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## Canadian Equity Strategy (Bi-weekly)

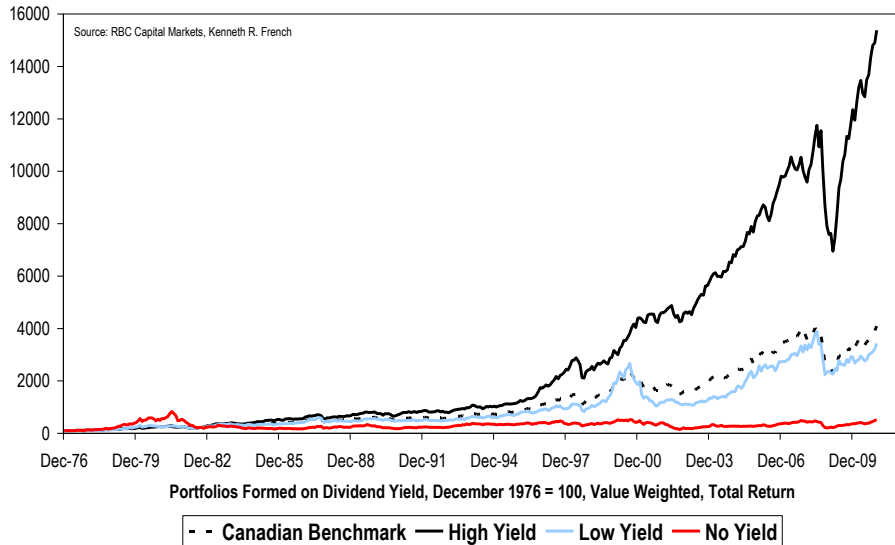
### Enhancing the High Income Portfolio

In this report, we take a deeper dive into Canadian dividend investing:

- **Relatively high dividend-yielding portfolios outperform through time.** This is a strategy shown by Professor Kenneth French to work well in several countries across the globe, including Canada. The problem with the professor's strategy for Canada is that many stocks in his portfolio would either be illiquid or too small to be bought or sold by institutional investors in an orderly manner.
- **A relatively simple, but more realistic, Canadian dividend strategy also adds substantial value.** We've tested several alternative methods, finding that sustainable high-yielding TSX large-cap companies generate high odds of outperformance.
- **The weighting structure of a TSX high-yielding portfolio does not seem to alter the conclusions all that much.** In this report, we highlight three variations of a high-yielding portfolio strategy: 1) Equal Weight, 2) Yield Weight, and, 3) Quintile Yield Weight with each of these portfolios outperforming their respective cohorts as well as the TSX 60. In our opinion, this work suggests that it is the dividend strategy more so than the choice of a weighting structure which determines overall performance.

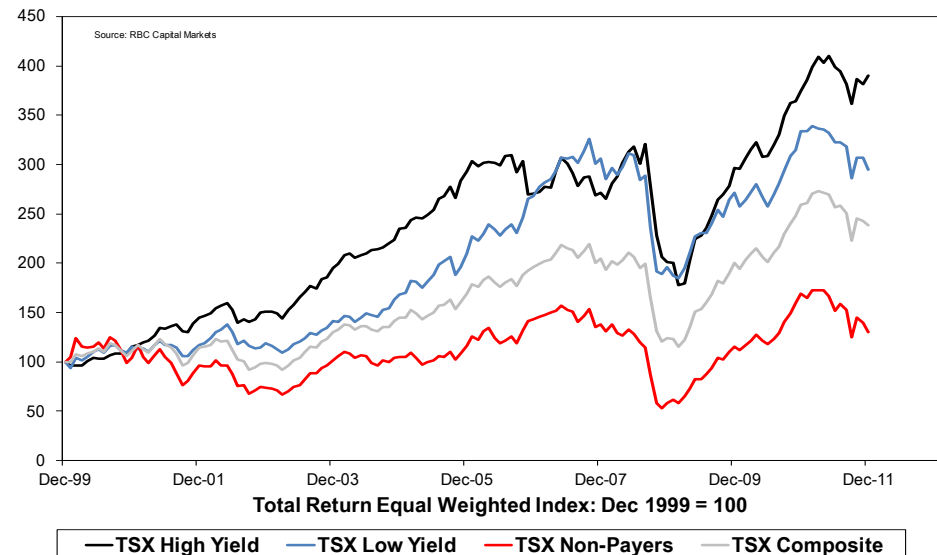
**Bottom Line:** A portfolio of relatively high-yielding TSX 60 stocks consistently outperforms its peers as well as the corresponding large-cap benchmark. The high-yielding portfolio also offers appealing risk-adjusted performance metrics. **Please see page 6 for a list of the current constituents of this strategy.**

