



Market Bulletin

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Commentary – US equity indexes in uncharted territory

What's driving this rise? Record earnings thanks to the highest operating margins in history

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In ancient times, maps used to bear the legend “here be dragons” to indicate uncharted territories or waters where unknown dangers could lurk. Perhaps a similar cautionary sign should be appended to present-day charts of the Dow Jones Industrial Average and the S&P 500, now that these indexes are in unexplored territory as they surge to new highs (Figure 1). Actually, the two indexes have been breaking new ground since spring of this year, with the DJIA and S&P 500 smashing past their previous record of 14,198 and 1,576 (both set in October 2007) on March 5 and April 10, 2013, respectively. Last week, the DJIA vaulted over the 16,000 level and the S&P 500 breached the 1,800 level for the first time. The indexes are now about 13% to 14% past their October 2007 records, with the DJIA more than 1,850 points higher and the S&P 500 about 225 points higher. Uncharted territory indeed!

Although this relentless advance may seem frothy at times, it is being driven by real earnings growth, which in turn is the result of operating margins for the S&P 500 that are the highest they have ever been. Howard Silverblatt, senior index analyst at S&P, estimates operating margins for S&P 500 companies overall reached 9.61% in Q3 (Table 1), beating the previous record of 9.60% set in Q3 of 2006. Silverblatt expects margins to set a new record in Q4.

As a result, S&P 500 index EPS is estimated to increase 10.7% this year (from \$96.82 in 2012 to \$107.19 in 2013), and accelerate to a 12.7% growth pace next year, to an estimated \$120.81. On that basis, the S&P 500 is trading at forward multiples of 16.8x forecast FY13 EPS, and 14.9x FY 14 forecast FY14 EPS. **Though multiples are getting stretched, they are not yet at levels that have marked previous peaks, so while we believe this parabolic rise in US indexes will eventually end badly, the rally may still have room to run. Overall, your inclination to test this unexplored market terrain should be wholly dependent on your risk tolerance level.**

Table 1: S&P 500 Operating Margins – 2006 to 2013

QTR	2013	2012	2011	2010	2009	2008	2007	2006
Q4		8.04%	8.70%	8.68%	7.27%	-0.04%	5.68%	8.86%
Q3	9.61%	8.92%	9.51%	8.95%	6.94%	5.96%	8.06%	9.60%
Q2	9.51%	9.41%	9.44%	8.83%	6.19%	6.11%	9.41%	9.35%
Q1	9.52%	9.07%	8.99%	8.34%	4.56%	6.25%	9.23%	9.03%

Source: Howard Silverblatt, S&P Senior Index Analyst

Figure 1: DJIA, S&P 500 and Nasdaq Composite – 20 years (1993 to 2013 YTD)



Source: Bloomberg

Chart of the Day – Interesting divergence between TSX Composite and loonie
Tight correlation until mid-2011 has broken down as TSX trades at 2½-year high

The TSX and C\$ are going their separate ways as the index trades at its highest since July 2011 even as the C\$ tests support at USD 0.95, a full 10 cents lower than its levels at that time. The C\$ should recover next year, in our view, as global interest is reignited in the TSX, but even if it continues to flounder, a weaker loonie would be positive for Canadian corporate earnings.

Figure 2: TSX Composite vs. C\$ – 2008 to 2013 (Source: Bloomberg)



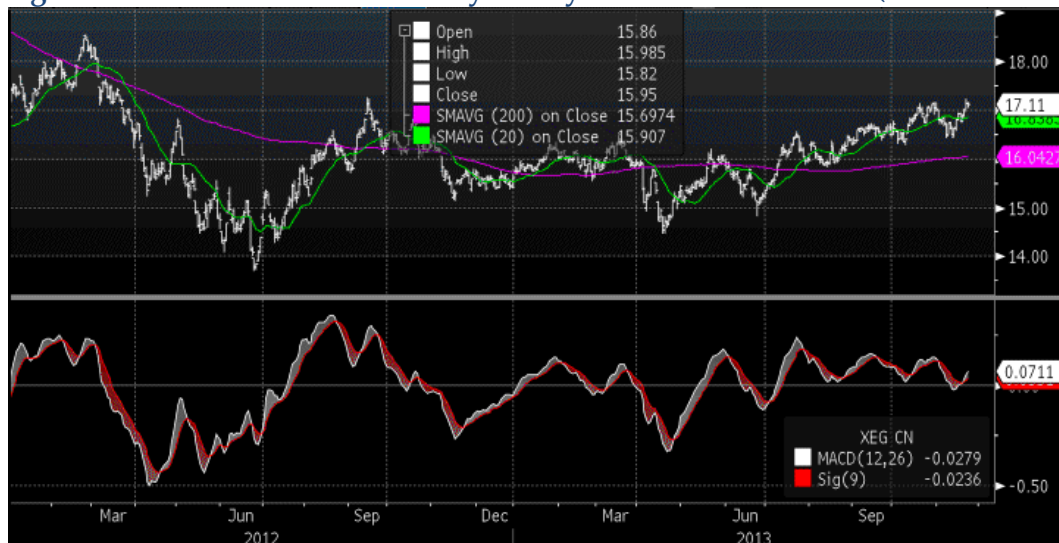
ETF Watch – XEG appears to be breaking out, XDV nears 2007 record high

