



The Bigger Picture

A weekly snapshot of the markets

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Summary

Stocks to watch: EnCana spin-off **PrairieSky Royalty (TSX: PSK)** to commence trading after IPO completion on May 29; **CIBC** reports Q2 earnings May 29, -3.5% EPS decline expected.

Economy Watch: U.S. Q1 GDP on May 29 (forecast -0.5% annualized), Canadian Q1 GDP on May 30 (forecast +1.8% annualized).

Chart of the Day: Global market capitalization set new records this month, now at \$63.6 trillion.

Short Takes: New texting record; Pentagon's plans for Zombie Apocalypse.

Commentary – TSX firing on all cylinders as new record within reach

Strong bank earnings may provide the boost required to scale 15,000

Elvis Picardo, CFA

This is an unusual time of year for the TSX Composite to be reaching for a new record high, given the general nervousness that accompanies the beginning of the historically volatile May-to-October period for global equities. But with the S&P 500 closing above the 1,900 level for the first time on Friday, perhaps there's no time like the present.

The TSX is now less than 500 points or 3% away from its all-time high of 15,154 reached in June 2008. Although the current level of investor complacency can be a little disconcerting (the VIX is at 11.36, half the level it was at in June 2008), there's little denying that the global economy is on much firmer footing presently than it was six years ago.

The TSX is now beginning to fire on all cylinders, with the lagging Financials sub-index catching up in recent weeks (Figure 1). The Financials sector has the biggest weight in the TSX at 34.1%, and thus has a significant bearing on the fortunes of the index. Last week's Q2 earnings reports from Royal Bank and T-D Bank were impressive, with the two largest Canadian banks reporting EPS growth of 15% and 16% respectively. Prior to RY and TD reporting their numbers, the Big Six were expected to post quarterly EPS growth of about 6%-7%. If that growth rate is instead in the low double-digits, that would bode well for a further advance in the Financials sub-index, and by extension, for the TSX. The TSX needs a boost to scale the 15,000 barrier, and strong bank earnings may provide a timely fillip required to do so.

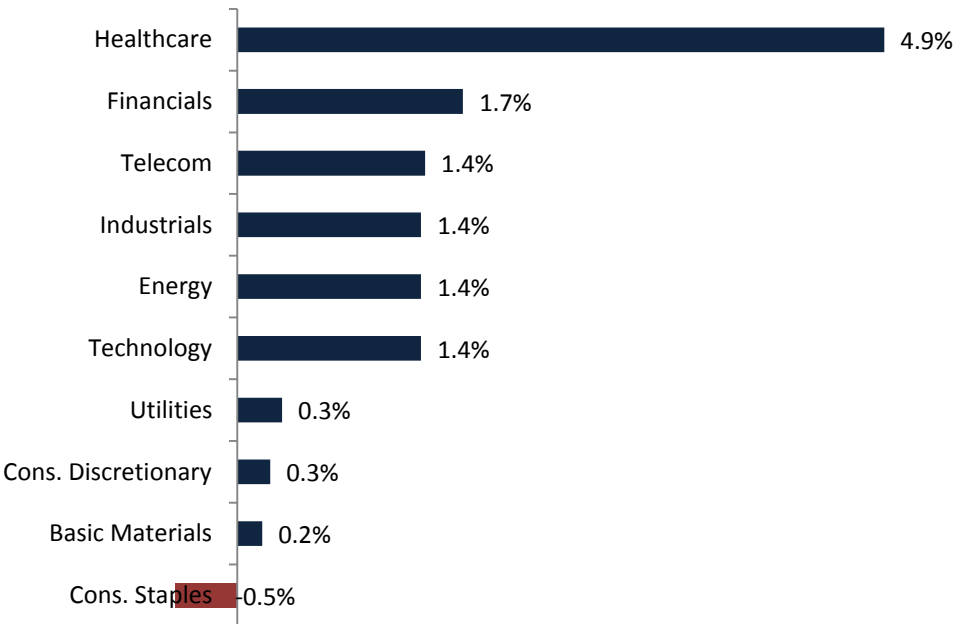
Figure 1: TSX and Top Three sub-sectors YTD performance (%)



Source: Bloomberg

TSX Sector Watch

Weekly change for TSX sectors (week ended May 23, 2014)



Source: Bloomberg

The Week Ahead

Stocks to watch

EnCana (TSX: ECA, \$24.95) spin-off **PrairieSky Royalty** will begin trading on the TSX under the symbol **PSK** after the close of its IPO, which is expected May 29. The \$1.46-billion PrairieSky IPO is the largest public offering in Canada since Sun Life Financial's IPO in 2000. Investor demand for the secondary offering by EnCana is robust, as evidenced by the increase last week in the number of shares that EnCana proposes to sell in the IPO to 52 million (from 32.5 million previously). EnCana also raised the indicative offering price range to between \$26.50 and \$28.00 per share (from \$23.00 to \$26.50 earlier). EnCana is selling a 40% stake in PrairieSky, which would have a post-IPO market value of \$3.64 billion, based on 130 million shares outstanding and a closing price of \$28. Expect the greenshoe option to be exercised, which implies the sale of an additional 15% or 7.8 million shares. Although the reception to recent IPOs in the U.S. has been tepid at best, in our opinion, the PrairieSky IPO may do well in its first day of trading. Given the possibility of frenzied trading, we strongly suggest using limit orders rather than market orders when the issue commences trading.