# High Yield Portfolio Outperformance

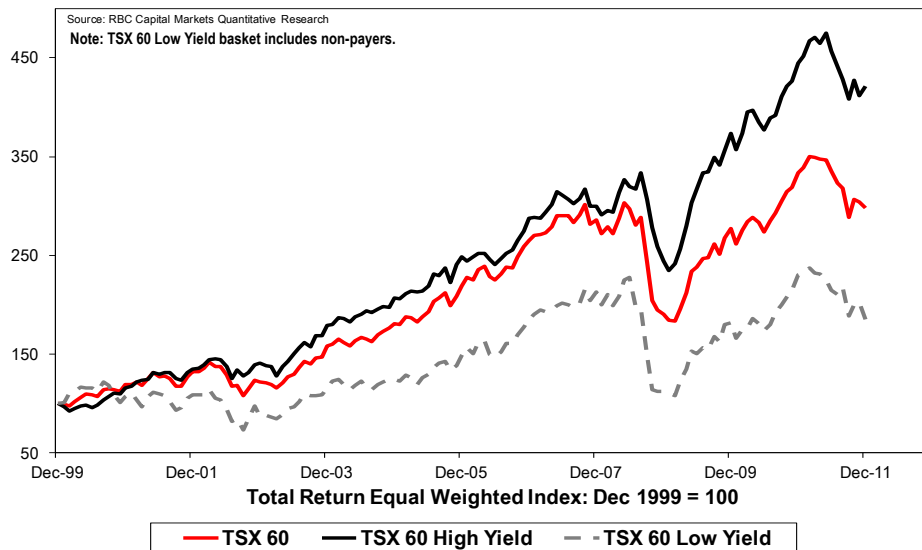


- Professor Kenneth French’s work shows that yield offers a significant performance advantage in several countries across the globe, including Canada. A portfolio of the top 30% of stocks based on yields in his Canadian universe beats its lowest ranked 30% of yielders and non-paying cohorts as well as his overall Canadian universe.

- In replicating the study for the TSX, based on a quarterly rebalance, we find a similar performance dynamic.
- The problem with the professor's strategy for Canada, and ours for the TSX Composite, is that many of the stocks in the high yield portfolios would either be illiquid or too small to be bought or sold by institutional investors in an orderly manner.



