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Market Bulletin

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Commentary

Implications of the Fed's tapering delay

Renewed wrangling over US debt ceiling could present buying opportunity

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The Federal Reserve surprised market-watchers by leaving the $85-billion monthly pace of its bond-buying program unchanged last week, saying it decided to await more evidence that the economy's progress will be sustained before adjusting the pace of its bond purchases. Prior to the meeting, investors were quite comfortable with the consensus expectation that the Fed would scale back its purchases by $10 billion. Market reaction to this unexpected bonus bordered on the near-euphoric, as the S&P 500 and Dow Jones Industrial Average surged to new records on September 18, bond yields fell, and gold soared by more than $50. Scant attention was paid to the Federal Reserve's economic projections – which were revised lower yet again – that were released the same day.

But this positive development has been offset by the re-emergence of renewed political wrangling over the US debt ceiling, a depressing repeat of the brinksmanship and grand-standing seen late last year. With government funding set to expire on October 1, the US Treasury will hit the statutory debt limit in mid-October and will be unable to borrow more funds. On Friday, the US Republican-controlled House voted to finance the federal government through mid-December and stop funding for President Obama's health-care law, setting up a potentially prolonged showdown with the Senate and White House.

<u>While the US budget battle could take a toll on market sentiment, we believe a consequent pullback in equities may present a buying opportunity</u>. The Fed is most likely going to slow down its bond purchases later this year, but this may have little impact on upward market momentum. We present below our thoughts on what the Fed's "tapering" delay means for the markets.

- **Taper Timing**: Most economists (24 out of 41) in a Bloomberg survey said they expect the Fed to slow the pace of its bond purchases in December (the FOMC meeting is on December 17-18). St. Louis Fed president James Bullard said on Friday that the Fed could scale back its bond buying by a small amount after its October 29-30 meeting. Regardless of the exact timing, we believe that markets will be able to absorb the taper news without too much of an impact, since sentiment is generally strong in the last two months of the year.

- **Low for long(er)**: The Fed revised its forecast for US GDP to 2.0%-2.3% for 2013 (from 2.3%-2.6% in June), 2.9%-3.1% for 2014 (from 3.0%-3.5%), and 3.0%-3.5% for 2015 (from 2.9%-3.6%). This amounts to a reduction of about 0.3 percentage points in the Fed's GDP forecast for this year and next. But these softer numbers mean that the Fed may very likely hold interest rates low as far out as 2016. As many as 14 out of 17 Fed officials see the federal funds rate well below 2% in 2015, and 10 out of 17 see the fed–funds rate at or below 2% by 2016.

- **Market impact**: With the Fed willing to wait before reducing policy stimulus, strategists are now beginning to raise their targets for the S&P 500. Barclays's strategist last week boosted the end-2013 target for the S&P 500 by 12.5 % to 1,800, while Tobias Levkovich at Citigroup on September 13 raised his year-end target to 1,650 and forecast the index will rise 15% to 1,900 in 2014. According to Bloomberg's compilation of strategists' forecast, the average S&P 500 target is at 1,694 for 2013 and 1,836 for 2014 (an 8.4% advance). Index EPS estimates for this year and next are at $108.76 and $114.92 respectively. Based on the year-end targets and EPS estimates, strategists are assigning a P/E multiple of about 15.6x for FY13 and 16.0x for FY14.

- **TSX takeoff?** The TSX quietly reached a two-year high of 12,964.86 on September 19. It is still up only 3% YTD, underperforming the S&P 500's 19.9% surge this year by almost 17 percentage points. We continue to maintain that as US equities power ahead, investors may choose to focus their attention on sectors that are leveraged to global growth, which the TSX possesses in abundance.

- **Sector choices**: Energy and Materials are two sectors that may be positioned to make up for their underperformance of the past couple of years. Among the rate-sensitive groups, the Utilities sector – which was one of the worst-hit by concerns about rising interest rates in recent months – was among the better performers last week in both Canada and the US.

Overall, equities continue to be the place to be in the current environment of easy monetary policy and strong earnings growth. Note that the TSX is currently expected to post double-digit earnings growth next year (based on analysts' estimates), with index EPS forecast to increase about 12.7%, from $833 this year to $939 in 2014. If investors gain confidence that those earnings forecasts are likely to be achieved, the TSX may make our end-2013 target of 13,000 look conservative.

Equity Screens

With the Fed on hold for the present, stocks that pay above-average dividends could come back into favour. Accordingly, we screened all TSX-listed stocks to identify those that satisfy our criteria for relatively stable dividends, and extended the same criteria to the Russell 1000 index for identifying US stocks. Our criteria were –

- Market cap > $250 million
- Estimated dividend yield between 5% and 8% (since yields above 8% may indicate concern about an imminent dividend cut).
- Dividend payout ratio (based on the company's last filing) < 80%
- Beta < 0.9 (i.e. 10% lower volatility than the broad market)

17 stocks made the cut on the TSX (Table 1), while seven did so on the Russell 1000 (Table 2). The TSX list is dominated by REITs, while the Russell 1000 unearthed a couple of offshore drillers, of all things. The last two columns in these tables show each stock's current distance from its 52-week low and high. As can be seen, most of the Canadian REITs are close to their 52-week lows, which may indicate a potential opportunity. Please note that equity screens such as these are only a starting point for further analysis, and you should do your own due diligence. (If the Tables do not show up clearly on your device or desktop, please check out the Bulletin at the following link – http://www.globalsec.com/market_news/market_research.aspx)

