# Top Ideas from BMO Capital Markets

As the second half of 2019 unfolds, there's much to keep an eye on, from the impact of ongoing U.S./China trade negotiations to low and declining interest rates. The BMO Nesbitt Burns Portfolio Advisory Team gathered highlights from their **2019 BMO Nesbitt Burns Research Conference** in late June, where analysts from across BMO Capital Markets ("BMO CM") shared their top ideas. This article presents a summary of these analysts' views on various market sectors, in no particular order. As a reminder, the views below are for informational purposes only. It's important to consult with your BMO financial professional for advice specific to your personal situation.

## Economic outlook

According to BMO Chief Economist Douglas Porter, the widespread theme in the second half of the year continues to be the bullish market, largely a result of dovish remarks by U.S. Federal Reserve Chairman Jerome Powell in mid-July. Chairman Powell has strongly hinted at a pending rate cut, and Mr. Porter anticipates there will be two 25 basis points ("bps") trims in the second half of the year, beginning July 31. However, the Bank of Canada ("BoC") is less likely to cut rates for three reasons:

1. The starting point for short-term rates is lower than what the BoC considers to be neutral;
2. The BoC does not want to light another fire under the housing market, especially after signs that some markets are stabilizing or even regaining strength; and
3. Core inflation, unlike the U.S., is not below the BoC's target.

For Mr. Porter, the test for the economy in the coming months will be whether or not consumer spending and employment maintain momentum as trade/exports/manufacturing results continue to struggle. Geopolitical concerns, namely U.S./China trade tensions, as well as friction with Iran, remain top of mind as economic data shows increasing damage from this trade war. This damage is most obvious in sentiment surveys, especially among manufacturers, as supply chains are being disrupted by tariffs. Mr. Porter suspects that weakness will seep into the broader economy, and that U.S. Gross Domestic Product ("GDP") growth will average just 1.6% over the next seven quarters — precisely half the pace of the past year.

## Commodities

Looking at commodities, BMO CM sees oil trading at US$50-$60 per barrel, with uncertainty with Iran, Libya and Venezuela supporting these prices. U.S. shale companies need oil prices trading at US$55 or higher in order to grow cash flow, and a trade war or recession could dampen demand. Top picks in Canada are Suncor ("SU"); and Enerplus ("ERF"). BMO CM is also positive on energy infrastructure with TC Energy ("TRP") (formerly known as TransCanada Pipelines) being its top pick in this sub-sector. TC Energy has a 95% regulated/contracted asset base and a current yield of 4.5%. The company has a track record of exceeding expectations, and should deliver an attractive dividend growth of 8-10% per annum through to 2021.

## Retail and consumer products

BMO Capital Markets is positive on the Canadian Grocery space, seeing increased food inflation as positive for earnings. Loblaw Companies Ltd. ("L") is their top pick, based on growth in its online grocery, operational improvements, and increasing margins as reasons for favouritism. Indeed, key themes in this sector include e-commerce and a shift to digital (think online grocery shopping and delivery/pick-up services); investment in technology; increasing price transparency; and uncertainty regarding tariffs.

BMO CM's top three U.S. Retail picks are Wal-Mart ("WMT"); Costco ("COST"); and Dollar General ("DG"). Specifically, Wal-Mart may be uniquely positioned among other U.S. retailers for potential long-term e-commerce profitability, given its significant investments in e-commerce infrastructure and its third-party marketplace. Costco has an advantaged business



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model, consistent execution and increasing connection to its loyal membership base. Dollar General is attractively positioned given its minimal exposure to online competition, and the fact that Wal-Mart is not focused on growing small-format stores.

## Internet and media

Top picks in this sector include the industry's dominant players—Netflix ("NFLX"); Amazon ("AMZN"); and The Walt Disney Co. ("DIS"). Netflix has strong sustained subscriber trends, and no regulatory risk. As for Amazon, its profits are scaling as the company ramps up its advertising business and Amazon Web Services. Amazon's ad business is also gaining significant momentum and is expected to take share from online ad sellers such as Google and Facebook. Additionally, Amazon Prime is expanding into new countries, which is expected to support the stock's multiple. It's difficult to talk about the internet and media without mentioning Alphabet ("GOOGL"). BMO CM is cautious on the trajectory of margins at Google due to the emergence of Amazon's advertising business. In fact, Amazon may be the company's biggest competitive threat since Facebook. Finally, Disney is a top pick due to its "other businesses" (i.e., leading content, including key Disney franchises and its recently acquired intellectual property from 21st Century Fox earlier this year—one of the biggest media mergers to take place).

## Industrials and transportation

Union Pacific ("UNP") is BMO Capital Market's best idea in Transportation. UNP has the potential to reduce operating costs by US$2.3 billion, and is on track to realize US$500 million in costs savings in 2019. With a buyback supporting a lower share count and modest revenue growth of 2-3%, UNP can deliver solid double-digit earnings per share ("EPS") growth. In trucking and logistics, the sentiment has shifted from neutral to negative. Further, cost pressures (specifically, labour costs) are expected to remain high throughout 2019. The sentiment on the small parcel segment is positive, with both FedEx ("FDX") and United Parcel Service ("UPS") trading at historically low multiples, reflecting moderating cyclical tailwinds and trade concerns. While BMO CM favours both stocks, they see more upside in FedEx.

## Financials

BMO CM remains positive on U.S. and Canadian banks. They see Bank of Nova Scotia ("BNS") and TD Bank ("TD") as strong long-term holdings. The Canadian economy continues to perform well and loan growth continues to be led by domestic resiliency and international expansion. Low interest rates are accommodative for strong credit quality in bank portfolios, which is additionally supported by favorable employment trends. BMO CM also believes that Visa ("V") has a long runway for growth, driven by increased penetration in business to business payments ("B2B"). Paypal ("PYPL") is another strong conviction name with a potential revenue growth surprise from e-commerce, as is Bank of America ("BAC"). Expectations for BAC's earnings are very low, with positive surprises expected from higher fees, buybacks lower provisions and tax rates. Bank of America is trading at an unwarranted discount to its peers, and as the company demonstrates its earnings potential, the discount should narrow.

## 2019 and beyond

While uncertainty regarding global trade and tariffs, and news and Twitter headlines may cause some concern among investors, many industries do continue to experience growth. The odds of a recession in the next year are still quite low at 30%, and the overall sentiment at the 2019 BMO Nesbitt Burns Research Conference was generally positive.

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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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