Over past 10 years, XEG is +9.8% from December to May, -1.4% from June to November

The iShares TSX Capped Energy Index Fund (XEG, \$17.11) appears to be breaking out (Figure 3) and should be an easy short-term trade. There is a strong element of seasonality to this ETF over the past 10 years that is a slight variation of the well-known “Sell in May and go away” market phenomenon. Over the 10-year period from 2004 to 2013, the XEG ETF has advanced by an average of 9.8% cumulatively from December to May, and has declined 1.4% over the June to November period. On a technical basis, the MACD recently registered a bullish crossover; the positive crossover between the 200-day and 20-day moving averages that took place in September is also encouraging, as both MAs are in a rising trend. The ETF’s top five weights presently are – Suncor (19.8%), Canadian Natural Resources (13.1%), Cenovus Energy (8.1%), Crescent Point Energy (5.4%), and Encana (5.2%). The ETF has an indicated dividend yield of 2.5%.

An ETF that appears poised to set a new record imminently is the **iShares Dow Jones Canada Select Dividend Index Fund (XDV, \$24.36)**, which is within striking distance of its July 2007 high of \$24.63. The XDV ETF has trounced the TSX Composite by almost 54 percentage points (total returns basis) since the beginning of this rally in March 2009, with a total return of 158%, compared with 104% for the TSX. The ETF has benefited from its overweighting in the financial sector, with a 56% combined weight in banks, insurance companies and diversified financial services. The ETF is also overweight in telecoms (13.6%), but is underweight in Energy (11.9%, vs. 24.7% for the TSX) and has no representation from the Materials sector. It has an indicated dividend yield of 4.0%.

Figure 3: XEG – MACD and 200-day/20-day MA – 2012 to Present (Source: Bloomberg)



Screen Shots – US stocks with very high P/S ratios that have doubled YTD

Signs of a biotech bubble?

There is little doubt that with US indexes hitting new highs, certain sectors and stocks are exhibiting “frothy” behaviour. In a bid to identify such stocks, we screened the Russell 3000 for equities that have doubled YTD and that are trading at a Price/Sales multiple of at least 10.

As can be seen in Table 2, 42 stocks satisfied these criteria. As many as 19 of these stocks are from the Biotechnology sector; if we include all the pharmaceuticals and others, the Health Care segment accounts for 26 stocks, or 62% of the total. Technology-related stocks are a distant second, at 9. It might be best to avoid these names, given the downside risks to these high-fliers if and when market sentiment turns.

Table 2: Russell-3000 companies with P/S > 10, YTD gains >100% (ranked by P/S)

