

# Canada Core Pick List

## September 2015

The Canadian Core Buy list outperformed the S&P/TSX 60 Index during August, posting a total return that came in at negative 1.2% to the benchmark's negative 4.3%. The top performers for the period were **Canadian Imperial Bank of Commerce CM** and **Cameco CCO**, with total returns of 3.5% and 3.1%, respectively. These gains were offset by weaker performance from **Canadian Pacific Railway CP** and **National Bank of Canada NA**, with negative 9.2% and negative 5.3%, respectively.

The Core Buy list retains its cumulative outperformance against the benchmark; with a total return since inception of 155.2% versus 93.8% for the S&P/TSX, a difference of 61.4 percentage points.

Our analyst coverage of energy sector companies remains under review while our oil midcycle pricing assumptions are reevaluated. Although we continue to believe that crude oil futures prices are well below the levels required to encourage sufficient investment to meet demand beyond 2017, recent

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**The Morningstar Canada Core Pick List Strategy**

The Morningstar Canada Core Pick List features our most attractively valued names among larger Canadian companies with sustainable competitive advantages (what we refer to as "economic moats"). These best ideas are further refined into a Consider Buy and a Consider Hold list.

### Canada Core Picks

Company	Ticker	Sector	Morningstar Rating	Current Price (CAD)	Fair Value (CAD)	Economic Moat™	Uncertainty Rating	Market Cap (CAD Mil)	Dividend Yield (%)
<b>Consider Buying</b>									
Cameco	CCO	Basic Materials	★★★★	18.51	30	Narrow	High	7,326.12	2.16
Potash Corporation of Saskatchewan	POT	Basic Materials	★★★★	34.26	52	Wide	High	28,595.07	5.64
National Bank of Canada	NA	Financial Services	★★★★	43.3	64	Narrow	High	14,272.55	4.8
↑ Bank of Montreal	BMO	Financial Services	★★★★	71	93	Narrow	High	45,582.00	4.62
* CI Financial	CIX	Financial Services	★★★★	31.45	38	Narrow	Medium	8,762.72	4.2
* Restaurant Brands International	QSR	Consumer Cyclical	★★★★	50.48	55	Narrow	Medium	23,597.02	1.27
Canadian Pacific Railway	CP	Transportation	★★★★	191.09	207	Wide	Medium	30,822.82	0.73
Rogers Communications Class B	RCI.B	Communication Services	★★★★	44.91	48	Narrow	Medium	23,117.27	4.28
<b>Consider Holding</b>									
IGM Financial	IGM	Financial Services	★★★★	37.65	45	Narrow	Medium	9,317.56	5.98
↓ Canadian Imperial Bank of Commerce	CM	Financial Services	★★★★	96.69	122	Narrow	High	38,408.58	4.63
Toronto-Dominion Bank	TD	Financial Services	★★★★	52.48	65	Wide	High	97,276.93	3.89
Power Financial	PWF	Financial Services	★★★★	32.34	40	Narrow	High	23,066.14	4.61
Power Corporation Of Canada	POW	Financial Services	★★★★	28.8	35	Narrow	High	11,928.68	4.03
Great-West Lifeco	GWO	Financial Services	★★★★	33.63	39	Narrow	High	33,525.04	3.88
Fortis	FTS	Utilities	★★★★	35.69	37	Narrow	Low	9,944.02	3.81
Thomson Reuters	TRI	Consumer Cyclical	★★★★	51.18	51	Narrow	Medium	39,938.66	3.43
BCE	BCE	Communication Services	★★★★	53.2	53	Narrow	Medium	45,145.52	4.89
↑ Valeant Pharmaceuticals International	VRX	Healthcare	★★★★	304.99	288	Narrow	Medium	104,547.18	0
<b>Consider Selling</b>									

All prices as of Aug. 31, 2015. | ↑ = Upgrade, ↓ = Downgrade, \* = New Addition

industry developments point toward our current long-term oil price outlook of \$75 Brent and \$69 West Texas Intermediate as being too high. Two developments underpin our decision to adjust our long-term pricing outlook. First, cost-advantaged supply continues to grow, thanks to ongoing productivity improvements across U.S. tight oil plays as well from sanctions relief that will result from the Iran nuclear deal. Further, our originally anticipated point of global supply and demand coming into balance continues to get pushed further into the future, and it appears increasingly likely that crude markets will not approach any semblance of normalcy until 2017. This, in turn, has led to a collapse in near-term investment that has unleashed cost and currency deflation exceeding our previous expectations, resulting in lower industry break-even levels across the board. While we continue to believe that the vicious sell-off of energy stocks has created a handful of compelling opportunities for long-term investors, the industry hasn't faced a downturn of this magnitude since the 1980s. Tremendous uncertainty exists as to how commodity prices will trend over the next several quarters. Accordingly, investors should be both discriminating in their stock-picking and duly prepared to weather additional volatility as the industry embarks on what is likely to be a long recovery process. As a result, **Suncor Energy SU** and **Tourmaline Oil TOU** were removed from the Consider Buy list, and **Enbridge ENB** and **TransCanada TRP** were removed from the Consider Hold list.

Our model recommended several additional changes to September's Core Pick list. Canadian Imperial Bank of Commerce was moved from the Core Buy list to the Core Hold list, while **Bank of Montreal BMO** was elevated to the Core Buy list from the Core Hold list. **CI Financial CIX** and **Restaurant Brands International QSR** were newly added to the Core Buy list, and **Valeant Pharmaceuticals International VRX** was shifted to the Core Hold list from the Core Sell list.

