Market Bulletin

Issue No. 229
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Summary

Recommendations

- **Suncor** – Reiterate Buy; target price unchanged at $40.

Commentary – Positive reaction to jobs data underscores bullish sentiment

Rising risk of a blowout US rally over the next few months, in our view

"Buy the dips" the preferred strategy at this point

Elvis Picardo, CFA

The trading action on Thursday and Friday last week was a little confusing, but it did underscore the strength of the present rally, and showed that "buying the dips" may be the preferred strategy in this bullish environment. We had expected equity indexes to post gains on Thursday due to a number of positive drivers, including – Twitter's much-anticipated IPO, faster-than expected US GDP growth in Q3 (annualized: 2.8% actual vs. 2.0% forecast), and a surprise rate cut by the European Central Bank. Twitter (NYSE: TWTR, $41.65) performed as expected, soaring as much as 93% before closing the day up 73%, the biggest one-day gain for an IPO of more than $1 billion since 2007. However, US equity indexes endured their biggest one-day decline (S&P 500 -1.3%, Nasdaq -1.9%) since August 27, as the GDP numbers reignited concern about Fed tapering and traders booked profits on high-flying momentum names (presumably to plow the proceeds into Twitter). On Friday, while the strong U.S. jobs numbers initially caused some nervousness, indexes soon rebounded as investors loaded up on stocks, including many that had been hit the hardest by the previous day's selloff.

<u>In our opinion, there is a rising risk of a blowout rally in US equities over the next few months. This would mark the final phase of the incredible US rally</u> that has resulted in the Nasdaq Comp and Russell-2000 indexes tripling from their March 2009 lows, while the S&P 500 and DJIA have gained as much as 166% and 144% respectively. **<u>This rally is largely being driven by unprecedented monetary stimulus, and at some point, we will see a full-blown reversal in market sentiment that will be exacerbated by the fact that major central banks have few options left to combat risks to their economies</u>**. But with that turning point in sentiment still months away, we see little reason to trim equity exposure presently (especially with the post-Thanksgiving period of seasonal strength around the corner).

Economic Analysis

Canadian jobless rate holds near five-year low of 6.9% in October

Jobs gains slightly above expectations, but not strong enough to force Bank of Canada's hand

The Canadian economy added jobs for the third successive month in October, creating 13,200 positions, slightly above economists' average expectation for a gain of 11,000. The jobless rate held at 6.9%, the lowest since December 2008, while the labour participation rate was unchanged at an 11½-year low of 66.4%. Key points of the October jobs report –

- For the first time in months, job gains were driven by the public sector (+47,300), rather than the private sector, which shed 22,100 positions. Job gains were led by full-time workers and employee positions for the second straight month.
- The unexpected decline in private-sector positions may merely reflect a return to normalized employment levels, after close to 136,000 jobs were created by the private sector in the preceding three months, including 73,600 in September alone.
- The services sector (+25,400) continued to drive job creation, offsetting a decline of 12,200 jobs in the goods-producing sector. In the services sector, gains in accommodation/food services, health care/social assistance, and public administration offset job losses in business/support services and trade.
- Of the four biggest provinces, Quebec had the most robust job market in October, adding close to 40,000 full-time positions. In Ontario, part-time job losses caused a net decline in positions, while Alberta's employment numbers were little changed as higher part-time positions offset a drop in full-time jobs. BC lost 5,300 jobs, as an increase of 5,600 part-time positions was offset by a decline of 11,000 full-time jobs. BC's jobless rate moved lower to 6.5% (from 6.7%), as more than 10,000 people left the labour force.

Table 1: Canadian employment metrics (Source: Statistics Canada)

	July '13	Aug. '13	Sept. '13	Oct. '13
Unemployment Rate	**7.2%**	**7.1%**	**6.9%**	**6.9%**
Employment (net change)*	**-39,400**	**59,200**	**11,900**	**13,200**
Full-time	-18,300	17,400	23,400	16,000
Part-time	-21,200	41,800	-11,500	-2,700
Worker classificn. (net change)	**-39,400**	**59,200**	**11,900**	**13,200**
Employees	-42,500	39,900	57,300	25,200
Self-employed	3,200	19,200	-45,400	-12,000
Public/private sector (net chg.)	**-42,500**	**39,900**	**57,300**	**25,200**
Public sector	-74,000	9,000	-16,300	47,300
Private sector	31,400	30,900	73,600	-22,100
*totals may not add up due to rounding				

U.S. jobs numbers blow past expectations as government shutdown has little impact

Bond yields rise but equities surge on optimism about improving US economy

October's jobs data confirms that the US employment situation is indeed improving, with the economy adding 204,000 jobs over the month despite the partial government shutdown. The jobs numbers were well above the median 120,000 forecast of economists polled by Bloomberg, and in fact even exceeded the highest estimate of 175,000. The payroll numbers for August and September were also revised higher by a combined 60,000. The unemployment rate ticked higher to 7.3%, from a near five-year low of 7.2% in September. Average hourly earnings for all employees rose by 2 cents from the previous month to $24.10, and continued to register a healthy 2.2% increase over the past 12 months.

