Canadian Equities Overview

[CIBC Asset Management logo]

[Soft music plays]

[Colum McKinley
Senior portfolio manager
CIBC Asset Management]

Equity volatility has been a reality for investors for—really since the beginning of time, and the last year has been no exception to that.

[Sheets of Canadian money being printed. The Bank of Canada and the Federal Reserve buildings.]

We've had to deal with significant inflation, we've seen central banks take interest rates to record levels, so the Fed has gone from 0% to 5% in the last year.

[The Ukrainian flag flying high over Kyiv. Soldiers lined up in a row.]

We've seen very significant geopolitical challenges, a very unfortunate war in Ukraine. We've seen equity markets in Canada and the U.S. down as of March 31st, 2023.

[Canadian equities trends and CAM opportunities in 2023]

Throughout this though, we're reminded that the volatility creates opportunity.

["Be greedy when others are fearful and fearful when others are greedy."
Warren Buffet]

[A picture of Warren Buffet.]

Warren Buffett has a great saying, "Be greedy when others are fearful and fearful when others are greedy".

[Stock market data on screens.]

We often look through periods of volatility for opportunities to add to positions in great companies.

[Canadian and U.S. currency.]

And we’re starting to see inflation come under control. Not that that problem is completely dealt with, but it is becoming a lesser issue. And so, markets are forward looking and they're seeing a bit of a light at the end of the tunnel.

[The White House in summer.]

Now for sure we're going to have more volatility in the marketplace. Coming this summer, we have a big, important debt negotiation for the United States.

[A man goes over financial spreadsheets.]

We have some uncertainty around earnings. I think the next several quarters, businesses are going to find more clarity around their earnings growth. It's not hard to envision a period of time where we have a sluggish growth. Companies are still growing, but maybe not growing as fast as we would like.

[A man looks over documents. Two men in suits shake hands. Two people go over financial spreadsheets on a table.]

But all in all, businesses continue to have a fairly positive and optimistic outlook. We're encouraged that companies continue to focus on generating strong free cash flow in their business and returning that capital to shareholders.

[CAM opportunities in 2023]

I think a great example of that where we have seen a significant opportunity across our portfolios is in the energy stocks.

[Images of natural gas refineries.]

Specifically, CNQ, Canadian Natural Resources, is an energy producer that has benefited from higher commodity prices. They've also implemented fairly significant discipline, on how they grow and how they reinvest in their business. And as a result, this discipline is producing substantial cash flows. CNQ in 2022 returned just over $10 billion to shareholders through a combination of share buybacks and a combination of dividend increases.

[Business people on sit on bench and work on various devices.]

Most recently they increased it 6%. And over the last five years, that dividend has grown quite substantially in excess of 30% a year, for the last five years.

[Canadian equities and dividend paying stocks look attractive]

When we look at an individual stock, we think about them on a total return basis. We like to combine the income stream that can be earned through dividends and long-term capital appreciation for equity investors.

[Investors like approvingly at their laptops.]

For Canadian investors, the dividends from Canadian companies, there's obviously a tax advantage to that, that income stream that we want to avail to shareholders.

When we look at businesses, we want to think about the sustainability of that dividend. So, how are the cash flows of that business evolving and changing over time? What are the levers that management is pulling to ensure those dividends can grow over time? How are they reinvesting in their business? And that leads to the second part of great returns for equity investors—is good companies think about their future.

[Business people look at financial data on various screens.]

They continuously reinvest capital to generate excess returns to grow their business over time. And the combination of the two of them is what we think will generate above average returns over the long term for investors.

[A series of natural gas pipelines.]

One example of an area where we're seeing very attractive dividend yields today and dividend growth, is in the pipelines and the midstream businesses. And these businesses today are yielding around 6.5%, 7%. So very attractive dividend yields, and those dividends have been growing.

[People adjust their thermostats]

Companies like Enbridge as an example, their cash flow relationships, or their business relationships with their customers, are contractually tied in. So, they have certainty around the level of cash flow that they will generate through their business.

[The OPEC flags waves in the breeze. People look approvingly at their energy bills.]

Second is their customers are doing quite well today, that oil prices at record levels ensures that their customers have strong cash flows. They're able to pay their bills, they're able to invest in future growth. That helps pipeline and midstream companies grow, as well.

[Canada vs. U.S. banking system and Silicon Valley Bank]

Recently, we have had some very concerning news out of the U.S. banking system where we've seen failures of banks.

[Aerial views of Silicon Valley Bank.]

And the most significant is Silicon Valley Bank, which was the 16th largest bank in the United States.

[A computer-generated image of a newspaper headline, "Financial Crisis".]

The immediate reaction was this was bringing back fears and nightmares about the global financial crisis. As a result, we saw reaction.

[Market data on screens.]

Financial stocks around the world sell off in fears of what could be happening. And as we looked at this to understand the situation, our view was this was not similar to the global financial crisis.

[Colum McKinley sits on a desk by a bank of monitors showing market data.]

There's a couple of reasons for that.

[The Federal Reserve building and seal on a banknote. An aerial view of a Bank of America tower. A small regional branch in a town.]

Coming out of the global financial crisis, the U.S. made a number of changes to their regulatory regime and as a result they ended up really with a two-tier regulatory system, one for larger banks and then one for smaller banks, banks with less than $250 billion in assets.

[The CIBC logo on a wall in CIBC Square. The Canadian flag displayed on government buildings in Ottawa.]

And Canadian banks, our financial regulator has continued to be quite disciplined and apply the highest standards, and so our regulatory system looks like, if not better than the one that is applied to large U.S. banks.

[The exterior of a Silicon Valley Bank office.]

And here's two main differences for those smaller banks where we were seeing the problems occur. The first is they are not required to take mark-to-market losses on securities that are

held for sale. And so, Silicon Valley Bank as an example, were taking in deposits, investing those assets in long-term government bonds as interest rates rose very, very quickly, they faced significant losses in those portfolios. They're not required to report those losses as part of their capital positions.

[A large CIBC logo sign outside CIBC Square. People analyze market data on a bank of screens.]

In contrast, Canadian banks, already reflect mark-to-market losses on available for sale securities.

The second big difference is a liquidity capital ratio.

[A modern CIBC bank machine. People take out U.S. currency from an older looking bank machine.]

Our regulator requires Canadian banks to hold capital so that they can withstand 30 days of stressed withdrawals. In the United States they had a liquidity problem that that all of a sudden depositors wanted their money back and they didn't have enough liquidity to meet those needs. And so, Canadian banks have to maintain that liquidity capital ratio at 100%.

[Images of CIBC Square from a variety of vantage points.]

Most of the Canadian banks are in excess of that level, 130 to 140% on average. So, they're holding excess capital above and beyond what they need to do for regulatory system.
We continue to remain overweight the banks across our mandates. We think they have very, very strong capital positions today. They're very well managed businesses. They have demonstrated ability to generate excess cash flow and return that cash flow to shareholders via dividends over time. We continue to think that Canadian banks remain a strong place for us to invest for unitholders.

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