Why These 2 Blue-Chip Names Could Outperform the Market

Description

Canadian investors should take careful note of **Canadian National Railway Company's** (TSX:CNR)(NYSE:CNI) Q3 results—they reported an 18% increase in net income (and over half of the increase was due to revenue growth). These are hugely impressive results considering the Canadian economy was in a technical recession and commodity prices are at multi-year lows.

What was CN's secret to success? Outside of operational excellence and inherit competitive advantages, it was CN's strong exposure to key sectors of the U.S. economy that drove growth.

The outlook for the Canadian economy is much weaker than other major economies (particularly the U.S.), and geographic diversification and exposure outside of Canada will be key to outperforming the market going forward.

Fortunately, this does not mean you need to buy U.S. stocks directly. Canadian investors can take advantage of the large U.S. exposure of Canadian blue-chip names. It is no surprise that CN is one of these names, and investors would also be wise to consider **Bank of Montreal** (TSX:BMO)(NYSE:BMO) given its large and growing U.S. business.

Why Canadians should look south

A recent slew of economic statistics reveal that Canadians need to look south if they want to generate market-beating returns over the next several years. The Canadian economy is expected to grow by only 1% this year and 1.7% next year. This is compared to the U.S. economy, which is expected to grow by about 2.6% both years.

Canada's output growth is being limited by weakness in commodity exports, which are being affected by a permanent slowdown in the Chinese economy as the country shifts from investment to household consumption. China is the world's largest importer of many key commodities like coal and oil, and this will serve as a long-term headwind for the Canadian economy.

The U.S., however, is a net importer of oil, and the decline in gas prices has led to a boost in consumer spending. Combining this with low interest rates and low debt levels means the U.S. will see consumer spending grow by 3.1% in 2016, residential investments grow by 7.2%, and business investments grow by 4.4%. This is compared with 2.1%, -0.7%, and 0.5%, respectively, for Canada.

CN Rail has strong exposure to U.S. consumer spending

CN's recent revenue growth came largely from three segments: forest products, intermodal, and automotive, all of which had boosts in both volume and pricing. Each of these three segments are heavily exposed to the U.S. economy, which was their source of growth.

The company's largest segment—intermodal—comprises 24% of revenue. About 30-40% of the revenue in this segment comes from transporting consumer goods to and from the U.S. as well as within the United States. This gives CN a direct play on solid U.S. consumer spending.

Thirteen percent of CN's revenues also come from forest products, and these products are largely transported from western Canada to U.S. destinations, where demand is rapidly growing thanks to the booming U.S. housing construction market.

CN also has U.S. consumer spending exposure through its automotive segment, where it connects auto production plants to destinations throughout North America.

Bank of Montreal has a quickly growing U.S. segment

Bank of Montreal also offers U.S. exposure for investors looking for exposure to U.S. consumer as well U.S. businesses. BMO currently obtains about 20% of net income from its U.S. operations, and the bank has a particular strength in commercial banking.

BMO recently accomplished 13 consecutive quarters of double-digit commercial loan growth, and the bank's overall U.S. personal and commercial segment has also been experiencing double-digit growth (11% year over year). This is compared with its Canadian segment, which has been experiencing growth in the 6-7% range.

The bank recently made a move to deepen its U.S. exposure by purchasing **General Electric's** Transportation Finance business, which has 90% of its assets located across the United States. The acquisition brings total U.S. loans to 32% of overall loans, and the transportation sector is a strong play on overall U.S. growth.

BMO is an excellent way to gain access to U.S. economic growth from the safety of a Canadian bank.

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