## Fine Tuning the High Yield Portfolio for Money Managers

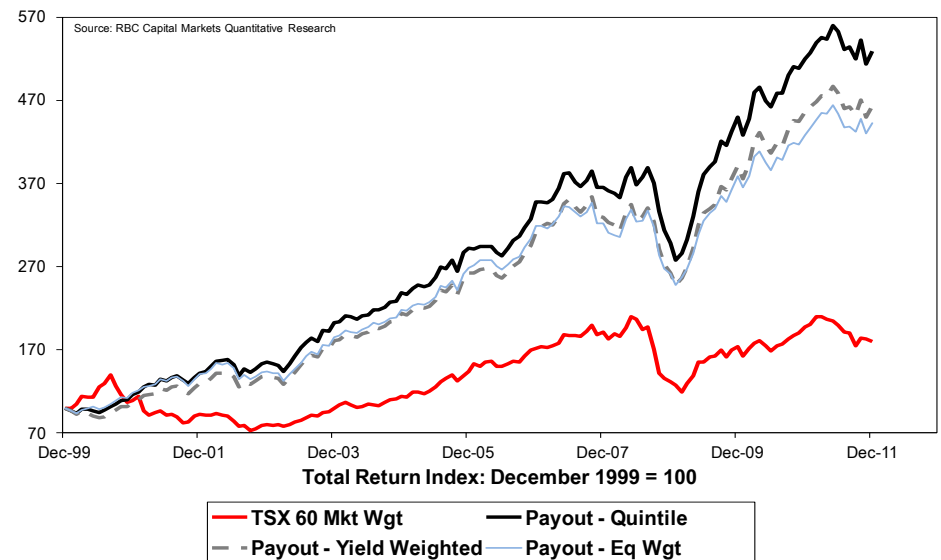


- We took our analysis one step further and applied various weighting structures to our high yielding-payout ratio baskets to see if we could generate even better results. Ultimately, the effort yielded three variations of our latest strategy: 1) Equal Weighted, 2) Yield Weighted, & 3) Quintile Yield Weighted.
- Each of these portfolios outperformed their respective cohorts as well as the TSX 60, meaning that it's the strategy rather than simply the weighting structure that determines overall performance.

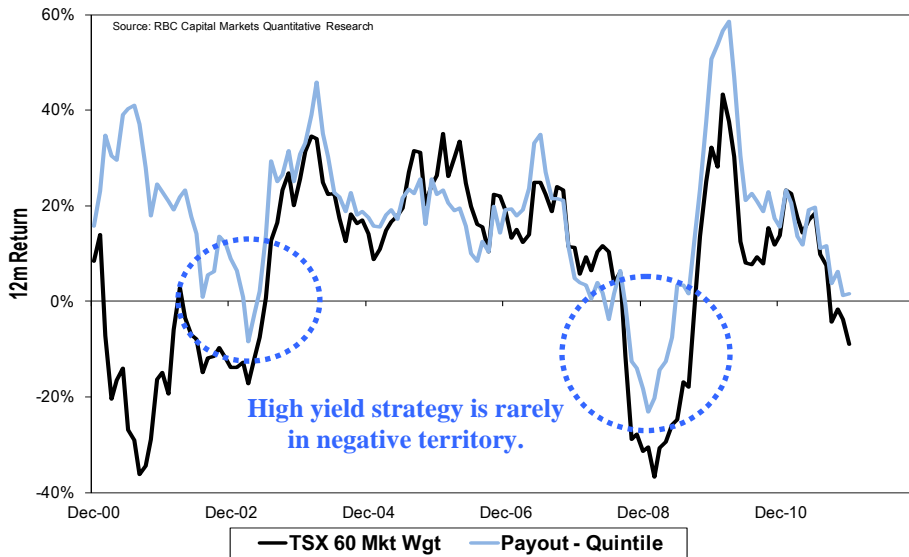
- We were hoping to find a similar performance dynamic within the TSX 60 given that it is a more money manager-friendly universe.
- Fortunately, the high yield strategy also proves to be successful within the TSX 60.

### Could this strategy be enhanced?

- First, we rounded down the number of stocks to be considered in the portfolio to an even 20.
- We tested several alternative methods and ultimately found that by introducing an additional hurdle of a payout ratio threshold, we were able to lower the downside risk while at the same time generate superior excess returns. In essence, this helps avoid the companies who might not be able to sustain their dividend in the future.

