

Canadian Strategy Snapshot

Thoughts on TSX Performance Reversals

Bottom Line

Many market pundits remain skeptical of the recent July rebound, suggesting it is a dead cat bounce driven by the most oversold companies in the index. While these so-called laggards have certainly been the key drivers of recent upward price pressure, our work suggests this is a common characteristic of market troughs. In fact, in six of the last seven market corrections the most oversold stocks were the key drivers of the rebound and posted the strongest returns on average six months after the market troughed. More importantly, a significant portion of the recent rebound has been driven by quality factors, which meaningfully underperformed in the early part of the year as investors became increasingly skeptical on the sustainability of profit margins, particularly in the face of rising inflationary pressures. As such, it is not surprising to us that these have been among the best-performing factors during the rebound, especially given the resilience of profitability metrics over the last year. Furthermore, we believe the sharp rebound in quality factors highlights rising confidence in fundamentals as we officially head into the second half of the year.

Overview:

- **Performance Reversals Sign of Market Trough**
 - ✓ Sharp rebounds in most oversold stocks is a typical sign of a market trough, not a dead cat bounce.
- **Rebound in Quality Factors a Sign of Rising Fundamental Confidence**
 - ✓ From our perspective, the sharp rebound in quality factors after broad underperformance in the first half of the year, highlights rising confidence in fundamentals as we head into the second half of the year. Particularly given the resilience of profitability metrics in the face of slowing growth and inflationary pressures.
- **Cyclical Rotation Into Early Cyclical**
 - ✓ After being among the worst performing sectors to start the year on concerns of a slowing economy and inflationary margin pressures, the early cyclical areas have become a key area of strength after valuation compressed to historical averages and profitability has remained strong.

Stocks That Fit the Theme: BMO Outperform-Rated S&P/TSX Stocks with Strong and Stable Profitability + Negative Price Performance year-to-date

Investment Strategy

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CDN Strategy – S&P/TSX Targets

S&P/TSX Price Target	
2022 Calendar Year End	24,000
S&P/TSX EPS Target	
2022 Calendar Year End	\$1500

Source: BMO Capital Markets Investment Strategy.

CDN Strategy – Recommended S&P/TSX Sector Weightings

Sector	Opinion	Tgt. Wgt.
Communication Services	MW	5.0%
Consumer Discretionary	OW	4.0%
Consumer Staples	MW	4.0%
Energy	MW	17.0%
Financials	OW	33.0%
Health Care	MW	0.5%
Industrials	MW	12.5%
Information Technology	MW	5.5%
Materials	OW	14.0%
Real Estate	MW	2.5%
Utilities	UW	2.0%

Source: BMO Capital Markets Investment Strategy.

