Market Bulletin

Issue No. 248
April 17, 2014

Summary

Currencies: Canadian dollar at inflection point as bearish factors abate.
Chart of the Day: Correlation between TSX and global growth may drive index to new record.
Screen Shots: Total returns over past year for 24 large-cap energy stocks averages 35.4%.
ETF Watch: Energy ETF (XEG) at best levels since July 2011, dividend ETF (XDV) at new high.

Commentary – Equities rebound on earnings, easing of Ukraine tensions

TSX at six-year high of 14,500, less than 5% away from record high

Elvis Picardo, CFA

The "Sell in May and go away" phenomenon may be looming around the corner, but equities staged a strong rebound this week, boosted by healthy earnings from U.S. corporate bellwethers and an easing of tensions in Ukraine. We summarize these factors below –

- **Ukraine accord takes first steps at de-escalation**: Four-way talks on the Ukraine crisis (involving Russia, Ukraine, the U.S. and European Union) resulted in an accord that could de-escalate the conflict. Tensions in the region have been rising after Crimea joined Russia last month, with pro-Russian separatists seizing government buildings in eastern Ukraine and an estimated 40,000 Russian troops massed on Ukraine's border. While the accord is a step in the right direction, the situation remains fraught with peril and should be monitored over the long weekend for its potential market impact.
- **Q1 earnings performance driving stock performance**: Perhaps as a result of recent market volatility, which has spurred profit-taking in last year's hottest stocks, investors are paying close attention to corporate earnings. Bellwethers like Intel and General Electric have seen their shares rise after topping earnings estimates, while IBM and Google traded lower today after missing estimates. While it's still a bit early to assess how this earnings season is shaping up, the overall tone seems to be mildly bullish.
- **Energy stocks propel TSX to six-year high**: Rising crude oil prices have caused a breakout in the energy group, which is in turn boosting the TSX. The index is up 6.5% YTD, with the top three groups being Energy (+14.1%), Utilities (+9.3%) and Materials (7.7%). The TSX is currently only 4.5% away from its record high of 15,154.77 set in June 2008, and on current form, looks like it could breach this level in the next 6-12 months.

Currencies

Canadian dollar at inflection point

Direction of monetary policy in Canada and U.S. not as divergent as it seemed a month ago

Rapid developments in recent weeks have forced us to reassess our outlook for the Canadian dollar more often than we would have liked. As recently as March 21, we were of the view that bearish factors besetting the currency – primarily divergent monetary policy in Canada and the U.S., and the spectre of Quebec separatism – could drive the loonie lower. But with those factors having changed recently, it seems like the loonie is now at an inflection point.

Firstly, the Quebec issue is off the table after the electoral outcome earlier this month, with the Liberals winning enough seats to form a majority government in the province. Secondly, the relative direction of monetary policy in Canada and the U.S. is no longer as obviously divergent as it seemed a month ago.

Economic data today showed that Canada's inflation rate rebounded to 1.5% in March (from 1.1% in February), after rising energy prices led to the biggest increase in shelter costs – which make up 26% of the CPI basket – since December 2010. The core rate rose to 1.3%, from 1.2% in February. While the Bank of Canada said yesterday that faster inflation this year is likely to be temporary due to economic slack and heightened retail competition, it may have to rethink its neutral stance on interest rates a little sooner than current expectations if economic data continue to surprise to the upside. Meanwhile, in the U.S., the concern about rising interest rates that was triggered by Fed chair Janet Yellen's infamous "about six months" comment on March 19 has all but dissipated, thanks to some adroit damage control by Yellen.

Chart of the Day

Positive correlation between TSX and global growth may drive index to new highs

Index should be boosted by stronger global economy, weaker loonie

Figure 1 shows the strong positive correlation between the TSX Composite and global GDP growth, as well as the breakdown in the correlation between the TSX and Canadian dollar over the past year. The index should be boosted by the stronger global economy in the months ahead. As noted in last week's Bulletin, the IMF recently fine-tuned its forecast for global GDP growth to 3.6%% and 3.9% for 2014 and 2015 respectively, which is appreciably faster than the growth rate of the past two years (3.2% in 2012 and 3.0% in 2013). While the weaker loonie should have a positive impact on Canadian corporate earnings, it remains to be seen whether the historical positive relationship between the TSX and Canadian dollar reasserts itself shortly, or if the currency and stock market continue to go their separate ways.

Figure 1: TSX Composite vs. C$ and global GDP growth (%) – 2004 to 2014

Source: Global Securities Research, Bloomberg

Screen Shots

TSX energy stocks are on a tear

Average total returns over the past year for these 24 stocks is 35.4%

With energy stocks surging lately, we ran a basic screen to check out the performance of the large-cap stocks (market cap > $5 billion) in the TSX Energy sector. The advance in this group has been broad, with all 24 stocks having positive returns over the past year. Total returns (including dividends) over this period average 35.4%, ranging from just over 10% for Talisman Energy and TransCanada, to over 60% for Paramount Resources and Vermilion Energy. These 24 stocks have an average dividend yield of 2.8% (only three of these 24 stocks do not pay a dividend), and the average yield of the ten highest yielders is 4.3%. We have been bullish on the energy group for a while, with our large-cap picks including **Suncor**, **Talisman Energy** (both of which are in our Model Portfolio), and **Canadian Oil Sands**. As noted below, the iShares TSX Energy Index ETF (XEG, $19.85) is a good way to play the broad advance in the energy sector, which is the best performing group on the TSX this year with a 14.1% gain. Suncor and Canadian Oil Sands kick off earnings for the sector at the end of this month, and their earnings reports should give investors insights on whether energy companies' YTD advance is justified by their operating performance in Q1.

