



Market Bulletin

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*** Happy Holidays ***

The next Market Bulletin will be published on January 6, 2014.

Commentary – A review of the markets in 2013

TSX underperformed this year but may do well in 2014

Global economy firing on all cylinders heading into year-end

Lower “fiscal drag” should boost markets

Elvis Picardo, CFA

Global equity markets are on course to finish the year on a strong note, as the MSCI World Index trades near its highest levels since January 2008. With the uncertainty generated by the Federal Reserve’s scaling back of its bond purchase program now out of the way, global equities have rallied so far this month, led by the Nasdaq Composite (+3.9%), Japan’s Nikkei (+3.2%), Mexico’s IPC (+3.1%), and Germany’s DAX (+2.9%). We present below a brief review of the markets in 2013.

- **TSX underperformed S&P 500 by huge margin, but may outperform in 2014** – Our somewhat contrarian call is for the TSX to outperform the S&P 500 in 2014, redressing to a limited extent the massive gap in performance between the two indices. The TSX has only advanced about 80% since this rally commenced in March 2009, whereas the S&P 500 has surged 174%. The 2% gains made by these two indices over the past week erodes some of the returns we had projected in our 2014 Outlook report released on December 17. Our end-2014 targets of 14,400 for the TSX Composite and 1,895 for the S&P 500 imply index appreciation of 7.1% and 3.7% respectively (from today’s closing levels of 13,447.70 and 1,827.99). On a total returns basis, based on their dividend yields of 2.96% and 1.92% respectively, we now expect the TSX to generate returns of just over 10% in 2014, compared with 5.6% for the S&P 500.
- **TSX will benefit from global growth expansion in 2014** – The TSX has been hindered by the abundance of macroeconomic risk since the beginning of this recovery in 2009; the significant abatement in this risk in 2013 has been a primary driver of the spectacular returns in many markets this year. 2014 might be finally be the turn of the TSX, as its leverage to global growth may enable the index to best its best performance since 2010.

Figure 1 below, which has been reproduced from our 2014 Outlook report, depicts the positive correlation between global GDP growth and the TSX. The chart also shows the breakdown in the correlation between the TSX and Canadian dollar this year. Although the weaker loonie benefits Canadian corporate earnings, we do not expect that boost to last for long, as we think the historical relationship between the TSX and Canadian dollar will reassert itself in 2014, resulting in a stronger currency.

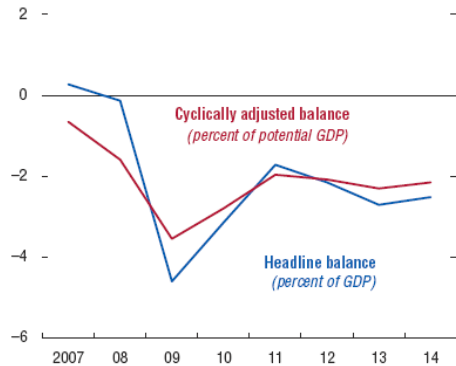
Figure 1: TSX Composite vs. C\$ and global GDP growth (%) – 2009 to 2013



Source: Global Securities Research, Bloomberg

- Global growth should also benefit from lower “fiscal drag”** – A December 4 Bloomberg article noted that the “age of austerity” may be nearing an end, as governments ease the fiscal cuts that had hampered recovery in many nations. The IMF projected in its October 2013 Fiscal Monitor that the average budget shortfall for all economies will fall from an estimated 3.7% of GDP this year to 3.0% in 2014, compared with the peak level of 7.4% in 2009. For the advanced economies, which have borne the brunt of the fiscal problems, the gap will decline from an estimated 4.5% of GDP this year to 3.6% in 2014, compared with the peak level of 8.9% in 2009 (Figure 2).
- US economy gaining momentum** – The US economy expanded at a revised 4.1% annualized rate in Q3, the strongest growth pace since Q4 of 2011. The growth figure was revised significantly higher from the previous estimate of 3.6%, reflecting upward revisions to consumer spending and non-residential fixed investment. US equities added to their gains today after IMF Managing Director Christine Lagarde said yesterday that the IMF will raise its forecast for the US economy. Lagarde said that the recent budget agreement (which was reached on December 10 and covers spending levels for the next two years) and the Fed’s commencement of tapering should boost confidence in the US economy. The IMF had forecast 2014 US GDP growth of 2.5% in October.

Figure 2: Fiscal balance – advanced economies



Source: IMF Fiscal Monitor October 2013

- Markets take tapering in stride:** Financial markets have easily absorbed the December 18 news of the Fed’s commencement of its long-awaited tapering program. From January onwards, the Fed will scale back its \$85-billion monthly purchase of mortgage-backed securities and Treasuries by \$10 billion. Economists now expect the Fed to reduce its bond purchases in \$10 billion increments over the next seven meetings before stopping it altogether in December 2014.
- Best and worst performing sectors – TSX and S&P 500**