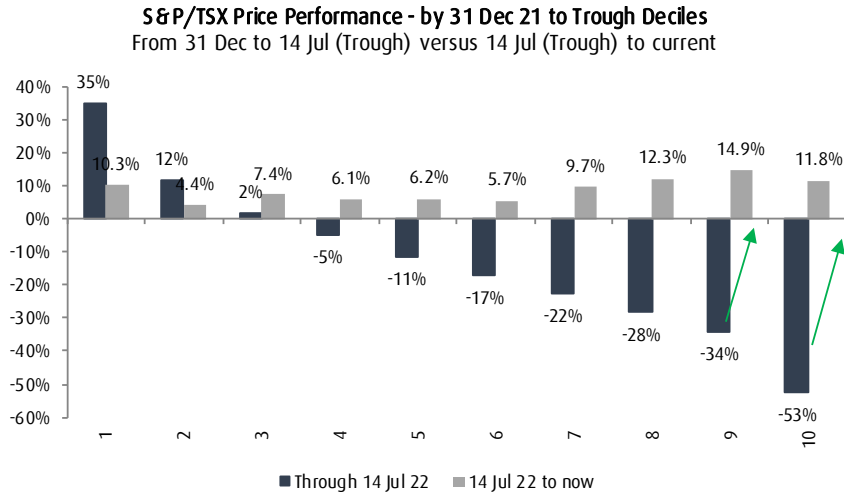
OW: Overweight

MW: Market Weight

UW: Underweight

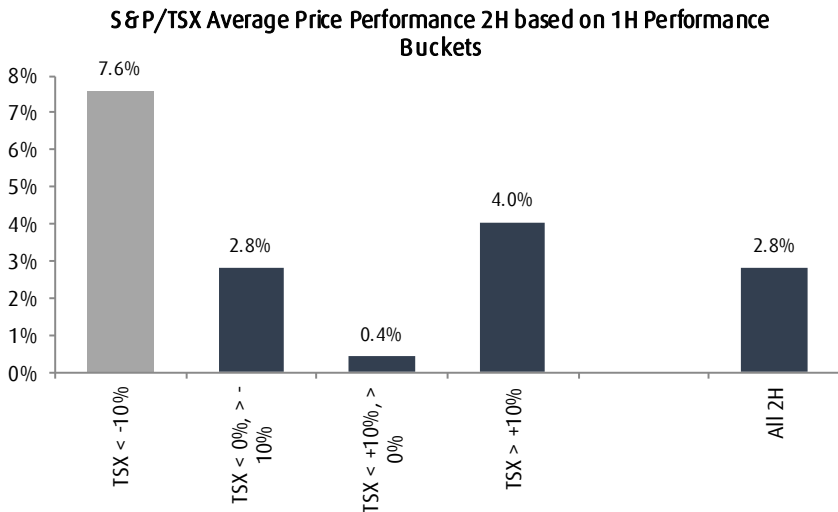
Performance Reversals Sign of Market Trough

Bottom and Top 2 Deciles Saw Sharpest Performance Reversals Since Jul 14 Trough



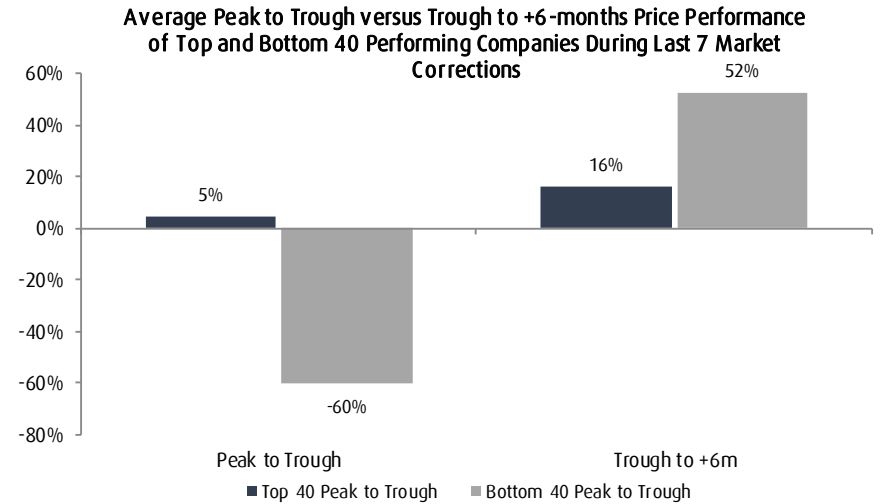
Source: BMO Capital Markets Investment Strategy Group, Factset, Compustat, IBES.

Back Half Returns Often Strong Post Weak First Halves



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

Price Reversals Are Common After Market Troughs



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

Many market pundits remain skeptical of the July rebound, suggesting it is a dead cat bounce driven by the most oversold companies in the index. While the most oversold companies have certainly been the key drivers, our work suggests this is common characteristic of market troughs. In fact, in six of the last seven market corrections the most oversold stocks were the key drivers of the rebound and posted the strongest returns on average six months after the market troughed. To be clear, fundamentals do matter, and we continue to believe a stabilization in earnings growth remains key for continued market strength in the back half of the year.

- Yes, many companies reached oversold territory in June. The bottom 2 deciles of TSX companies in the first half have been the top-performing stocks since the market troughed on July 14.
- Yes, rebounds from oversold territory are a key sign of market troughs. On average in the last seven market corrections since 2008, the 40 worst-performing names during the correction were the top-performing names six-months after the market troughed and the key drivers of the rebound.
- Furthermore, since 1956 when the TSX was down more than 10% in the first half (like 2022), the TSX posted its strongest second half price return on average.

