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# The Bigger Picture

## A weekly snapshot of the markets

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## Observations on the sixth anniversary of the bull market

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Today marks the sixth anniversary of the current bull market that was launched on March 9, 2009, when most global equity indices closed at multi-year lows.

This bull market is a little different from previous bulls in a few ways:

- it has been fuelled by record low interest rates and unprecedented measures such as the Federal Reserve's three rounds of quantitative easing;
- the global recovery remains tenuous even at this late stage of the economic cycle;
- the six-year bull run has been marked throughout by a great deal of scepticism about its longevity and sustainability.

The numbers tell the story, however. The S&P 500 has more than tripled from its March 2009 close of 676.53, and has not had a 10% decline since the summer of 2011, when markets were roiled by the U.S. credit rating downgrade and elevated concerns about U.S. and European sovereign debt. A Bloomberg article notes that the S&P 500 has posted more than 50 record closes over the past year, while the current bull run – which has lasted almost 2,200 days – is only two months away from overtaking the 1974-1980 bull market as the third-longest one since 1929. To top it all, the Nasdaq Composite last week traded above the 5,000 level for the first time in 15 years, closing above that level (on March 2) for only the third time in history.

So where do we go from here? We make some observations below that may help you decide.

1. **The TSX Composite has underperformed U.S. indices by a huge margin**: Figure 1 shows the relative performance of the TSX Composite versus the U.S. benchmarks – the S&P 500, Dow Jones Industrial Average and Nasdaq Composite. While the TSX Composite has nearly doubled since March 9, 2009, the S&P 500 has more than tripled and the Nasdaq Composite has almost quadrupled. Over this six-year period, the TSX had total returns (including dividends) of 134.2% or 15.23% annually, compared with 244.0% for the S&P 500 (22.85% annually) and 215.4% (21.09%) for the DJIA.

**Figure 1: TSX Comp. vs. S&P 500, DJIA and Nasdaq – % change from Mar.9,2009**


2. **U.S. equity indices have outperformed most major global indices**: Since March 2009, U.S. indices have had the biggest price appreciation of global indices. Notable laggards over the past six years – the Euro Stoxx 50 (+71.4%), Shanghai Composite (+70.2%), Russian RTS $ index (+56.7%) and Brazil's Ibovespa (+1.9%). The TSX Venture index (-16.9%) has lagged even more.

| **Index** | **Country** | **Change (%)** |
|---|---|---|
| Nasdaq Comp. | U.S. | 289.6% |
| S&P 500 | U.S. | 207.4% |
| Sensex | India | 192.2% |
| DJIA | U.S. | 174.9% |
| DAX | Germany | 169.5% |
| Bolsa | Mexico | 154.0% |
| S&P/ASX 200 | Australia | 125.1% |
| Nikkei 225 | Japan | 116.0% |
| FTSE 100 | U.K. | 112.4% |
| TSX Composite | Canada | 96.3% |

3. **Which groups have driven index gains?** As can be seen in Table 1, there is wider variance in sector returns for the TSX Composite over the past six years, compared with the S&P 500. Four of the top five groups (Health Care, Industrials, Consumer Discretionary and Financials) are the same for both the TSX and S&P 500. The biggest divergence in sector returns for the two indices are in IT (+30.4% for TSX vs. +256.0% for S&P 500), and Materials (-3.3% for TSX vs. +190.8% for S&P 500).

**Table 1: TSX and S&P 500 Group Performance**

| Index Group Performance: March 9, 2009 to March 9, 2015 | | | |
|---|---|---|---|
| **TSX Composite** | **96.31%** | **S&P 500** | **207.37%** |
| Health Care | 1071.44% | Consumer Discretionary | 377.37% |
| Industrials | 247.46% | Financials | 290.60% |
| Consumer Discretionary | 200.11% | Industrials | 267.36% |
| Consumer Staples | 182.19% | Information Technology | 256.01% |
| Financials | 175.55% | Health Care | 227.38% |
| Telecom Services | 107.75% | Materials | 190.77% |
| Utilities | 50.13% | Consumer Staples | 151.59% |
| Energy | 36.16% | Utilities | 92.77% |
| Information Technology | 30.42% | Energy | 79.08% |
| Materials | -3.31% | Telecom Services | 74.89% |

4. **Which sectors have the most influence?** Relative group performance has altered the composition of the TSX Composite and S&P 500 quite significantly (Fig. 2(a) and 2(b) below). For instance, the Energy group was the biggest sector in the TSX six years ago, with a weight of 29.1%, but has since slipped to No.2, with a 20.9% weight in the index. Similarly, the weight of the Materials group on the TSX has declined by almost nine percentage points since March 2009.

