The Bigger Picture

A weekly snapshot of the markets

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Commentary – How do Canadian Equities stack up against the rest of the world

Gint Austrins

Key Take-Aways:

- **Week In Review:** A brief review of need-to-know market events from last week including key economic data in the US and geopolitical events overseas
- **How Canadian Equities Stack Up:** We maintain a positive view towards Canadian equities driven by above average consensus EBITDA growth expectations over the next 2 years

Week In Review:

The S&P 500 jumped 1.2% last week to 1,931.59, rising the most since early March, while the TSX advanced 0.52% to 15,148.53. Geopolitics drove last week's market action overseas, lead by developments in the Russia-Ukraine crisis while economic data capped gains in North America:

Economic sanctions made against Russia influenced European markets:

- Euro zone economic outlook remained fragile as a new round of sanctions elevated tensions with Russia, while Germany reported weak Q2 factory orders prompting the ECB to announce that it would keep interest rates at record lows to stimulate the economy
- The Euro Stoxx 50 index declined 2.14% on the week.

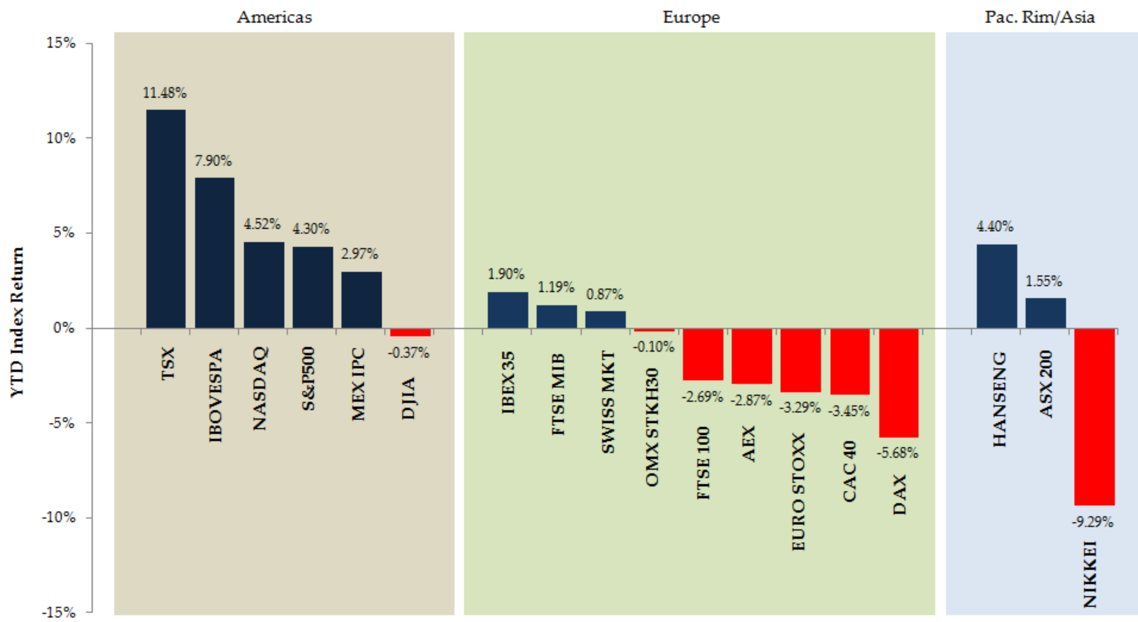
Speculation of an early US rate hike limited a recovery from the previous week's losses

- Positive economic data included a 1.1% rise in factory orders (vs. 0.6% expected), U.Mich. Consumer Confidence rose to 81.8 (vs. 81.3 in June) and 289k in July initial jobless claims (vs. 304k expected) but was weighed by a fall in construction spending of 1.8% (vs. an expected gain of 0.5%)
- The Fed is expected to begin raising rates in mid-2015 but positive economic data in recent weeks has fueled speculation that they may unexpectedly hike rates sooner.

Canadian Equities vs. The World:

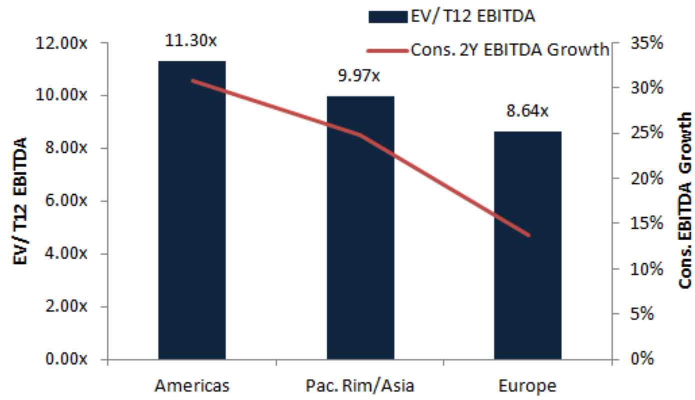
The TSX has generated top returns for shareholders so far this year returning 11.48%, while the S&P500 returned 4.30% with other key International indexes like the Euro Stoxx losing 3.29% and Nikkei down 9.29%.