Rebound in Quality Factors a Sign of Rising Fundamental Confidence

Quality Factors Dominated the Top 10 Factors in July

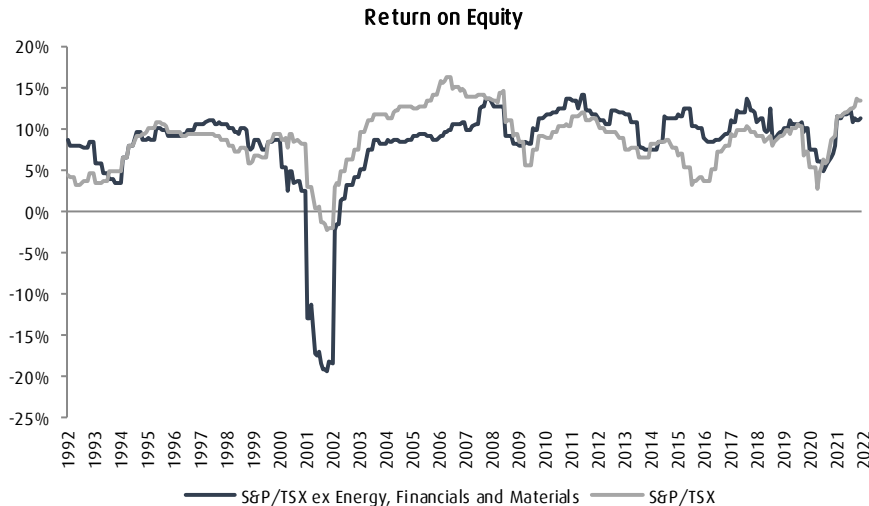
Top 10 BMO Investment Strategy Factor Profile Returns in July 2022

Factors	1H22	Jul-22
1 YR Growth - Sales	-5%	12%
ROE	-13%	11%
ROIC	-14%	11%
Cash % Assets	-31%	11%
1 YR Chg. ROE	-15%	11%
5 YR EPS Growth	1%	10%
ROA	-14%	10%
High BETA	-9%	10%
NTM PE	-2%	9%
1 YR Chg. Profit Margin	-10%	9%

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

* grey shaded = quality factors

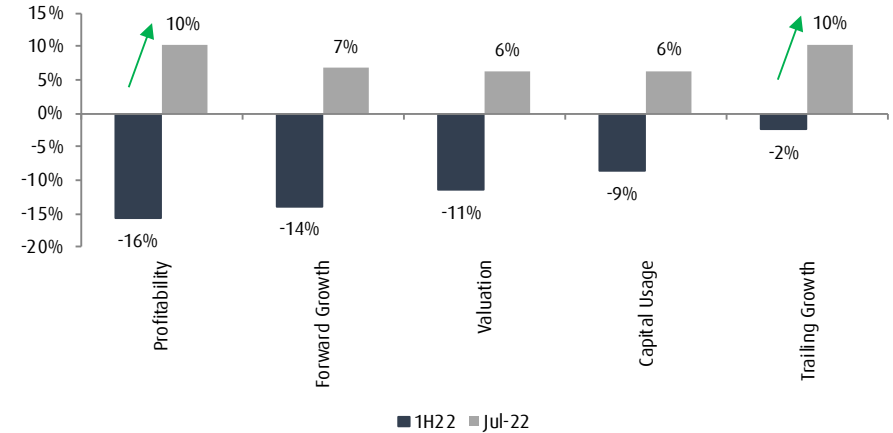
Profitability Has Been Strong and Stable



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

Quality Factors Saw a Sharp Rebound, but Trailing Growth Factors Have Remained Strong

Fundamental Factor Profile Categories Total Return: 1H22 vs July 2022 sorted by 1H22 performance