Table 1: Large-cap stocks on the TSX Energy index (ranked by dividend yield)

Ticker	Short Name	Mkt.Cap.($ bn)	Price (I)	Dvd Yld (%)	Total Return:1-year(%)	EPS T12M	P/E
CPG	CRESCENT POINT	$17.50	$44.21	**6.24**	35.6	$0.39	77.6
COS	CANADIAN OIL SAN	$11.34	$23.44	**5.97**	33.6	$1.73	12.7
BTE	BAYTEX ENERGY CO	$5.83	$46.39	**5.69**	35.0	$0.25	201.7
IPL	INTER PIPELINE L	$9.30	$29.10	**4.05**	25.4	-$0.23	N/A
PPL	PEMBINA PIPELINE	$13.63	$42.74	**3.86**	43.0	$1.11	41.5
ARX	ARC RESOURCES LT	$10.27	$32.93	**3.64**	28.5	$0.77	48.4
TRP	TRANSCANADA CORP	$36.36	$51.43	**3.58**	10.7	$2.42	22.7
HSE	HUSKY ENERGY INC	$34.84	$35.87	**3.35**	34.6	$1.85	19.6
VET	VERMILION ENERGY	$7.25	$71.75	**3.34**	62.7	$3.24	26.1
KEY	KEYERA CORP	$5.60	$70.62	**3.20**	23.4	$1.88	37.9
ALA	ALTAGAS LTD	$5.84	$47.57	**3.13**	37.7	$1.57	31.1
PRE	PACIFIC RUBIALES	$6.86	$21.64	**3.10**	14.7	$1.33	14.6
CVE	CENOVUS ENERGY	$24.31	$32.28	**3.00**	16.2	$0.88	25.2
ECA	ENCANA CORP	$18.95	$25.73	**2.86**	40.4	$0.31	35.5
TLM	TALISMAN ENERGY	$12.10	$12.00	**2.48**	10.5	-$1.15	N/A
ENB	ENBRIDGE INC	$42.86	$51.69	**2.44**	14.5	$0.56	95.2
PEY	PEYTO EXPL & DEV	$6.14	$40.16	**2.19**	52.2	$0.97	41.4
SU	SUNCOR ENERGY	$59.27	$40.40	**1.81**	47.9	$2.60	13.0
CCO	CAMECO CORP	$9.96	$25.12	**1.59**	41.0	$0.81	30.6
CNQ	CAN NATURAL RES	$48.20	$44.41	**1.29**	53.4	$2.08	20.9
IMO	IMPERIAL OIL	$44.08	$52.00	**0.94**	35.2	$3.34	14.9
POU	PARAMOUNT RES -A	$5.44	$56.30	**0.00**	67.2	-$0.63	N/A
MEG	MEG ENERGY CORP	$8.46	$38.09	**0.00**	37.2	-$0.75	N/A
TOU	TOURMALINE OIL C	$10.67	$54.95	**0.00**	49.4	$0.80	98.1

ETF Watch – XEG at best levels since July 2011, XDV at record high

Indicated dividend yield on XEG down to 1.9%, from 2.5% in November

The **iShares TSX Capped Energy Index Fund (XEG, $19.85)** is up 16% since we had identified it as a breakout candidate on November 25, 2013. Our view at that time was based on the ETF's strong seasonal trend; specifically, over the preceding 10 years, the ETF had gained an average of 9.8% from December to May, but had declined by an average of 1.4% from June to November. This ETF is a quick and easy away to play the broad energy sector. Its top five weights presently are – Suncor (17.6%), Canadian Natural Resources (14.3%), Cenovus Energy (7.3%), Encana (5.7%) and Crescent Point Energy (5.2%). The ETF has an indicated dividend yield of 1.9%, down from 2.5% in November.

The **iShares Dow Jones Canada Select Dividend Index Fund (XDV, $25.04)**, which was within striking distance of its July 2007 high of $24.63 back in November 2013, only got above that level this month and traded at a record high today. This ETF is only up 2.8% since November 25, as it has been hindered recently by its 53% weight in the financial sector (which is up 2.7% YTD). The ETF currently has an indicated dividend yield of 4.0%, little changed since November.

Figure 2: iShares Energy ETF (XEG) – 2011 to Present

Source: Bloomberg

Market Snapshot

At close on Thursday, April 17, 2014

S&P TSX	14500.39	+53.87	**Commodities**			**Yields (%)**	**Can.**	**US**
TSX Venture	998.77	+0.80	Canadian $ (US cents)	90.82	-0.05	90 Day T-Bill	0.92	0.02
DJIA	16408.54	-16.31	Gold (Spot)-US$	1295.15	-0.04	2-Year Bond	1.07	0.40
S&P 500	1864.85	+2.54	Oil (WTI-May)	104.54	+0.78	10-Yr.Bond	2.44	2.72
NASDAQ	4095.52	+9.29	CRB Index	311.46	+1.74	30-Yr. Bond	2.94	3.52

Thought for the Day

"It is better to be approximately right than precisely wrong." – John Maynard Keynes

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