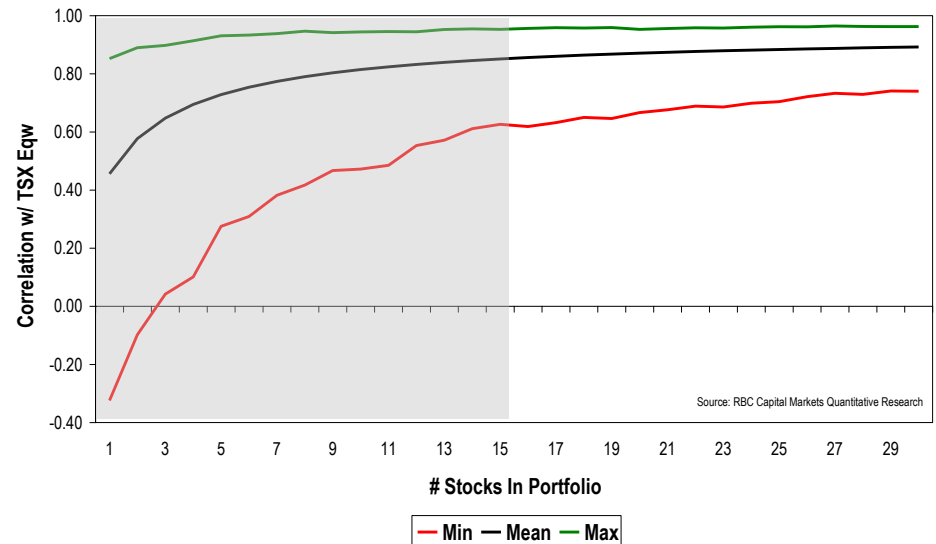


## Fine Tuning the High Yield Portfolio for Money Managers (cont'd)



- A rolling 12-month return analysis revealed that the strategy's returns mirror those of the market when the latter is expanding, but rarely suffers from drawdowns when the market is contracting.

- Lastly, a Monte Carlo analysis of the TSX confirmed that by limiting our portfolio to just 20 stocks, we should realize the majority of the benefits offered by diversification.



## Fine Tuning the High Yield Portfolio for Money Managers (cont'd)

TSX 60 Dividend Yield Portfolios		TSX 60	Quintile Wgt	Yield Wgt	Equal Wgt	
<b>Summary Statistics</b>						
Total and Risk-Adjusted Performance	Average Yield	2.13%	4.09%	4.02%	3.54%	Absolute and risk-adjusted outperformance.
	CAGR	5.0%	14.9%	13.6%	13.2%	
	Ann Alpha	-	11.9%	10.7%	10.3%	
	Beta	-	0.45	0.47	0.47	
	Corr w/ TSX 60	-	0.58	0.60	0.63	
	Sharpe Ratio	0.22	0.96	0.87	0.87	
	Sortino Ratio	0.14	0.79	0.70	0.69	
	Upside Potential Ratio	6.69	13.13	12.69	12.48	
Absolute Downside Performance	Worst 12m Return	-36.8%	-23.1%	-23.2%	-20.5%	Superior downside protection.
	% Negative 12m Periods	33.1%	9.0%	13.5%	15.8%	
	Median 12m Return TSX <0	-14.8%	6.3%	5.3%	3.3%	
	Max Drawdown	-47.6%	-28.6%	-29.9%	-28.6%	
	Duration Underwater	60	11	22	22	
Relative Downside Performance	Worst 12m Return	-	-13.2%	-16.4%	-14.2%	
	% Negative 12m Periods	-	25.6%	27.8%	30.1%	
	Median 12m Return TSX <0	-	21.0%	20.8%	19.3%	
	Max Drawdown	-	-29.3%	-34.3%	-27.2%	
	Duration Underwater	-	49	50	54	

Source: RBC Capital Markets Quantitative Research

- A closer look at the performance metrics for each of the portfolios suggests that, regardless of our weighting scheme, the strategy substantially outperformed on an absolute and risk-adjusted basis, as well as provided significant downside protection.

**Bottom Line:** A portfolio of relatively high-yielding TSX 60 stocks consistently outperforms its low-yielding peers as well as the corresponding large-cap benchmark. The high-yielding portfolio also offers appealing risk-adjusted performance metrics. **Please see page 6 for a list of the current constituents of this strategy.**