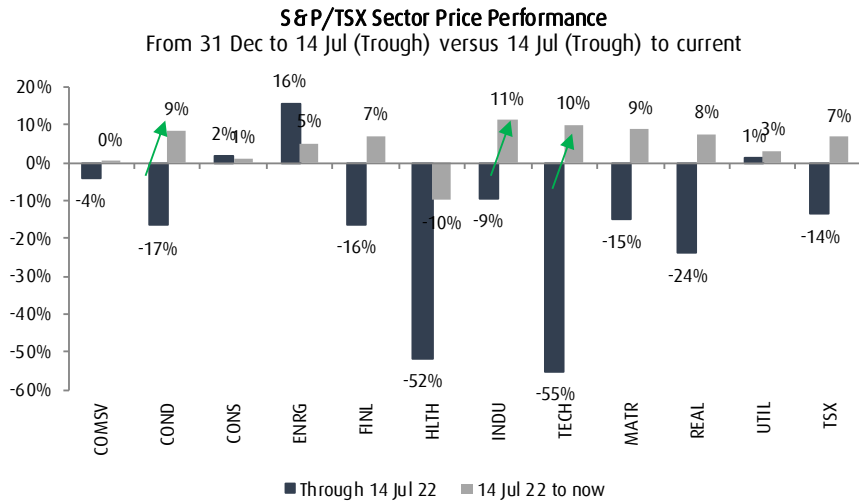
Source: BMO Capital Markets Investment Strategy Group, Factset, Compustat, IBES.

As investors became increasingly skeptical on the sustainability of profit margins, particularly in the face of rising inflationary pressures, quality and profitability metrics were among the worst-performing fundamental factors in the first half of 2022. As such, it is not surprising to us that these have been among the best-performing factors during the rebound, especially given the resilience of profitability metrics over the last year. Overall, we believe the sharp rebound in quality factors highlights rising confidence in fundamentals as we head into the second half of the year.

- Six of the top 10 performing individual factors in July were quality metrics, led by return on equity and return on invested capital. Furthermore, these factors all underperformed the broad market in the first half of the year.
- Overall, our profitability/quality factor category was the worst performing fundamental factor category in the first half of 2022 and was the second-best performing category in July.
- Trailing growth which was the best performing category in the first half was also the best performing category in July, driven largely by the Energy sector.
- Despite concerns surrounding profitability and margins, return on equity excluding the resources has remained strong and stable.

