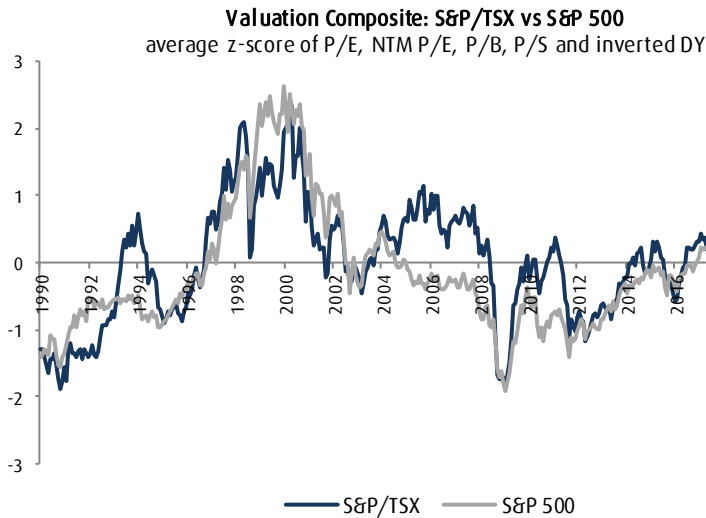
Source: BMO Capital Markets Investment Strategy Group, Haver, StatCan, BEA

One of the primary concerns and rationales for the steep valuation discount of the TSX we hear from Canadian investors is that Canada faces significantly tougher growth headwinds relative to its neighbor to the South. Indeed, the higher debt levels of the Canadian household and the mortgage maturity structure of the Canadian market means the Canadian consumer will likely face stronger headwinds over the coming years. However, from our perspective, these growth concerns are overstated. Yes, while retail sales are likely to be more sluggish in Canada versus the US, ultimately Canadian economic activity is highly correlated with America and is unlikely to significantly decouple. As such, we believe Canadian investors should remain focused on the leading nature of US economic activity when looking at the broader growth profile of Canadian equity markets.

- The Canadian consumer faces significant headwinds versus the US. Indeed, Canadian retail sales growth has slowed sharply and is likely to remain below the US as rates remain elevated and Canadian mortgage renewals continue.
- Despite concerns around consumer spending, Canadian and US economic growth remains highly correlated, with the US being the primary driver. Follow US growth!
- Canadian household debt levels are elevated, as rising rates are having a greater impact on the consumer and will continue to for the foreseeable future.

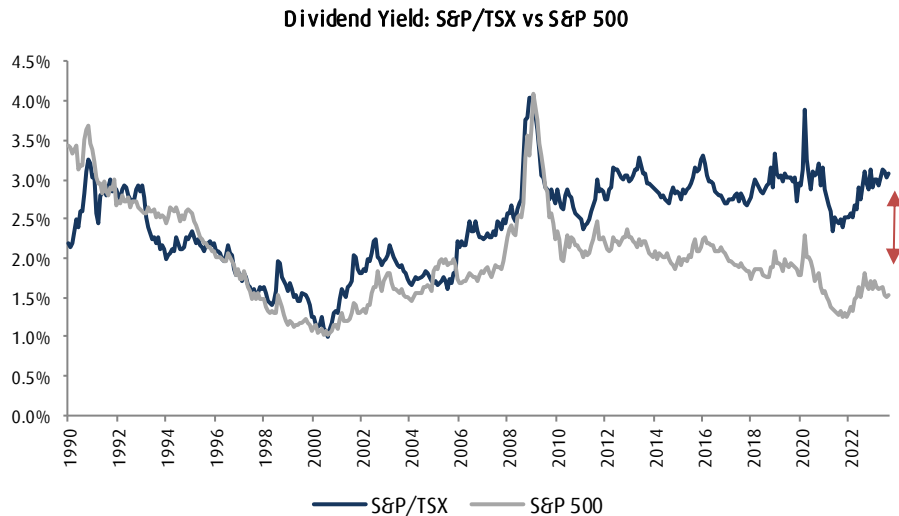
## Growth Divergence Has Been Largely Priced In