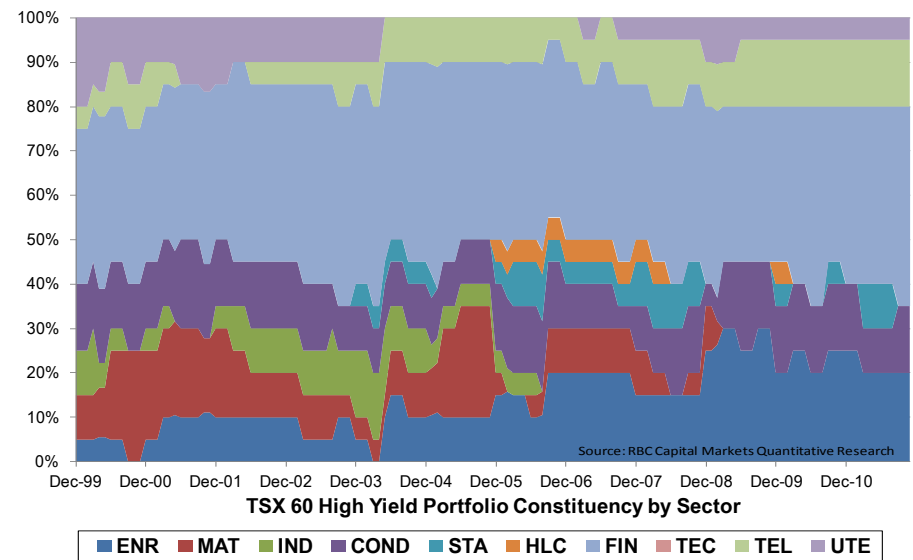
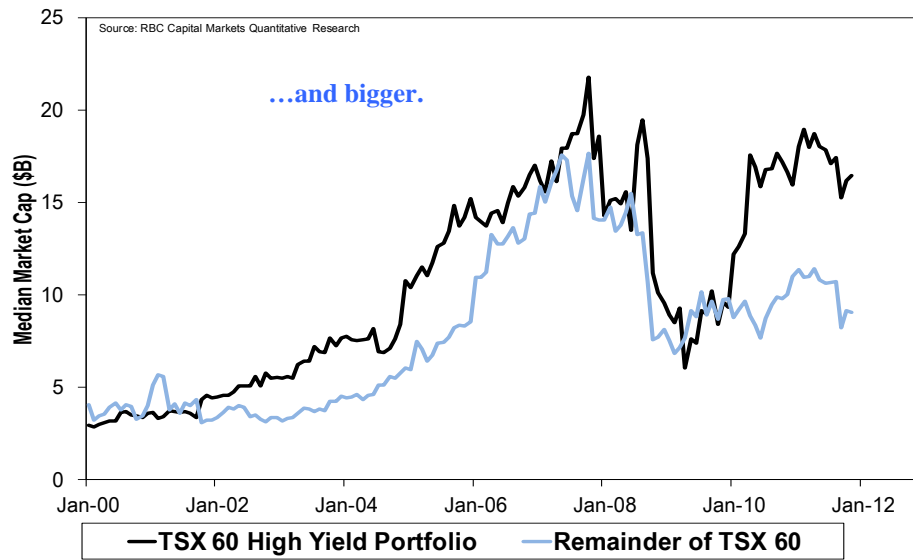
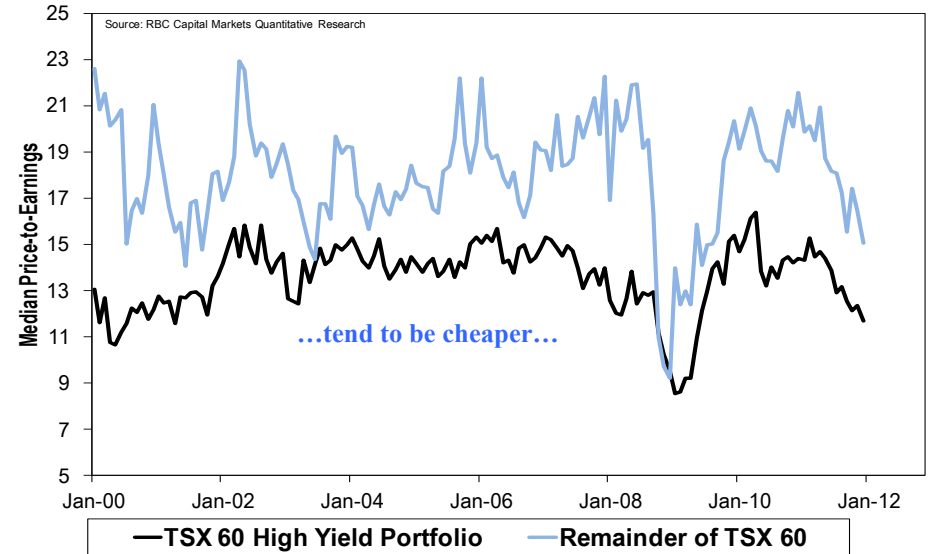
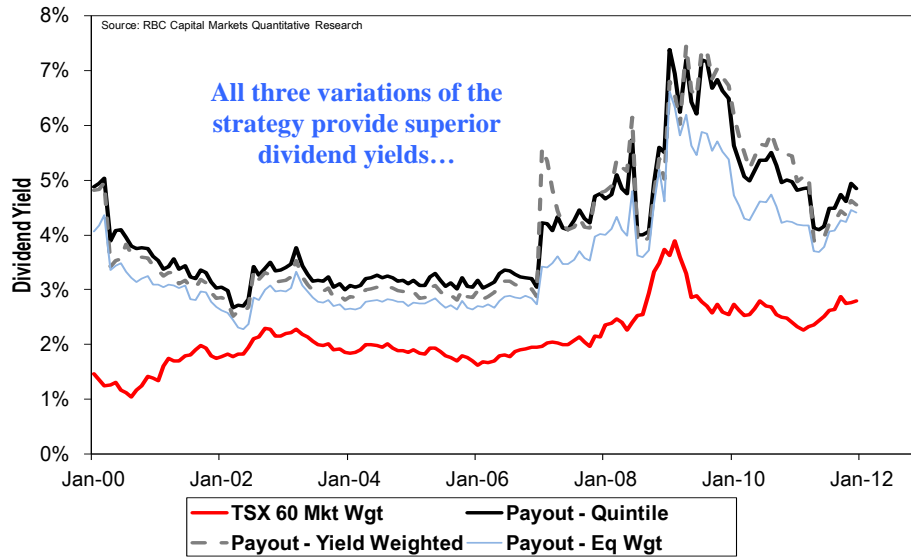
## TSX 60 High Yielding Portfolio