Ticker	Short Name	GICS Sector	GICS Sub-index	Market Cap (\$mm)	Last Px	Price/Sales	YTD chg.(%)
AMPE	AMPIO PHARMACEUT	Health Care	Pharmaceuticals	\$324.7	\$7.71	5576.5	117.0
ACAD	ACADIA PHARMACEU	Health Care	Biotechnology	\$2,048.1	\$22.34	1151.0	383.2
PRTA	PROTHENA CORP PL	Health Care	Biotechnology	\$585.1	\$27.11	391.7	248.6
GERN	GERON CORP	Health Care	Biotechnology	\$700.1	\$5.27	383.9	268.8
GALE	GALENA BIOPHARMA	Health Care	Biotechnology	\$408.3	\$4.00	308.9	128.1
CLDX	CELLDEX THERAPEU	Health Care	Biotechnology	\$2,349.7	\$28.31	279.8	288.8
KERY	KERYX BIOPHARM	Health Care	Biotechnology	\$1,052.0	\$12.85	143.2	388.9
PCYO	PURE CYCLE CORP	Utilities	Water Utilities	\$157.2	\$6.25	108.3	134.6
AEGR	AEGERION PHARMAC	Health Care	Biotechnology	\$2,011.4	\$71.55	85.1	168.7
ALNY	ALNYLAM PHARMACE	Health Care	Biotechnology	\$3,670.4	\$58.33	76.1	208.4
INSM	INSMED INC	Health Care	Biotechnology	\$605.8	\$15.30	42.1	127.5
ANAC	ANACOR PHARMACEU	Health Care	Biotechnology	\$527.7	\$12.83	40.0	146.3
OPK	OPKO HEALTH	Health Care	Biotechnology	\$4,001.2	\$9.99	34.8	106.7
LNG	CHENIERE ENERGY	Energy	Oil & Gas Storage & Trans.	\$9,539.1	\$39.98	32.4	109.2
ISIS	ISIS PHARM	Health Care	Biotechnology	\$4,153.1	\$36.18	30.6	220.2
PCRX	PACIRA PHARMACEU	Health Care	Pharmaceuticals	\$1,846.7	\$54.63	29.0	206.7
SPLK	SPLUNK INC	Information Tech.	Application Software	\$7,640.9	\$73.56	28.1	106.4
HALO	HALOZYME THERAPE	Health Care	Biotechnology	\$1,601.0	\$14.09	24.6	108.1
LGND	LIGAND PHARM-B	Health Care	Biotechnology	\$1,108.3	\$53.54	22.8	150.7
TEAR	TEARLAB CORP	Health Care	Health Care Supplies	\$282.8	\$8.59	21.6	112.2
HPTX	HYPERION THERAPE	Health Care	Biotechnology	\$499.0	\$24.79	21.0	114.4
YELP	YELP INC	Information Tech.	Internet Software & Services	\$4,397.8	\$62.39	19.6	239.2
SCTY	SOLARCITY CORP	Industrials	Electrical Components & Equip.	\$3,825.3	\$46.59	18.2	302.5
INCY	INCYTE CORP	Health Care	Biotechnology	\$7,822.4	\$48.52	18.2	188.6
DWRE	DEMANDWARE INC	Information Tech.	Internet Software & Services	\$1,862.1	\$55.50	17.7	104.4
NPSP	NPS PHARM INC	Health Care	Biotechnology	\$2,456.6	\$23.86	17.5	155.9
DXCM	DEXCOM	Health Care	Health Care Equipment	\$2,334.4	\$32.41	16.2	141.1
DYAX	DYAX CORP	Health Care	Biotechnology	\$980.5	\$8.03	15.7	131.3
DDD	3D SYSTEMS CORP	Information Tech.	Computer Hardware	\$7,600.6	\$73.30	15.1	103.0
Z	ZILLOW INC-CL A	Information Tech.	Internet Software & Services	\$2,893.1	\$73.06	14.5	170.2
FNGN	FINANCIAL ENGINE	Financials	Asset Management & Custody Banks	\$3,342.9	\$66.60	14.4	138.0
WETF	WISDOMTREE INVES	Financials	Asset Management & Custody Banks	\$1,845.1	\$14.34	14.0	117.3
TRIP	TRIPADVISOR INC	Consumer Disc.	Internet Retail	\$12,406.3	\$87.40	13.9	108.2
MAKO	MAKO SURGICAL	Health Care	Health Care Equipment	\$1,540.3	\$29.93	13.0	132.8
FLDM	FLUIDIGM CORP	Health Care	Life Sciences Tools & Services	\$825.0	\$32.07	12.4	126.8
MITK	MITEK SYSTEMS	Information Tech.	Application Software	\$196.7	\$6.58	12.2	108.1
FLT	FLEETCOR TECHNOL	Information Tech.	Data Processing & Outsourced Services	\$10,036.8	\$120.93	11.7	122.5
MDSO	MEDIDATA SOLUTIO	Health Care	Health Care Technology	\$3,190.2	\$120.00	11.7	198.9
CSGP	COSTAR GROUP INC	Information Tech.	Internet Software & Services	\$5,210.6	\$180.56	11.6	102.8
SSTK	SHUTTERSTOCK INC	Information Tech.	Internet Software & Services	\$2,596.6	\$74.23	11.4	181.7
FANG	DIAMONDBACK ENER	Energy	Oil & Gas Exploration & Production	\$2,442.8	\$51.53	11.2	170.6
CELG	CELGENE CORP	Health Care	Biotechnology	\$67,212.7	\$163.33	11.0	102.1

Market Snapshot

At close on Friday, November 22, 2013

S&P TSX	13478.34	+3.01	Commodities			Yields (%)	Can.	US
TSX Venture	932.15	+5.44	Canadian \$ (US cents)	95.11	+0.04	90 Day T-Bill	0.93	0.07
DJIA	16064.77	+54.78	Gold (Spot)-US\$	1243.63	+0.55	2-Year Bond	1.10	0.28
S&P 500	1804.76	+8.91	Oil (WTI-Dec.)	94.84	-0.60	10-Yr. Bond	2.57	2.74
NASDAQ	3991.65	+22.49	CRB Index	275.21	-0.34	30-Yr. Bond	3.14	3.83

Thought for the Day

"Think like a man of action, and act like a man of thought." – Henri Bergson

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Buy: Expected total returns of 10% to 20% over the next 6 – 12 months.

Speculative Buy: Significant gains expected over the next 6 – 12 months, but entire investment may be at risk.

Hold: Expected total returns of 0% to 10% over the next 6 – 12 months.

Reduce: Expected total returns of up to -10% over the next 6 – 12 months.

Sell: Expected total returns of over -10% over the next 6 – 12 months.

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