   The biggest gainer in sector weighting over the past six years has been the Financials group (34.9% current weight vs. 25.4% in March 2009), thanks to the tremendous rally in bank and insurance shares. The Health Care group has also been a huge gainer on the TSX (5.0% current weight vs. 0.5% in March 2009), propelled by the 1,900% surge in Valeant Pharma and 874% increase in Catamaran Corp.

   Sector weights have not bounced around as much on the S&P 500, which tends to have better balance than the cyclical sector-dominated TSX. But even here, the Financials group has made the biggest gain in sector weights (16.2% current weight vs. 8.9% in March 2009) as U.S. banks have soared from their distressed levels six years ago. The Energy group has shrunk from 14.3% of the S&P 500 six years ago to about 8.0% currently.

   A major reason why the S&P 500 has outperformed the TSX by more than 100 percentage points since March 2009 is because of this variation in sector returns. The five best-performing groups on the S&P 500 account for 74% of the index, while the top five on the TSX account for only 59%; excluding the Financials group, the four best-performing groups on the TSX make up less than one-quarter of the index. As well, the TSX has been weighed down by the influential Energy and Materials sectors, whose combined weight has declined from 45% in March 2009, but still account for about one-third of the TSX Composite.

**Fig. 2(a): TSX Comp. sector weights – March 2009 vs. Current**

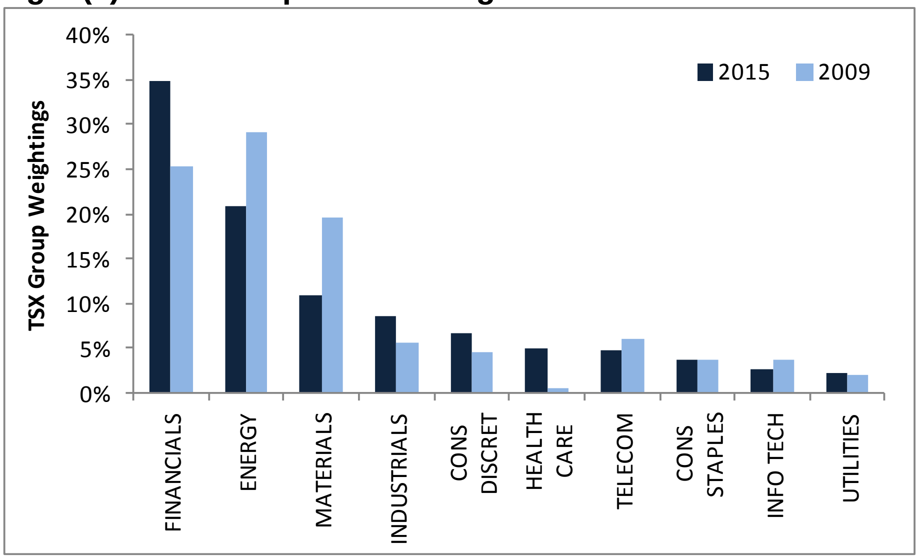
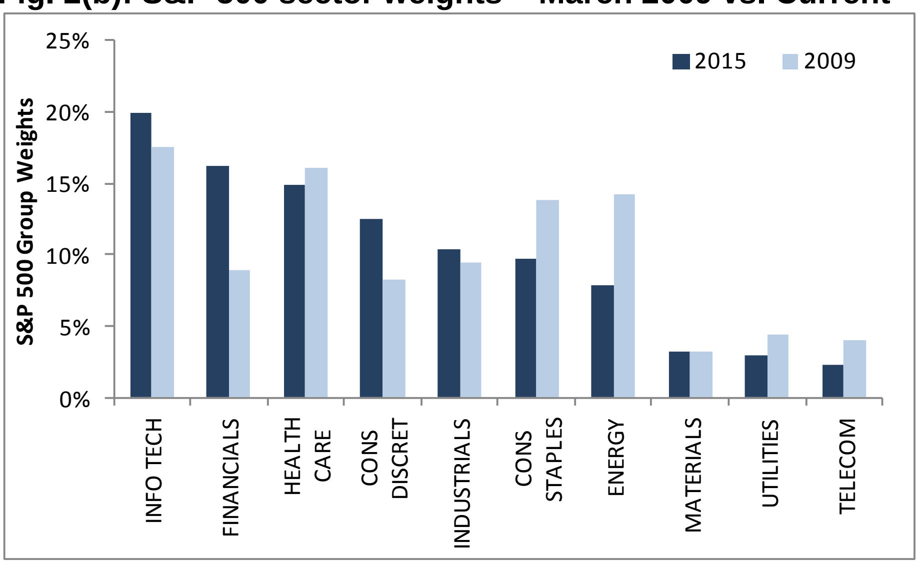