Bank earnings will continue to be in the spotlight this week, with Scotiabank and National Bank set to announce fiscal Q2 results tomorrow, followed by Bank of Montreal on May 28 and Canadian Imperial Bank of Commerce on May 29. **CIBC (TSX: CM, \$98.96)** is the best-performing bank stock of the Big Six this year, with a 9.05% advance YTD. But although its peers have all scaled new highs in recent weeks (except National, which did so in November '13), CIBC is the only major Canadian bank stock to still be some distance away from its 2007 record levels. While Royal Bank and Toronto-Dominion Bank last week reported double-digit profit increases on gains from consumer banking and wealth management, CIBC is expected to report its first profit decline since 2009. CIBC is forecast to report a 3.5% drop in EPS to \$2.05, on lower domestic retail banking earnings after the bank sold half of its Aerogold Visa credit-card business in December. Earnings may also be affected by challenges in its Caribbean banking operations; on May 15, CIBC recorded a \$420-million impairment charge on its Caribbean business and booked \$123 million of incremental loan losses in the region.

Economy Watch

- The **Canadian GDP** number due out on May 30 is expected to show the economy grew 1.8% on an annualized basis in Q1, the slowest quarterly growth pace since 2012.
- **U.S. GDP** scheduled for release on May 29 could show that the economy contracted for the first time in three years, as capital spending was hampered by the unusually harsh winter and inventories grew at a slower pace. The consensus forecast is for Q1 growth of -0.5%, compared with a preliminary estimate in April of 0.1%.

Chart of the Day

Global market capitalization at new record

Rally has taken longer to reach new highs; market cap-to-GDP ratio also lower than in 2007

Global market capitalization reached a new record of over \$63 trillion this month, surpassing the previous high of \$62.6 trillion set in October 2007. Global market cap is currently at \$63.6 trillion, which should come as no surprise given that a number of major markets including the U.S., U.K., Germany and India (which collectively account for 47.6% of global market capitalization) are at all-time highs.

Two factors support the view that this global rally may have more room to run –

- Global market cap has taken a little longer to double in this rally, doing so in five years. The previous run from \$30 trillion to over \$60 trillion occurred in just over three years, from August 2004 to October 2007. The growth pace has been more measured this time.
- The global market cap-to-GDP ratio (based on end-2012 GDP of \$72.44 trillion) is presently at 0.88, compared with 1.06 in 2007 (based on end-2007 GDP of \$56.5 trillion).

Figure 2: Global market capitalization – 2004 to Present



Source: Bloomberg

Short Takes

- New world record for fastest texting:** 16-year old Brazilian Marcel Fernandes Filho has officially become the world's fastest texter after typing a 25-word paragraph in 18.19 seconds, beating the previous record of 18.44 seconds set by 15-year old Seattle teenager Gaurav Sharma. Fernandes, who used a mobile keyboard app called Fleksy designed by software company Syntellia, had to type the following paragraph without using autocorrect or predictive text features – "The razor-toothed piranhas of the genera Serrasalmus and Pygocentrus are the most ferocious freshwater fish in the world. In reality they seldom attack a human." Fernandes' texting speed is equivalent to 82.5 words per minute. For comparison with speed-typing, note that Mohammed Hussain from India in March set a new speed record of 47 seconds for typing a 103-character sentence – with his nose.
- Pentagon has contingency plan for Zombie Apocalypse:** The U.S. Defense Department, in keeping with its strategy of having a plan to deal with any conceivable disaster, has a contingency plan titled "CONPLAN 8888" to counter a possible Zombie Apocalypse. CONPLAN 8888 follows a three-step approach to protecting humans from a zombie horde – maintain a defensive perimeter; conduct operations to eradicate zombie threats; and aid civil authorities in restoring law and order. While the playbook sounds suspiciously like a random episode of "The Walking Dead," that's probably because the zombie survival plan was only developed by military trainers as an effective training tool, and not because the Pentagon believes a zombie apocalypse is a possibility.

Market Snapshot

At close on Monday, May 26, 2014

S&P TSX	14715.69	+7.59	Commodities			Yields (%)	Can.	US
TSX Venture	994.90	+6.95	Canadian \$ (US cents)	92.08	+0.07	90 Day T-Bill	0.90	0.03
DJIA	16606.27	Closed	Gold (Spot)-US\$	1292.75	+0.19	2-Year Bond	1.06	0.34
S&P 500	1900.53	Closed	Oil (WTI-July)	104.18	-0.17	10-Yr. Bond	2.32	2.53
NASDAQ	4185.81	Closed	CRB Index	308.26	Closed	30-Yr. Bond	2.85	3.39

Thought for the Day

"To conquer oneself is a greater task than conquering others." – Buddha

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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.

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