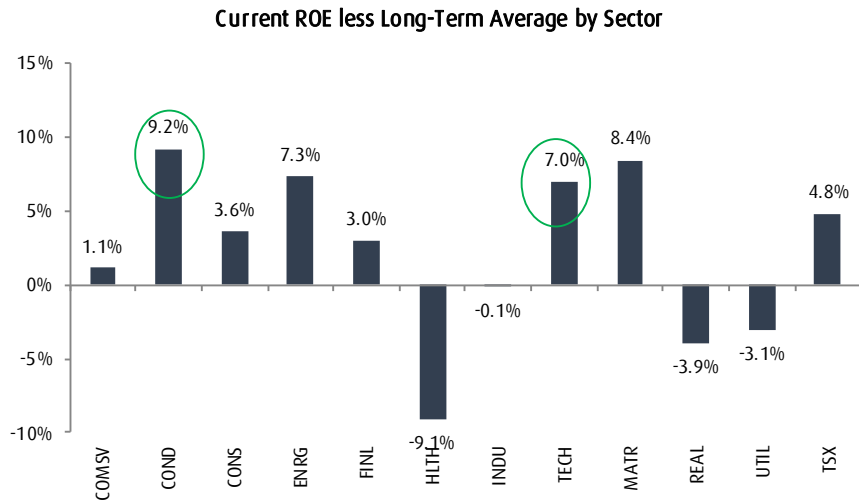
Cyclical Rotation Into Early Cyclical

Clear Sector Rotation Back into Early Cyclical



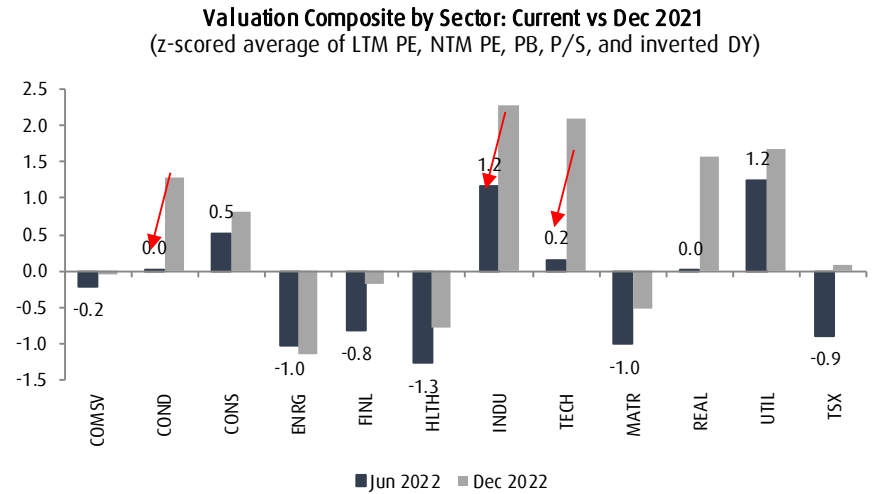
Source: BMO Capital Markets Investment Strategy Group, Factset, Compustat, IBES.

Profitability Has Been Strong and Stable Across Most Sectors



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

Valuations Compressed Sharply for Early Cyclical



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

From our perspective, another key sign of rising market confidence has been the clear rotation into the early cyclical areas of the market. In fact, these sectors saw a sharp compression in valuation in the first half of the year as the market became increasingly concerned about margin pressures and slowing earnings growth. However, despite these concerns profitability and margins have remained strong and stable in the face of cost pressures and a slowing economy. Indeed, the cyclical areas continue to have among the strongest return on equity in the TSX and as such are likely to remain keys areas of strength in the back half of 2022, in our opinion.

- Early cyclical sectors have been the top three performing sectors since the market trough after being among the worst-performing sectors to start the year.
- These cyclical areas saw the sharpest valuation compression to start the year. In fact, our valuation composite for both Consumer Discretionary and Technology dropped from being over one-standard deviation above the historical average to being in line with historical averages. From our perspective, this shows the more cyclical areas offer value in Canada and have largely priced in slowing earnings momentum.
- Additionally, profitability metrics for these sectors remain firmly above the historical averages, showing strong and stable operating efficiency, despite concerns around slowing earnings growth and inflationary pressures.

BMO Outperform-Rated Stocks That Fit the Theme

- BMO Outperform-Rated Stocks in the S&P/TSX index
- Negative price performance year-to-date
- NTM profit margin higher than its forecast at the start of the year
- Rated Outperform by BMO Capital Markets Equity Research

BMO Outperform Rated S&P/TSX Stocks with Strong and Stable Profitability + Negative Price Performance year-to-date

Ticker	Company	Price	BMO Rating	GICS Sector
AP.UN	Allied Properties Real Estate Investment Trust	32.76	OP	Real Estate
BAM.A	Brookfield Asset Management Inc. Class A	64.71	OP	Financials
BCE	BCE Inc.	64.02	OP	Communication Services
CFP	Canfor Corporation	26.53	OP	Materials
CLS	Celestica Inc.	13.91	OP	Information Technology
CRR.UN	Crombie Real Estate Investment Trust	16.52	OP	Real Estate
CRT.UN	CT Real Estate Investment Trust	17.01	OP	Real Estate
D.UN	Dream Office Real Estate Investment Trust Class A	19.52	OP	Real Estate
GIB.A	CGI Inc. Class A	108.73	OP	Information Technology
GIL	Gildan Activewear Inc.	39.39	OP	Consumer Discretionary
IAG	iA Financial Corporation Inc.	70.01	OP	Financials
IFP	Interfor Corporation	32.62	OP	Materials
NWH.UN	NorthWest Healthcare Properties Real Estate Investment Trust	13.18	OP	Real Estate
STN	Stantec Inc	60.81	OP	Industrials
T	TELUS Corporation	29.22	OP	Communication Services
TCN	Tricon Residential Inc	14.59	OP	Real Estate
TIH	Toromont Industries Ltd.	105.34	OP	Industrials
TOY	Spin Master Corp	47.31	OP	Consumer Discretionary
TRI	Thomson Reuters Corporation	146.77	OP	Industrials
WFG	West Fraser Timber Co. Ltd.	115.31	OP	Materials
ZZZ	Sleep Country Canada Holdings Inc	28.68	OP	Consumer Discretionary