TSX 60 High Yield Index - Q1 2012 Constituents			
Name	Ticker	Yield	Payout Ratio
Canadian Oil Sands Ltd	COS	5.2%	47.4%
Bank Of Montreal	BMO	5.0%	52.6%
Husky Energy Inc.	HSE	4.9%	58.5%
Canad'n Imp Bank Of Commerce	CM	4.9%	48.3%
BCE Inc.	BCE	4.9%	66.8%
Power Corp. Of Canada	POW	4.9%	47.9%
Manulife Financial Corp.	MFC	4.8%	54.7%
Thomson Reuters Corp	TRI	4.6%	74.0%
Shaw Communications Inc. 'B'	SJR.B	4.5%	59.7%
National Bank Of Canada (Restricted)	NA	4.2%	42.3%
Bank Of Nova Scotia (The)	BNS	4.1%	47.2%
TELUS Corporation	T	3.8%	59.0%
TransCanada Corporation	TRP	3.8%	74.0%
Rogers Communications Inc B	RCI.B	3.6%	48.0%
Fortis Inc.	FTS	3.6%	67.4%
Toronto-Dominion Bank (The)	TD	3.6%	41.1%
Magna International Inc. 'A'	MG	3.0%	22.7%
Enbridge Inc.	ENB	3.0%	77.9%
Bombardier Inc. 'B'	BBD.B	2.5%	18.1%