### Canadian Value Proposition Remains Near Record Levels



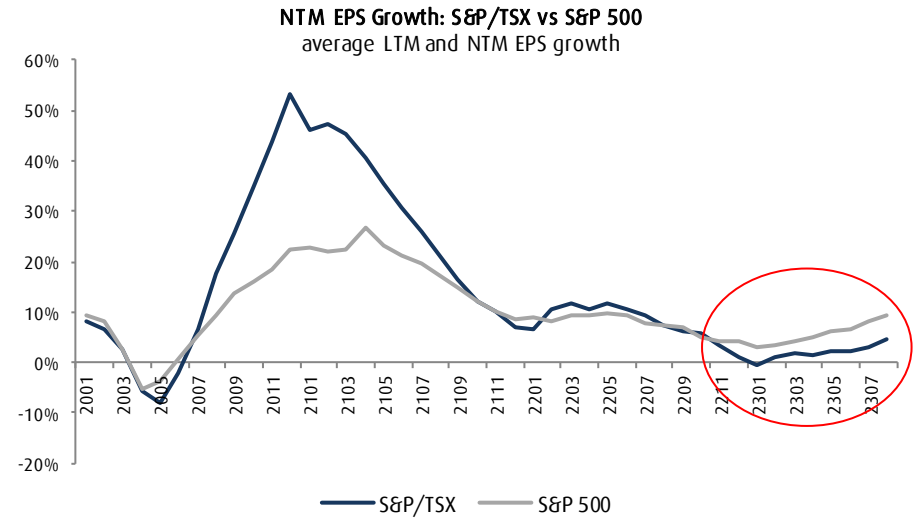
Source: BMO Capital Markets Investment Strategy Group, Factset, Compustat, IBES.

### Canadian Remains a Clear Income/YARP Market



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

### Forward Earnings Growth Is Rebounding in Both the US and Canada



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

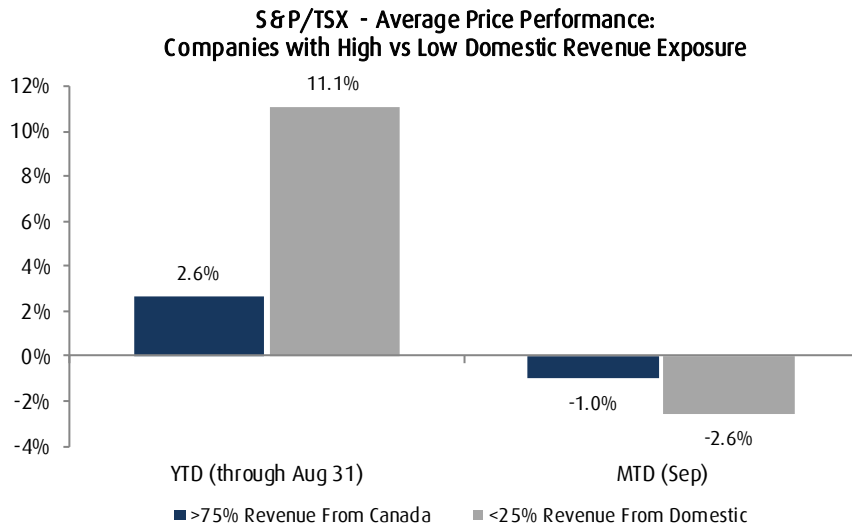
With this divergent economic outlook, Canadian equities are clearly in discount territory, especially relative to its neighbour to the South. Indeed, we believe much of this growth concern has been priced in. In fact, as we have stated many times, this valuation discount remains a distinct advantage for Canadian equities, especially over the coming years as global markets continue down the long road of normalization. Ultimately, we believe this valuation proposition should narrow as earnings confidence returns to Canada and growth stabilizes. Yes, Canadian earnings is lagging the US, however, forward earnings growth has stabilized in both countries and started to rebound.