Source: BMO Capital Markets Investment Strategy, FactSet, IBES. Priced as of August 9, 2022

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Recent Canadian Strategy Research Reports

Date	Title
Canadian Strategy Snapshots	
7/27/2022	Canadian Strategy Snapshot: Cyclical Deviation in Canada vs. US
7/21/2022	Canadian Strategy Snapshot: Consumer Discretionary Set for Rebound
7/13/2022	Canadian Strategy Snapshot: Contrarian Positives for Volatile Times
6/29/2022	Canadian Strategy Snapshot: Financials Remain Our Highest Conviction Overweight
6/23/2022	Canadian Strategy Snapshot: Our Market Weight Industrials
6/15/2022	Canadian Strategy Snapshot: TSX Positioning as US Enters Bear Market
6/9/2022	Canadian Strategy Snapshot: Fundamentals Dictate Increased Selectivity
5/30/2022	Canadian Strategy Snapshot: We Remain Overweight Canadian Materials
5/18/2022	Canadian Strategy Snapshot: Maintaining Our 2022 S&P/TSX Targets
4/20/2022	Canadian Strategy Snapshot: Remaining Overweight Canadian Financials
4/13/2022	Canadian Strategy Snapshot: Factor Style Preferences as Earnings Growth Slows
3/31/2022	Canadian Strategy Snapshot: Dividend Growth Balances Offense With Defense
3/24/2022	Canadian Strategy Snapshot: Communication Services – Our Contrarian Call of 2022
3/9/2022	Canadian Strategy Snapshot: Canadian Equities a Source of Stability
2/16/2022	Canadian Strategy Snapshot: Coping With Slowing Earnings Momentum
2/10/2022	Canadian Strategy Snapshot: Our Thoughts on January TSX Outperformance
1/27/2022	Canadian Strategy Snapshot: Tactical Canadian GARP Opportunities
1/20/2022	Canadian Strategy Snapshot: Remaining Overweight Industrials
1/13/2022	Canadian Strategy Snapshot: Assessing Small Cap Value Within a Value Market
12/16/2021	Canadian Strategy Snapshot: Notes From the Road – Canadian Year Ahead Edition
10/28/2021	Canadian Strategy Snapshot: Grading the Recovery Thus Far
10/14/2021	Canadian Strategy Snapshot: Why We Remain Market Weight Energy
9/22/2021	Canadian Strategy Snapshot: Positioning for an Epic Dividend Growth Cycle
Monthly Reports	
8/4/2022	Canadian Strategy: Canadian Chartbook – August 2022
8/4/2022	Canadian Strategy: Canadian Factor Profiles – August 2022
Podcasts	
11/24/2021	Videocast: BMO Virtual Fireside Chat With Brian Belski – 2022 Year Ahead for the US & Canada
10/22/2021	Podcast - We Are in the Home Stretch
Investment Strategy Snapshots and Special Reports	
11/18/2021	Investment Strategy: 2022 Market Outlook
11/19/2020	Canadian Strategy Snapshot: 2021 Year Ahead – Canadian Market Outlook
US Strategy	
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Buy	Outperform	53.6 %	18.6 %	52.0 %	56.4 %	59.5 %	57.7%
Hold	Market Perform	44.5 %	19.0 %	44.0 %	41.9 %	37.6 %	37.5%
Sell	Underperform	1.7 %	44.4 %	4.0 %	1.4 %	2.8 %	4.8%

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(S) = Speculative investment;

Spd = Suspended - Coverage and rating suspended until coverage is reinstated;

NR = No Rated - No rating at this time; and

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http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf

(January 2010 - April 2013)

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