As has been the trend for many months now, last month's job gains were again driven by the US private sector, which added 212,000 positions, offsetting a decline of 8,000 government jobs. Private-sector job creation continued to be concentrated in the service sector, with a total of 177,000 jobs added in areas such as leisure/hospitality, professional/business services, and retail trade. Goods producers continued to display steady improvement, adding 35,000 positions, led by an increase in manufacturing and construction jobs.

Market reaction: Investor reaction to the jobs numbers was unequivocally positive, with the DJIA, S&P 500 and Nasdaq posting gains of between 1.1% and 1.6% on Friday, as optimism about the strength of the US recovery offset concerns about potential Fed tapering. Bond yields rose significantly, with the US 10-year Treasury up 15 basis points to 2.75%. The US dollar gained against most major currencies, while gold plunged 1.5%. We believe concerns about the Fed scaling back its bond-buying program will again resurface as incoming data reinforce the perception that the US economy is gathering momentum. Against this backdrop, we expect US Treasury yields to revisit the highs seen in summer; however, we do not expect this uptick in Treasury / bond yields to derail the equity rally just yet.

Figure 1: US 10-year Treasury yield – 2013 YTD (Source: Bloomberg)

Recommendations

(Update) Reiterate Buy on Suncor, target at $40

We reiterate our Buy rating on Suncor Energy (TSX: SU, $36.87), with a target price of $40. The stock traded at a 28-month high of $38.68 on October 31, but has since drifted lower, presenting a buying opportunity in our view.

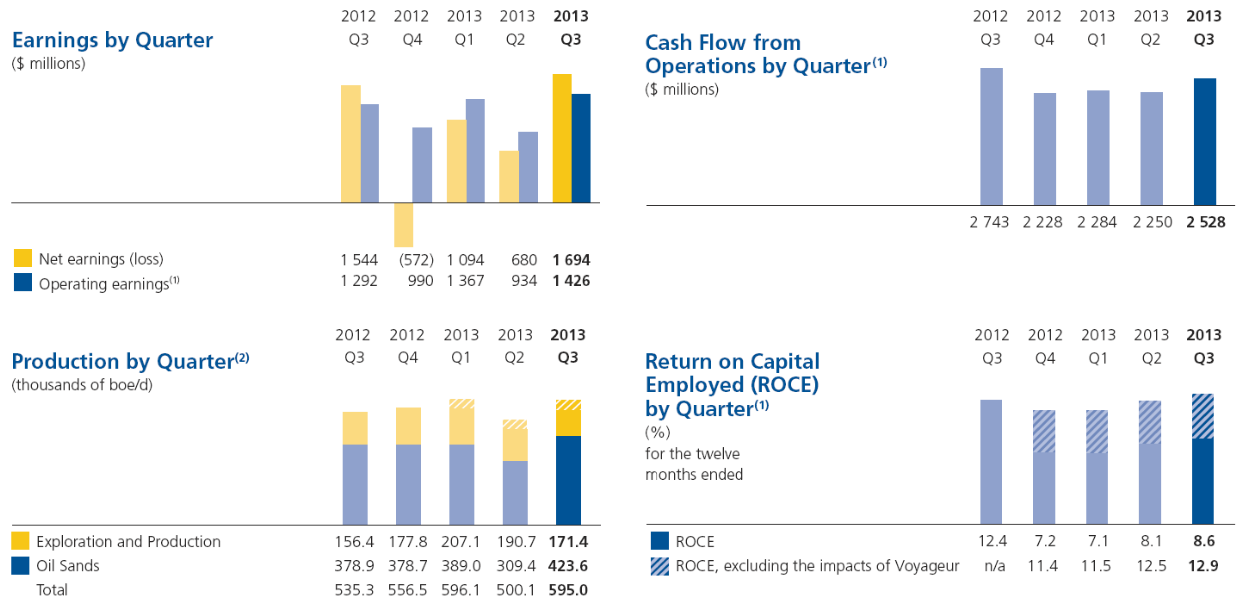
Suncor's Q3 results, which it reported on October 30, reinforced yet again the value of its integrated business model, which enables the company to capture Brent-based pricing on most of its oil sands output through its refining operations. Operating earnings of $1.426 billion (Figure 2) or $0.95 per share exceeded analysts' average $0.86 estimate, and rose 10% from a year earlier, driven by record production and earnings for the Oil Sands segment, strong reliability and favourable pricing for western Canadian crude oil. Net income rose 9.7% from a year earlier to $1.694 billion or $1.13 per share. Net income for the quarter included an after-tax gain of $130 million on the sale of Suncor's natural gas business in western Canada, as well as a forex gain of $138 million on revaluation of US$-denominated debt. Cash flow from operations fell 7.8% to $2.743 billion or $1.69 per share due to higher expected income tax expense.