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- The TSX valuation proposition remains clear, with near-record spread between our S&P/TSX and S&P 500 valuation composite.
- Despite the soft earnings growth, S&P/TSX has seen NTM EPS growth begin to rebound alongside the US.
- Canadian equities offer both strong relative free cash flow generation and income.

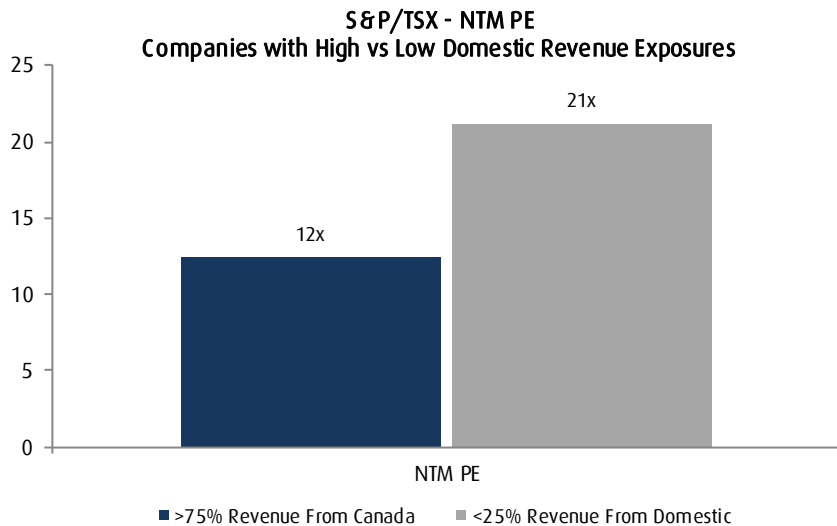
## Domestic-Oriented Companies Have Lagged, but Momentum May Be Shifting

### Domestic-Oriented Companies Have Underperformed YTD, but Have Rebounded MTD



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

### More Domestic-Oriented Companies Are at a Relative Discount



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

### More Domestic-Oriented Sectors Are Outperforming MTD After a Slower Start to the Year

	CDN Rev	Price Return YTD (through Aug 31)	Price Return MTD	NTM PE	NTM EPS Gr.
<b>S&amp;P/TSX</b>	<b>55%</b>	<b>4.7%</b>	<b>-0.4%</b>	<b>13.3</b>	<b>5.7%</b>
Communication Services	93%	-7.3%	-2.8%	15.9	8.0%
Consumer Discretionary	42%	4.8%	-0.9%	13.8	13.7%
Consumer Staples	71%	4.3%	0.7%	15.5	10.4%
Energy	66%	3.3%	0.3%	11.3	-1.4%
Financials	61%	0.1%	1.6%	9.7	5.3%
Health Care	24%	22.2%	-4.8%	10.0	10.4%
Industrials	31%	7.4%	-0.5%	21.5	15.4%
Information Technology	12%	51.3%	-8.1%	32.0	27.7%
Materials	20%	1.8%	-1.0%	17.0	-0.4%
Real Estate	47%	1.1%	0.4%	14.6	4.6%
Utilities	51%	-3.5%	0.5%	19.2	2.9%

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

Relative economic growth concerns are clearly apparent in Canadian equity market performance. In fact, according to our work, when we look at TSX-listed companies with over 75% of revenue coming from domestic sources, these companies have massively underperformed year to date versus those TSX-listed companies with less than 25% of revenue coming from domestic sources. Interestingly this trend may be starting to shift, with this relative performance trend starting to reverse month to date.

- Companies with high domestic revenue (those with more than 75% of 2022 revenue coming from domestic sources) were up only 2.6% on average in the first 8 months of the year, while companies with low domestic revenue (those with less than 25% of 2022 revenue coming from domestic sources) were up 11.1% on average during the same period. This performance differential started to shift in September.
- This trend can be seen at the sector level, as sectors with higher domestic revenue have typically underperformed the first 8-months of the year but are outperforming month to date.
- More domestic-oriented companies are currently trading at a steep discount to more foreign-oriented companies, highlighting that the market is pricing in a significant growth divergence between domestic and internationally exposed companies.