Fig 1: Global YTD Index Performance



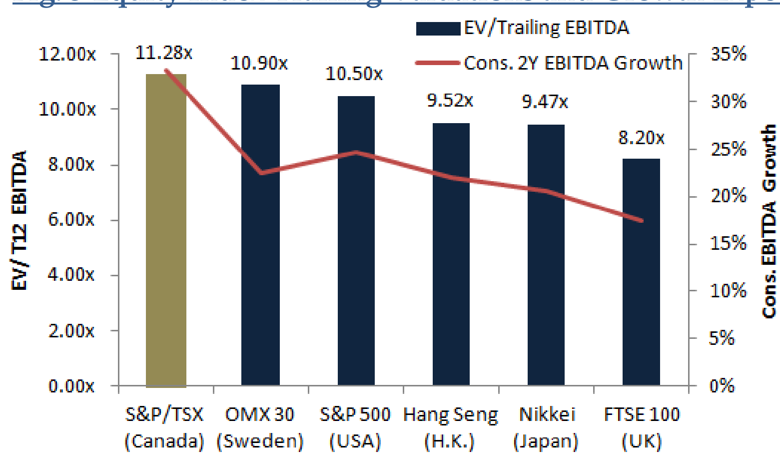
Americas based exchanges have generally outperformed their international peers this year, but they now also appear to be the most expensive. On an Enterprise Value (EV)/Trailing 12 month EBITDA basis, Americas equities trade at a valuation of 11.30x, while Pac. Rim/Asia trades at 9.97x and Europe at 8.64x. (Note that we elected to use EV/EBITDA over P/E as a valuation metric to account for the wide differences in capital structures among international equities.) **The broad based valuation premium in the Americas fits with our theme that near term gains in North America may be limited (discussed in Bulletin No. 262 – August 5, 2014), but we are not surprised to see these relative valuation levels given the consensus growth expectations for each region.** Americas based equities are, on average, expected to increase EBITDA by 31% over the next two years, while Pac. Rim/Asian and European companies are expected to see 25% and 14% EBITDA gains respectably over the same period.

Fig 2: Broad Regional Trailing Valuations and Growth Expectations



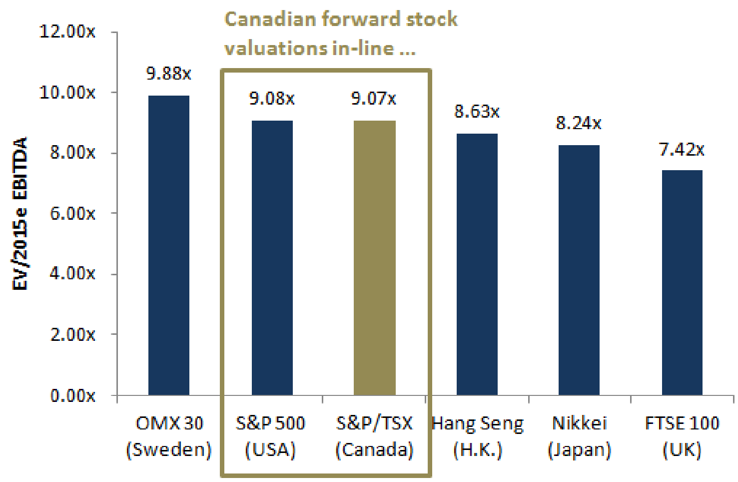
While being cognisant of the outperformance of the TSX this year, we wanted to see how the Canadian index matched up with some of the largest regional equity indexes around the world. Not surprisingly, on an EV/Trailing EBITDA basis, TSX equities trade at a premium to their international counterparts. As we highlighted with Americas based equities earlier, we view the premium valuation of the TSX as justified by its growth expectations - which came in the highest among the group of global exchanges we selected.

Fig: 3 Equity Index Trailing Valuations and Growth Expectations



We wanted to test our view that the market is rewarding the TSX for above average growth expectations and looked at how valuations stacked up on a 1Y forward (instead of trailing) basis. On a forward basis, the TSX trades on par with its American blue chip counter parts and generally in-line with the other exchanges we looked at. **To us, this confirms our positive bias towards Canadian equities given above average growth expectations and relatively reasonable valuation levels.**

Fig 4: Equity Index Forward Valuations



Market Snapshot

At close on Friday, August 8, 2014

S&P TSX	15148.53	+30.10	**Commodities**			**Yields (%)**	**Can.**	**US**
TSX Venture	1000	-0.89	Canadian $ (US cents)	91.14	-0.0040	90 Day T-Bill	0.95	0.03
DJIA	16446.46	+78.19	Gold (Spot)-US$	1310.60	-1.90	2-Year Bond	1.06	0.46
S&P 500	1931.59	+22.02	Oil (WTI-Sept.)	97.55	+0.21	10-Yr.Bond	2.05	2.43
NASDAQ	4348.41	-13.45	CRB Index	292.43	-0.65	30-Yr. Bond	2.62	3.23

Thought for the Day

"Finance is a gun. Politics is knowing when to pull the trigger."– Mario Puzo

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Strong Buy: Expected total returns of 20% or more over the next 6 – 12 months.
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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