**Fig. 2(b): S&P 500 sector weights – March 2009 vs. Current**




5. **This rally has fundamental underpinnings, driven by earnings and U.S. corporate buybacks**: EPS for the S&P 500 has more than doubled over the past six years, from $49.51 in 2008 to an estimated $112.82 in 2014, for a compound annual growth rate (CAGR) of 14.7%. EPS for the TSX Composite has grown at a more sedate rate, from $557.08 in 2009 (the trough year for TSX earnings) to an estimated $770.17 in 2014, for a CAGR of 6.7%. The equity rally has also been boosted by U.S. buybacks, estimated at a record $550 billion in 2014. S&P 500 companies have also boosted dividends by 40%, with S&P 500 index dividend up from $27.26 in Q1 2009 to $38.49 in Q3 2014, for a 6.5% CAGR.

**Bottom-Line**: Here are some takeaways from the foregoing discussion –

- **Valuations are not unduly expensive**: The TSX is forecast to post EPS of $828.50 in FY15, which represents earnings growth of 7.6%. The index presently trades at a forward P/E of 17.9x, and at a 2015 EV/EBITDA multiple of 10.3x. These metrics are at the upper end of the historical scale but are not egregiously expensive valuations. Likewise, while the S&P 500 is forecast to post 2015 EPS of $118.32, for earnings growth of 4.9%, the index trades at a forward P/E of 17.6x and at a 2015 EV/EBITDA multiple of 10.7x.
- **Strong fundamentals could continue to power U.S. equities higher**: Earnings growth may be slowing, but strong U.S. economic growth, combined with valuations that are not too rich, record buybacks and growing M&A activity could continue to extend the record-breaking run for U.S. equities.
- **TSX will continue to underperform**: We see little reason to change the investment thesis outlined in our 2015 Outlook report (released in December), that the TSX may underperform the S&P 500 for the fifth straight year. The Financials group constitutes more than one-third of the index, and this could be a major concern if the Canadian economy slows down due to the collapse in crude oil prices. Bank of Canada Governor Poloz pointed out in a recent interview, the worst of the oil shock is yet to come, and Canadian economic growth in Q1 may be below the 1.5% annualized rate projected as recently as January. Although Canadian banks have recovered after posting fiscal Q1 earnings that were better than expected, slowing growth could have a negative impact on future earnings.
- **Surging US dollar is a growing risk**: So far the bull market has overcome concerns about global sovereign debt, a potential break-up of the EU/euro, the Russia/Ukraine conflict and geopolitical risk in the Middle East. Two of the triggers that have caused major corrections in the past – i.e. rising short-term interest rates and a spike in crude oil prices – also do not seem to pose a substantial risk at present. In this scenario, the surging US dollar – trading at a 11-year high against most major currencies – may be the biggest risk to the bull market. The surging greenback poses a risk not just because of its impact on U.S. corporate earnings, but because of its potential to spark global contagion (similar to the Asian crisis / Russian debt default of 1997-98) as indebted nations and leveraged corporates struggle to repay USD-denominated liabilities.

## Market Snapshot

**At Close today**

| **S&P TSX** | 14854.49 | -98.01 | **Commodities** | | | **Yields (%)** | **Can.** | **US** |
|---|---|---|---|---|---|---|---|---|
| **TSX Venture** | 680.68 | -8.11 | Canadian $ (US cents) | 79.32 | +0.10 | 90 Day T-Bill | 0.58 | 0.01 |
| **DJIA** | 17995.72 | +138.94 | Gold (Spot)-US$ | 1167.15 | -0.04 | 2-Year Bond | 0.60 | 0.69 |
| **S&P 500** | 2079.43 | +8.17 | Oil (WTI-Apr.) | 50.00 | +0.39 | 10-Yr.Bond | 1.56 | 2.19 |
| **NASDAQ** | 4942.44 | +15.07 | CRB Index | 219.31 | -0.82 | 30-Yr. Bond | 2.20 | 2.80 |

## Thought for the Day

"I try to buy stock in businesses that are so wonderful that an idiot can run them. Because sooner or later, one will." – Warren Buffett

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