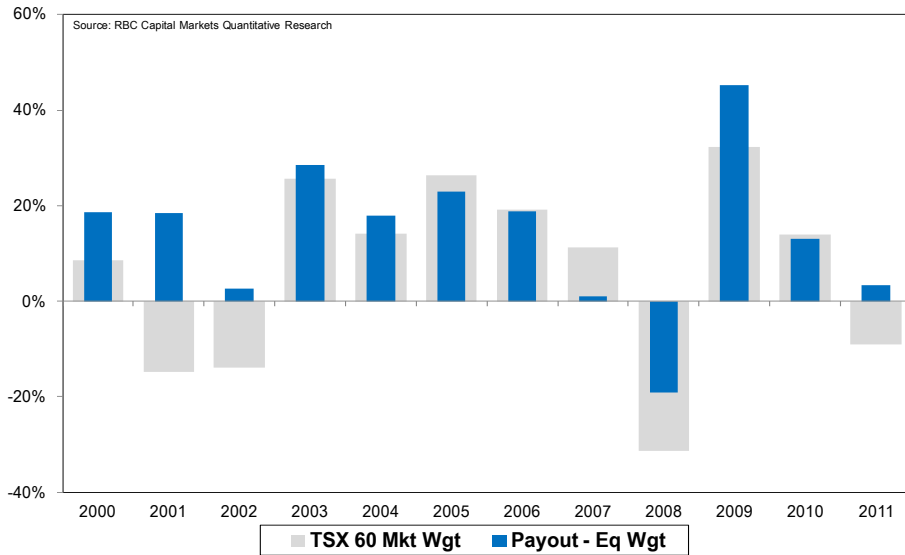
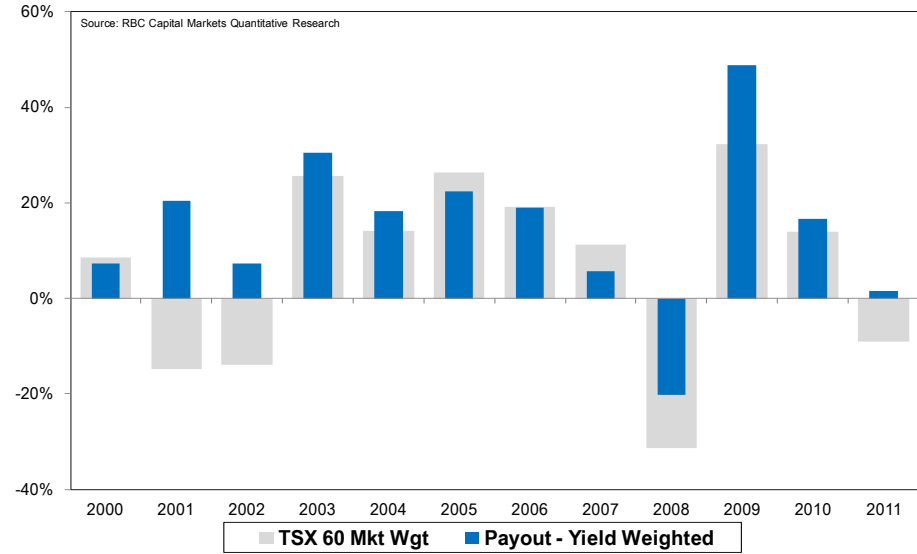
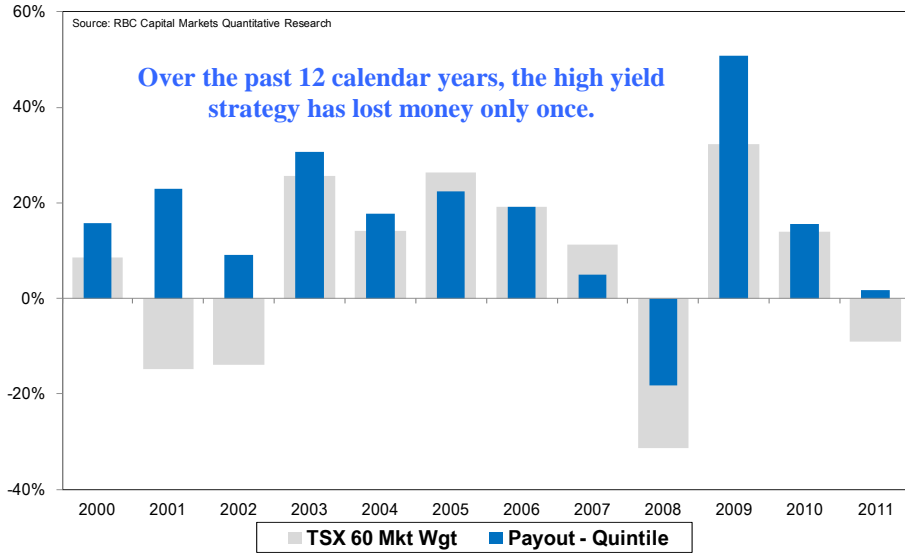
Note: Stats as of December 31, 2011

