

DM Monthly Report

OCTOBER 2018

PORTFOLIO ACTIVITY

In September, no new positions were added to DM portfolios and none were eliminated.

FEATURE STOCK

CP Rail (CP)

CP's very recent history is emblematic of many of the companies in DM portfolios and helps to underscore why we're not overly concerned about the recent market pullback. As part of its investor day on October 4th, the company pre-released Q3 results and estimated that quarterly revenues would grow by 19% to a record level of approximately \$1.9bn, with earnings per share jumping to \$4.35, also an all-time high. At the same time, management boosted full year guidance, with EPS now expected to climb by 20%, significantly higher than the low double digit gain that was previously forecast. As well, positive comments were made re: traffic volumes, pricing conditions, and cost control. On this news, the stock immediately surged from about \$272 to \$290 (or about 7%), but when the broad market fell, price retreated all the way to \$264. With the bounceback rally on Friday the 12th, CP shares recovered nicely to about \$270, but still sat below where they were when the market thought the company was going to earn significantly less. Needless to say, we like the outlook for our CP holdings at current price levels.

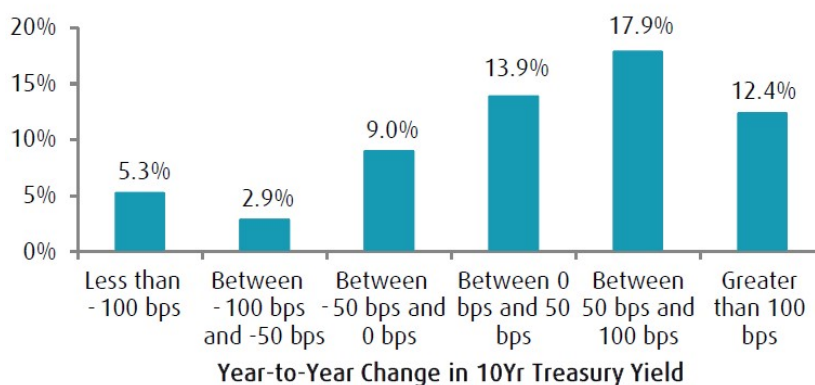
GOODBYE Q3

We bid farewell, not just to the calendar days of the third quarter, but to all of the equity gains accumulated during the period. Concerted selling in the second week of October precipitated a sharp decline in major markets and emphatically broke an extended run of calm that had seen the S&P 500 go 74 straight sessions without a single one closing up or down by more than 1%. Even worse, the plunge came just as envelopes were sealed on our Q3 client reports in which our commentary hailed the market's steadfast resilience in the face of so many potential selloff catalysts! (ugh)

As investors grapple with this dose of downside, a few points are worth noting:

- first, while no one can say for sure (even though many will present their theories with abounding confidence), the consensus seems to have settled on rising interest rates as the trigger for the market's latest wobble;
- if that's the case, the rate ascent is likely signaling a positive backdrop for future earnings; in other words, interest yields are climbing because the bond market is gaining confidence in the economic upswing and foresees a time when central bankers will need to tap the brakes to slow accelerating growth;
- that such a backdrop has tended to be positive for stocks as well as the economy is borne out by the data below which show that, since 1990, the S&P has generated its highest returns when the 10yr treasury yield is rising, not falling;
- companies in DM mandates continue to do very well (see CP to left) and we expect that upcoming quarterly earnings reports will help to reaffirm the fundamental case for stock ownership at this time;
- though some will attach great significance to the recent decline, the market fell by more last February when it shed about 10% in the month's first 6 trading days; by mid-summer, all was forgotten as stocks marched to new highs

S&P 500 Average Rolling 1Yr Performance Based on Year-to-Year Change in 10Yr Treasury Yield
monthly data, beginning 1990



Source: BMO Capital Markets