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**Economic Moat**

Morningstar's proprietary measure of the quantifiable, sustainable competitive advantage a company enjoys. All things held equal, we would expect a wide-moat firm to sustain relatively high returns on invested capital longer than a narrow-moat firm and a narrow-moat firm to sustain relatively high returns on invested capital for longer than a no-moat company.

**Uncertainty Rating**

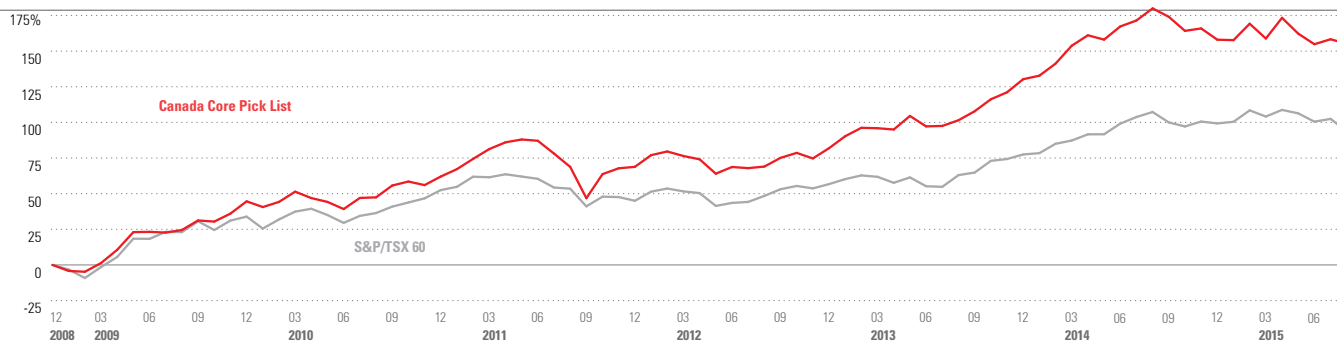
Morningstar's proprietary measure of the degree to which the economic value of a company is uncertain. Three factors go into the uncertainty rating: revenue variability, operational leverage, and financial leverage. The greater each of these measures, the greater the difficulty in bounding the ranges of possible outcomes for the firm.



Performance vs. S&P/TSX 60 (%)	This Month	Trailing 12 Months	2009	2010	2011	2012	2013	2014	Since Inception
Core Cons. Buying List	2.22	-8.85	44.46	12.04	4.16	7.78	26.74	12.04	155.18
S&P/TSX 60	-4.30	-6.52	33.93	13.89	-4.92	8.06	13.25	12.27	93.75

Inception: 1 Jan 2009

**Total Return: Canada Core Pick List vs. S&P/TSX 60 (%)**



**A Recap of the Stocks on This Month's Buying List**

**Cameco** remains on the list from last month. The stock trades at a 38.3% discount to our fair value estimate of \$30.

**Potash Corporation of Saskatchewan** remains on the list from last month. The stock trades at a 34.1% discount to our fair value estimate of \$52.

**National Bank of Canada** remains on the list from last month. The stock trades at a 32.3% discount to our fair value estimate of \$64.

**Bank of Montreal** was added to the list this month. The stock trades at a 23.7% discount to our fair value estimate of \$93.

**CI Financial** was added to the list this month. The stock trades at a 17.2% discount to our fair value estimate of \$38.

**Restaurant Brands International** was added to the list this month. The stock trades at a 8.2% discount to our fair value estimate of \$55.

**Canadian Pacific Railway** remains on the list from last month. The stock trades at a 7.7% discount to our fair value estimate of \$207.

**Rogers Communications** remains on the list from last month. The stock trades at a 6.4% discount to our fair value estimate of \$48.

**An Overview of the Canada Core Pick List**

The purpose of having a Consider Buy list and a Consider Hold list is to continually surface our best ideas in the Consider Buy list, while allowing users to track what's happened to former Consider Buy picks in the Consider Hold list. A Consider Buy list name "graduates" to the Consider Hold list once it is no longer among the top eight names based on our selection criteria, or once other fundamental factors have necessitated a change in our view of the company.

The Core Consider Buy list includes only Canadian companies with:

- Narrow or wide economic moats.
- A fair value uncertainty that is not very high or extreme.
- A market capitalization of greater than CAD 5 billion.

We keep sector exposure for the Consider Buy list capped at 38%. Because we use an absolute rather than a relative approach to a valuation, there will be times that some sectors have greater representation in the Consider Buy list than others. This is especially true for Canadian stocks, which tend to be concentrated among a few major sectors like financials, energy, and basic materials.

**The Morningstar Methodology**

The central tenet of the Morningstar approach to equity research is to buy strong businesses at appropriate margins of safety to what they're worth. This is what drives the star rating you'll find in each company report. A 5-star company is one we'd consider undervalued, meaning that its stock price is trading at a discount to its true worth that is greater than the margin of safety we'd need to consider buying it. A 1-star stock is, conversely, overvalued.

**Performance Tracking**

Morningstar tracks the performance of the Core Consider Buy and the Income Consider Buy lists on a trailing month, year-to-date, and trailing year basis. As more time passes, we'll be able to add longer terms of measurement. To track performance, we began with a fictional \$100,000 invested equally in each stock on the buy lists. At the end of each month, we reinvest the value of the lists (including dividends) back into the new buy list, again with equal weighting.