Source: RBC Capital Markets Quantitative Research

# Appendix: High Yield Index Characteristics



# Appendix: High Yield Index Characteristics (cont'd)



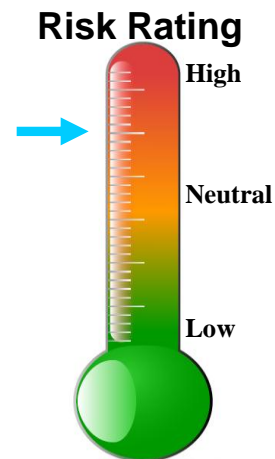


## RBC CM North American Market Views

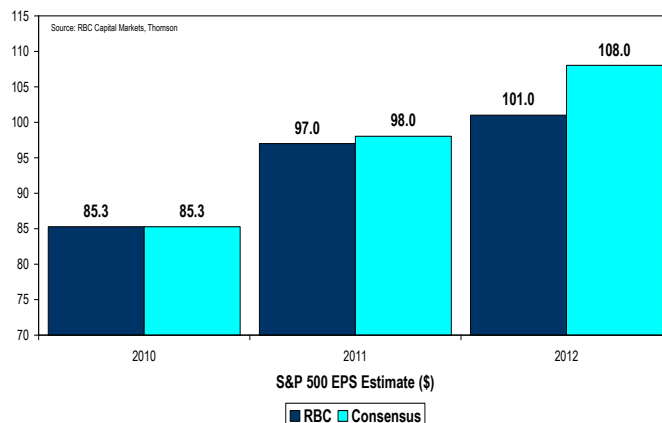
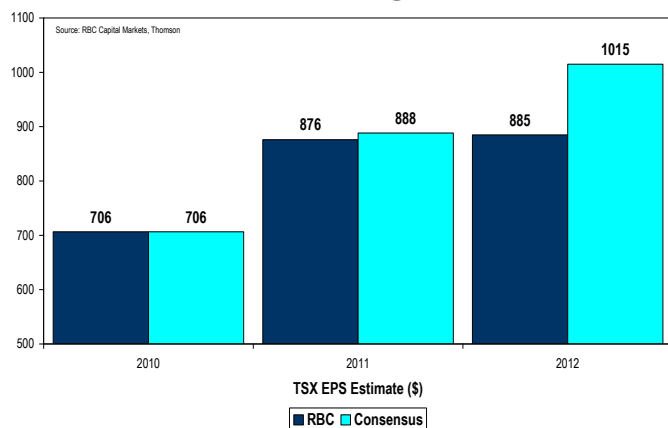
### Market Outlook (Next 6 - 9 months)

Overweight	
Market Weight +	X
Market Weight	
Market Weight -	
Underweight	

▲/▼ Directional Bias. Source: RBC Capital Markets



### TSX & S&P 500 Earnings Outlook



### TSX Sector Recommendations

#### RBC CM Recommended TSX Exposure

Canadian Equity Sectors	Current Recommendation	Recent Change (January 4, 2012)
Industrials	Overweight	Upgraded from Underweight
Financials	Overweight	None
Consumer Staples	Overweight	None
Telecom Services	Overweight	None
Consumer Discretionary	Market Weight	None
Materials	Market Weight	None
Health Care	Market Weight	None
Utilities	Underweight	Downgraded from Overweight
Information Technology	Underweight	None
Energy	Underweight	None

Source: RBC Capital Markets

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<b>HOLD[SP]</b>	<b>649</b>	<b>43.30</b>	<b>137</b>	<b>21.11</b>
<b>SELL[U]</b>	<b>70</b>	<b>4.70</b>	<b>7</b>	<b>10.00</b>

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