## Recent Canadian Strategy Research Reports

Date	Title
<b>Canadian Strategy Snapshots</b>	
9/12/2023	<a href="#">Canadian Strategy Snapshot: Post Summer Performance Observations</a>
8/16/2023	<a href="#">Canadian Strategy Snapshot: Four Observations From Q2 Earnings Season</a>
8/10/2023	<a href="#">Canadian Strategy Snapshot: Cash Generation Key Source of Strength &amp; Stability</a>
7/26/2023	<a href="#">Canadian Strategy Snapshot: The Canadian Value Proposition</a>
7/13/2023	<a href="#">Canadian Strategy Snapshot: Spotlight on Key Revision Trends in the TSX</a>
6/29/2023	<a href="#">Canadian Strategy Snapshot: 2023 Mid-Year Update for the TSX</a>
6/21/2023	<a href="#">Canadian Strategy Snapshot: Overweight Financials With Heightened Selectivity</a>
6/13/2023	<a href="#">Canadian Strategy Snapshot: Hidden Strength and Opportunities Within the TSX</a>
6/5/2023	<a href="#">Canadian Strategy Snapshot: Upgrading Technology to Overweight</a>
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5/10/2023	<a href="#">Canadian Strategy Snapshot: Downgrading Consumer Staples to Underweight</a>
4/26/2023	<a href="#">Canadian Strategy Snapshot: Canadian GARP Opportunities</a>
4/19/2023	<a href="#">Canadian Strategy Snapshot: Three Sparsely Mentioned TSX Observations</a>
4/12/2023	<a href="#">Canadian Strategy Snapshot: Increasing Our Cyclical Tilt in Canadian Small Cap</a>
3/22/2023	<a href="#">Canadian Strategy Snapshot: Our Materials Weight Remains Focused on Gold</a>
3/14/2023	<a href="#">Canadian Strategy Snapshot: Highlights From Fourth-Quarter Earnings Season</a>
2/22/2023	<a href="#">Canadian Strategy Snapshot: Stable Cash Flow and Distribution Strategies</a>
2/9/2023	<a href="#">Canadian Strategy Snapshot: Technology Showing Signs of Fundamental Inflection</a>
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1/18/2023	<a href="#">Canadian Strategy Snapshot: Market Observations Following a Difficult Year</a>
12/13/2022	<a href="#">Canadian Strategy Snapshot: 2023 Canadian Sector Positioning</a>
11/11/2022	<a href="#">Canadian Strategy Snapshot: TSX Outperformance During Rising Rate Cycles</a>
10/24/2022	<a href="#">Canadian Strategy Snapshot: A More Selective Approach to Financials</a>
10/13/2022	<a href="#">Canadian Strategy Snapshot: Resetting Market Assumptions</a>
<b>Monthly Reports</b>	
7/10/2023	<a href="#">Canadian Strategy: Canadian Chartbook – September 2023</a>
7/10/2023	<a href="#">Canadian Strategy - Canadian Factor Profiles – September 2023</a>
<b>Investment Strategy Snapshots and Special Reports</b>	
09/06/2022	<a href="#">Investment Strategy Comment: Hold the Line</a>
11/30/2022	<a href="#">Investment Strategy: 2023 Market Outlook</a>
<b>US Strategy</b>	
<i>Please call or e-mail us to be added to our standalone US Strategy research</i>	

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Buy	Outperform	48.8 %	17.9 %	51.3 %	54.4 %	59.4 %	57.7%
Hold	Market Perform	48.6 %	16.2 %	46.2 %	43.9 %	39.1 %	37.5%
Sell	Underperform	2.6 %	16.7 %	2.6 %	1.5 %	1.0 %	4.8%

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~ As of April 1, 2019.

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[http://researchglobal.bmocapitalmarkets.com/documents/2013/rating\\_key\\_2013\\_to\\_2016.pdf](http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf)

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