August 5, 2020; Market Overview & Energy Transition

BMO Nesbitt Burns

Week in **Review**

BMO Wealth Management
BMO Nesbitt Burns

Market Overview:

Equity markets continue to confound sceptics with the leading US S&P 500 index (up 2% YTD) despite the economic ravishes of Covid-19 and a healthy valuation at beginning of the year. We can attribute the resilience of the S&P to the relentless upward valuations of the Tech sector with big technology/communications names dominating the S&P, representing over 40% of the value. These names include Microsoft, Apple, Visa, MasterCard and also if we include Amazon, Alphabet and Facebook in the 'technology' category. The real question then is; are the valuations of these mega Tech names (trading at 25 – 50x's 2021 earnings) justified? Are their double digit earnings growths sustainable?

For example the Nasdaq is trading at 25x's 2021 earnings, the S&P 500 at 20x's while the Dow (with far less Tech) is trading at a more reasonable 18x's. For the most part these large Tech names have unlimited capital resources and enjoy growing global footprints. We will dig deeper into the Tech sector in the future however we plan to stay invested names such as Amazon, Alphabet, and the Tech ETF "VGT" (with Apple and Microsoft representing 50% of the total) for now. We note the Canadian TSX is trading at a modest 16x's 2021 earnings which includes Shopify accounting for 8% of the TSX while contributing almost no earnings thereby inflating the valuation (TSX would be trading with a far lower p/e excluding Shopify). Note that we use 2021 consensus forecast earnings as 2020 is not a normal year.

Government interest rates have been driven down by central bank stimulus actions in the developed world and as well for corporate bonds; creating significant returns for fixed income holders this year. The negative side of this action is that high quality bonds do not yield much over 0.75% now and if interest rates were to normalize to even say 2% this would create negative returns for bondholders. The flip side of this is that returns for preferred shareholders has been negative so far this year due to concerns that reset yields will get reduced and higher interest rates would most likely create positive returns in this fairly thinly traded sector of the capital markets.

Energy Transition:

After holding Enbridge as a core position for most of the past 10 years and given current and accelerating energy trends in NA, we believe that the demand for oil, accelerated by the Covid crises, is levelling off and will diminish going forward. In particular, the need for the US to import increasing amounts of oil from Canada, although Canada is still a favoured supplier, will trend down. This trend could be accelerated if a future US administration were to make reducing the dependence on oil a national goal. As a result, while we continue to view Enbridge as a strong, diversified pipeline and utility company, however given that 65% of its cash flows are derived from oil transportation, we now favour TC Energy, symbol "TRP" (formerly TransCanada) as our pipeline position. Both Enbridge and TC Energy have leading energy infrastructure operations in NA, however TC Energy derives 69% if its cash flows from Natural Gas shipment and we see NA demand for NatGas continuing to increase. The largest consumption segment in the US of NatGas is for electrical power generation (35%) and increasing as coal fired plants get retired. Secondly NatGas is used for production of petrochemicals and other industrial uses (33%) and lastly for heating purposes (29%); as reported by the IEA for 2018. An

additional growth area for NatGas is the export of Liquefied Natural Gas or "LNG" which is being shipped out of the US Gulf Coast and by 2023 Canada will begin LNG shipments from BC. We note that the Keystone XL Oil Pipeline project, sponsored by TC Energy, in our view is unlikely to get built and most analysts' forecasts do not include these cash flows in their forward estimates.

In addition we are allocating ½ of our previous Enbridge position to a renewable energy name and ½ to TC Energy. We highlight below three alternative renewable power companies but note that Brookfield Renewable is the only large pure play in renewables. As such we profile in more detail Brookfield Renewable but note that due to its current full valuation we would add to it slowly. Note that Brookfield Renewable trades on cash flow and although the earnings trends are choppy, cash flows continue to grow.

Energy Infrastructure Valuation Metrics - Bloomberg/ThomsonConsensus																			
		Share		Tgt.	Mkt	Ent.	eps				eps Gr.	Ebitda				Ebitda Gr.	EV/Ebitda	p/e	
C$	Symbol	Price	Yield	Price	Cap	Value	2019	2020	2021	2022	2020-2022	2019	2020	2021	2022	2020-2022	2020	2020	2021
Enbridge	ENB	43.87	7.39	51.73	88.8	165	2.67	2.67	2.87	3.09	7.6%	13.1	13.4	14.3	15.1	6.2%	12.3	16.4	15.3
TC Energy	TRP	63.46	5.11	72.13	59.6	112	3.86	3.85	3.87	4.18	4.2%	8.2	9.5	9.8	10.2	3.6%	11.7	16.5	16.4
Northland Power	NPI	37.30	3.22	35.55	7.2	15	1.39	1.50	2.08	1.70	6.5%	0.9	1.0	1.2	1.1	4.9%	15.2	24.9	17.9
Algonquin Power	AQN	18.26	4.56	20.84	10.7	18	0.82	0.89	1.02	1.12	12.2%	0.9	1.2	1.5	1.7	19.0%	14.9	20.5	17.9
Brookfield Ren. Pow.	BEP.UN	57.96	5.03	54.27	23.0	50	-1.30	1.09	1.26	0.94	-7.1%	2.6	2.1	2.3	3.6	30.9%	23.8	53.2	46.0

Brookfield Renewable Power "BEP":

BEP is a public company controlled and overseen by Brookfield Asset Management or BAM but is separately run and continues to attract capital from individual and third party institutional investors, similar to BAM's other major holdings. Brookfield Renewable just completed a re-org such that you can own it as a Limited Partnership or Corporation and can purchase either alternative in C$ or US$. BEP is a pure play in green power generation with its generating capacity roughly made up of 57% hydro, 23% wind and 20% solar and storage. BEP's hydro assets are located primarily in North and South America and wind and solar in the Americas and Europe with a small footprint in Asia. It recently completed a merger with Terraform a US wind and solar company which added another 25% to its asset base. We favour BEP as it is the largest, most diversified and that has its sole focus on power generation vs. Northland which recently purchased a Columbian electrical utility and Algonquin, in which about 65% of its asset base is made up of small North American utilities. While still highly valued, Brookfield Renewable is off about 5% from its recent high and we recommend starting to add the position at the current price.

Northland Power: "NPI":

Northland has developed mainly as an offshore wind generation company with major projects offshore Europe (North Sea) but now adding Asia (Japan & Korea) and Latin America. NPI also owns onshore and solar projects in North America as well as gas fired generating plants. It recently completed the acquisition of a Columbian gas and electric utility (EBSA) as an entry into the Latin American power market. Its current cash flows are comprised 66% from wind, 20% from gas & biomass, 8% from utilities and 6% from solar. Its major expansion thrust is to add wind and solar capacity. While demonstrating a successful track record of expansion and financial returns, given the current high valuation with the share price trading above the consensus forecast we recommend waiting before adding to this name.

Algonquin Power & Utilities "AQN":

Algonquin is a Canadian based renewable power and utilities company with 65% of cash flows derived from small utilities holding (Gas and electric) mainly in the US and 30% derived primarily from wind power generation. Algonquin has successfully grown its footprint in both of its key operating areas with an impressive 5 year annualized return of 18% and currently offers a 4.6% dividend yield with a 10 year track record of 10% annualized dividend growth. We view Algonquin as an attractive holding for dividend seeking investors offering both stability and growth. As we hold Fortis in most of our Portfolios (mainly a gas and electric utility name with operations across North America) for renewable energy exposure we prefer the pure plays of Brookfield Renewable and Northland Power.

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