PALOS

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Weekly Commentary

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The Big Six Report Card Gets Straight "A's"

Tuesday February 23 kicked off 'earnings week' for Canada's Big Six Banks. As a sector the economically sensitive banking sector underperformed for much of 2020. Obviously, the pandemic's disruption of the economy and the impact on consumers had an impact. For Q1 the Big Six reported approximately $1.6 billion in combined credit losses. While this may seem enormous, this was well below what was expected.

Bank of Montreal (BMO) and Bank of Nova Scotia (BNS) reported on Tuesday before markets opened. ***BMO*** announced adjusted Earnings per Share (EPS) of $3.06, significantly beating consensus estimates. Revenue was up by 6% from the year prior with strength in BMO Capital Markets, mortgage growth, and lower than expected loan provisions. U.S. operations were strong. BMO shares climbed by 4.6% on the week. ***BNS*** reported adjusted EPS $1.88, up 30% quarter-over-quarter (Q/Q) and 3% year-over-year (Y/Y). Despite some weakness from international operations BNS shares were higher by 5.8% as investors look to better times ahead.

On Wednesday, **Royal Bank** (RY) and **National Bank** (NA) stepped to the plate with RY reporting adjusted EPS of $2.26 (+10% Y/Y) and NA (adjusted EPS $2.15, +26% Y/Y), both beating consensus. ***Royal*** was driven by stronger than expected revenues in capital markets and wealth management. ***National Bank*** 'nailed it' with strong results from capital markets, wealth management, domestic retail, and investment banking. By Friday's close, RY showed the weakest performance on the week (+0.32%) while NA was the strongest amongst its peers (+6.8%).

Thursday closed out 'earnings week' with a 6-for-6 sweep by the Bix Six. TD Bank (adjusted EPS $1.77, +10%) beat estimates with lower credit costs and retail banking +14% Y/Y (mortgages, personal). ***CIBC*** (adjusted EPS $3.58) saw strong domestic performance from the mortgage business and elevated trading activity in the capital markets segment. Higher revenues in fixed-income, equities and currency trading saw profits +30% Q/Q. On the week TD shares rose 2.6% with CM higher by 3.1%.

Early in 2020 the ***OFSI*** (Office of the Superintendent of Financial Institutions) instituted pandemic related measures designed to protect our financial system. These measures included restrictions on dividend increases, share buyback programs and executive compensation. OFSI has publicly stated that there is no

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rush to ease these restrictions until the economic damage stemming from COVID-19 is well behind us. However, given plenty of excess capital currently in the system, expectations are rising that restrictions could be lifted in Q2. This would be a tailwind for the banks with potential dividend growth and U.S. acquisitions back in play.

Another catalyst for banks is the simple fact that as the summer months approach and vaccination programs pick up steam, the impact of lockdowns and restrictions should mitigate. If Q2 and Q3 growth projections are accurate and we receive a strong boost in economic activity, demand for consumer borrowing, commercial credit, and mortgages will surely follow. Mortgage demand has been strong despite the pandemic and persistent low rates are a boon for the housing market. The banking sector has emerged from the depths of the crisis in good shape thus concerns about weathering the pandemic appear to be in the rear-view mirror.

Not to be overlooked was the sharp rise in 10-year U.S. bond yields over the past week. As a rule of thumb, rising rates are beneficial to bank profitability. If markets are accurately signaling that interest rates are nearing a bottom, this should be supportive of the banking sector. Our Canadian banks have a well-earned reputation as conservative, 'best-in-class', dividend growing enterprises. We continue to view our Canadian banks as stable components of any income seeking portfolio.

The **Palos Income Fund LP** and the **Palos Equity Income Fund** continue to hold core positions in BMO, BNS, NA, RY and TD.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$9.31	6.41%
Palos Equity Income Fund - RRSP	PAL101	$6.77	6.01%
Palos Merchant Fund L.P. (Dec 31, 2020) [2]	PAL500	$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL210	$24.45	53.16%
Palos-Mitchell Alpha Fund [3]	PAL300	$13.32	11.90%
S&P TSX Composite (Total Return with dividends reinvested)			4.03%
S&P 500 (Total Return with dividends reinvested)			1.71%
S&P TSX Venture (Total Return with dividends reinvested)			16.38%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			1.40%
Canadian Government 10-Year			1.36%
Crude Oil Spot			US $61.50
Gold Spot			US $1728.80
US Gov't10-Year/Moody BAA Corp. Spread			214 bps
USD/CAD Exchange Rate Spot			US $0.7850

[1] *Period ending February 26, 2021. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

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