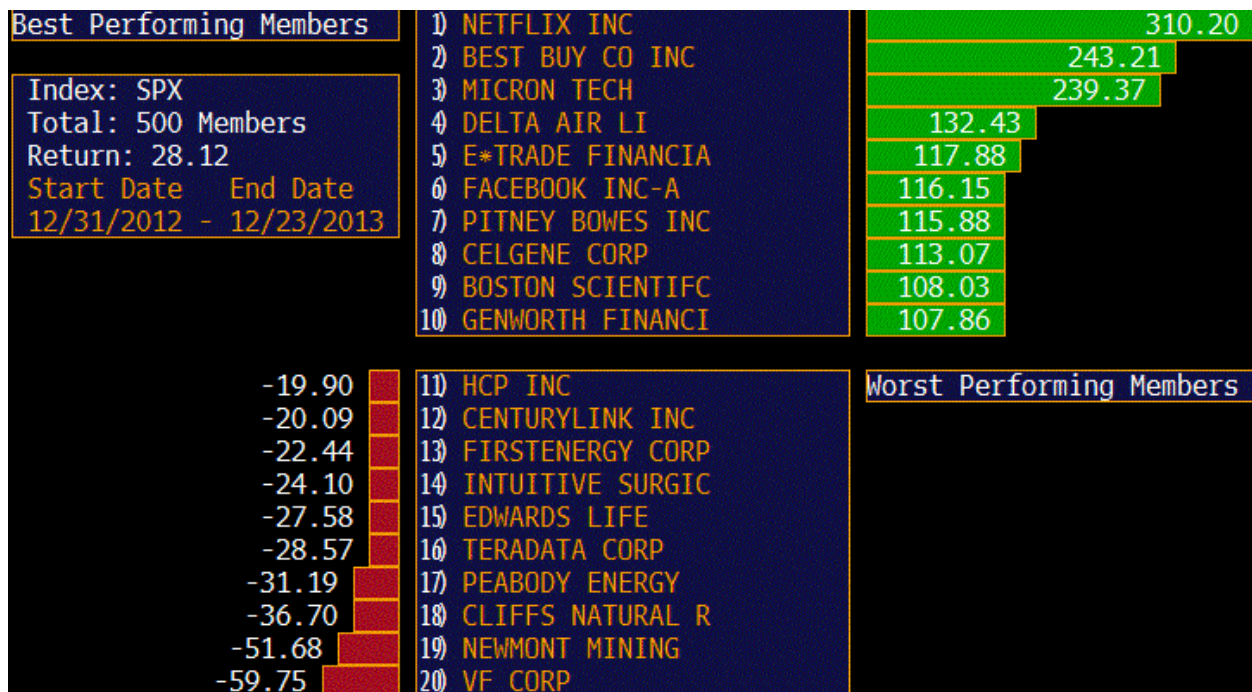
Figure 3: Sector Performance YTD 2013 – TSX (top panel) and S&P 500 (bottom panel)

All Group Performances		1) S&P/TSX HEALTH CARE IDX	66.81
Index: SPTSX		2) S&P/TSX INFO TECH IDX	38.12
Return: 8.16		3) S&P/TSX CONS DISCRET IDX	37.71
Start Date End Date		4) S&P/TSX INDUSTRIALS IDX	34.41
12/31/12 - 12/23/13		5) S&P/TSX CONS STAPLES IDX	21.10
		6) S&P/TSX FINANCIALS INDEX	17.67
		7) S&P/TSX ENERGY INDEX	8.83
		8) S&P/TSX TELECOM SERV IDX	6.78
		9) S&P/TSX UTILITIES INDEX	
		10) S&P/TSX MATERIALS INDEX	
-9.14			
-32.91			
All Group Performances		1) S&P 500 CONS DISCRET IDX	39.09
Index: SPXL1		2) S&P 500 HEALTH CARE IDX	37.94
Return: 28.17		3) S&P 500 INDUSTRIALS IDX	35.51
Start Date End Date		4) S&P 500 FINANCIALS INDEX	32.50
12/31/12 - 12/23/13		5) S&P 500 INFO TECH IDX	25.08
		6) S&P 500 CONS STAPLES IDX	21.38
		7) S&P 500 MATERIALS INDEX	20.11
		8) S&P 500 ENERGY INDEX	19.76
		9) S&P 500 UTILITIES INDEX	8.06
		10) S&P 500 TELECOM SERV IDX	5.21

Source: Bloomberg

- Best and worst performing stocks – TSX and S&P 500

Figure 4: Stock Performance YTD 2013 – TSX (top panel) and S&P 500 (bottom panel)



Source: Bloomberg

Market Snapshot

At close today

S&P TSX	13447.70	+48.10	Commodities			Yields (%)	Can.	US
TSX Venture	896.98	+8.80	Canadian \$ (US cents)	94.27	+0.25	90 Day T-Bill	0.88	0.06
DJIA	16294.61	+73.47	Gold (Spot)-US\$	1198.82	-4.48	2-Year Bond	1.11	0.38
S&P 500	1827.99	+9.67	Oil (WTI-Feb.)	98.91	-0.41	10-Yr. Bond	2.67	2.93
NASDAQ	4148.90	+44.16	CRB Index	282.09	-1.03	30-Yr. Bond	3.17	3.85

Thought for the Day

"Christmas is the time when kids tell Santa what they want and adults pay for it. Deficits are when adults tell government what they want and their kids pay for it." – Richard Lamm

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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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