Total upstream production in Q3 rose 11% from a year ago to 595,000 barrels of oil equivalent per day (boe/d). Production volumes for Oil Sands operations surged 16% to a record quarterly average of 396,400 barrels per day (bbls/d), due to the ongoing ramp up of Firebag production and execution of debottlenecking projects. Higher volumes led to a 2.2% decrease in cash operating costs per barrel, which fell to $32.60. Suncor's share of production from Syncrude plunged 28% from a year ago to 27,200 bbls/d due to maintenance issues.

Suncor's E&P segment contributed production of 171,400 boe/d, up 9.6% from a year earlier, due to much lower planned maintenance of assets on the Canadian east coast in the quarter. Q3 production was also impacted by the shut-in of output in Libya due to political unrest and related labour disputes that led to the closure of export terminals at some Libyan seaports. Note that while Suncor continued field activities in Libya through the quarter, it has not lifted production from the country since May 2013. In the Refining and Marketing segment, total refinery utilization was a strong 98%; total refinery crude throughput rose 1.7% to a record quarterly average of 448,800 bbls/d.

Suncor reduced its 2013 guidance by 25,000–35,000 boe/d (from its July outlook) to 545,000-590,000 boe/d, due to the shut-in of Libyan production, unplanned outages and maintenance at Syncrude, and the sale of the company's nat-gas business. The capex forecast was lowered by $300 million to $6.7 billion.

Figure 2: Suncor's quarterly metrics



Source: Suncor corporate website

Suncor also announced that it would proceed with the Fort Hills oil sands mining project, in which it has a 40.8% interest and is the project developer / operator. The total capital investment in the project is an estimated $13.5 billion, with Suncor's share at $5.5 billion. The Fort Hills project, which has reserves of about 3.3 billion barrels, is scheduled to produce first oil in Q4 of 2017 and achieve 90% of its planned production capacity of 180,000 bbls/d within 12 months from then.

Analysts are almost uniformly bullish on Suncor, with an average 12-month target price of $43.43. EPS estimates are rising, and are currently at $3.28 for FY13, with earnings forecast to increase 5.2% to $3.45 in FY14. On that basis, the stock trades at about 11.2x FY13 forecast EPS, and based on a 2013 cash flow per share forecast of $6.45, at 5.7x FY13 CFPS.

In our opinion, Suncor should be supported by its 2.2% dividend yield and the ongoing share buyback. Accordingly, we reiterate our Buy rating on this best-of-breed integrated oil company, with a target price of $40.

Market Snapshot

At close on Friday, November 8, 2013

S&P TSX	13378.33	+84.13	**Commodities**			**Yields (%)**	**Can.**	**US**
TSX Venture	937.41	-+6.33	Canadian $ (US cents)	95.44	-0.14	90 Day T-Bill	0.89	0.04
DJIA	15761.78	+167.80	Gold (Spot)-US$	1288.60	-19.05	2-Year Bond	1.12	0.31
S&P 500	1770.61	+23.46	Oil (WTI-Dec.)	94.60	+0.40	10-Yr.Bond	2.60	2.75
NASDAQ	3919.23	+61.90	CRB Index	274.39	+1.22	30-Yr. Bond	3.16	3.85

Thought for the Day

"And they who for their country die shall fill an honored grave, for glory lights the soldier's tomb, and beauty weeps the brave." – Joseph Drake

IMPORTANT RESEARCH DISCLOSURES

(1) The analyst and/or a member of the analyst's household have a long position in the following stocks discussed in this report – **Suncor**

Research Rating System
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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