Table 1: TSX Dividend Payers

Name	Ticker	Price (I)	Dvd Est Yld.	Dvd P/O LF	Market Cap.	Beta	52Wk High	52Wk Low	Distance from	
			(%)	(%)	($ mm)				52Wk Low	52Wk High
CAPSTONE INFRAST	CSE	$3.85	**7.8**	57.0	$295	0.62	$4.53	$3.72	3.5%	-15.0%
WHISTLER BLACKCO	WB	$12.69	**7.6**	28.0	$485	0.82	$14.35	$11.42	11.1%	-11.6%
ARTIS REAL ESTAT	AX-U	$14.29	**7.5**	46.3	$1,816	0.69	$17.03	$13.42	6.5%	-16.1%
COMINAR REA-TR U	CUF-U	$19.30	**7.4**	73.1	$2,451	0.75	$24.21	$18.35	5.1%	-20.3%
DUNDEE REAL ES-A	D-U	$30.27	**7.3**	41.2	$3,295	0.86	$39.30	$28.71	5.4%	-23.0%
NORTHLAND POWER	NPI	$15.21	**7.0**	46.0	$1,995	0.46	$19.90	$14.07	8.1%	-23.6%
INNERGEX RENEWAB	INE	$8.72	**6.7**	51.6	$823	0.54	$11.00	$8.37	4.1%	-20.8%
MORGUARD NORTH A	MRG-U	$9.15	**6.6**	28.8	$265	0.57	$11.95	$8.86	3.3%	-23.4%
H&R REAL-REIT UT	HR-U	$21.35	**6.3**	44.8	$5,751	0.58	$25.40	$20.33	5.0%	-15.9%
CALLOWAY REAL ES	CWT-U	$25.00	**6.1**	58.3	$3,316	0.80	$30.47	$23.86	4.8%	-17.9%
BONTERRA ENERGY	BNE	$55.23	**6.0**	56.7	$1,727	0.48	$55.53	$39.65	39.3%	-0.5%
MORGUARD-TR UTS	MRT-U	$16.28	**5.9**	29.7	$1,045	0.49	$19.58	$15.55	4.7%	-16.9%
ENBRIDGE INCOME	ENF	$23.95	**5.7**	69.4	$1,685	0.49	$26.70	$22.22	7.8%	-10.3%
RIOCAN REIT	REI-U	$24.56	**5.7**	69.3	$7,477	0.78	$29.60	$23.46	4.7%	-17.0%
GRANITE REAL EST	GRT-U	$37.45	**5.6**	56.6	$1,750	0.50	$40.22	$33.89	10.5%	-6.9%
KILLAM PROP INC	KMP	$10.88	**5.3**	33.7	$594	0.80	$13.19	$9.91	9.8%	-17.5%
WHITECAP RESOURC	WCP	$11.90	**5.2**	N/A	$1,966	0.66	$11.98	$7.20	65.2%	-0.7%

Table 2: Russell 1000 Dividend Payers

Name	Ticker	Price (I)	Dvd Est Yld	Dvd P/O LF	Market Cap.	Beta	52Wk High	52Wk Low	Distance from	
			(%)	(%)	($ mm)				52Wk Low	52Wk High
HOLLYFRONTIER CO	HFC	$41.35	**7.8**	62.7	$8,220	0.64	$59.20	$36.22	14.2%	-30.2%
SEADRILL LTD	SDRL	$47.30	**7.2**	24.7	$22,379	0.61	$48.09	$34.57	36.8%	-1.6%
COSTCO WHOLESALE	COST	$118.34	**6.9**	29.5	$52,053	0.68	$120.20	$93.51	26.6%	-1.5%
DIAMOND OFFSHORE	DO	$63.06	**5.4**	65.6	$8,936	0.87	$76.85	$62.83	0.4%	-17.9%
AT&T INC	T	$34.39	**5.2**	63.5	$184,876	0.76	$39.00	$32.71	5.1%	-11.8%
ALTRIA GROUP INC	MO	$35.58	**5.2**	69.7	$71,758	0.89	$37.61	$30.01	18.6%	-5.4%
REYNOLDS AMERICA	RAI	$50.16	**5.0**	75.4	$27,251	0.79	$52.93	$39.70	26.3%	-5.2%

Market Snapshot

At close on Friday, September 20, 2013

S&P TSX	12806.47	-120.31	**Commodities**			**Yields (%)**	**Can.**	**US**
TSX Venture	946.10	-6.78	Canadian $ (US cents)	97.05	-0.38	90 Day T-Bill	0.97	0.01
DJIA	15451.09	-185.46	Gold (Spot)-US$	1326.05	-40.30	2-Year Bond	1.22	0.33
S&P 500	1709.91	-12.43	Oil (WTI-Nov.)	104.75	-1.11	10-Yr.Bond	2.69	2.73
NASDAQ	3774.73	-14.66	CRB Index	287.44	-3.07	30-Yr. Bond	3.20	3.76

Thought for the Day

"Everyone is entitled to his own opinion, but not his own facts." – Daniel Patrick Moynihan

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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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