Take Stock – 2013 Year in Review (So Far) and Stocks to Watch for the Second Half

Description

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Welcome to the back half of 2013! We're obviously a tad past the "official" mid-point but given last week's cross-border holidays, let's call this the un-official first week of the second half of the year.

What we're going to do in this week's letter is quickly look back over the past six months at how the Canadian market performed. Then, because we Fools love stocks, we'll review some of the best and worst performers and pontificate on what might be in store for these names in the second half. There is quite a bit to cover, so let's go!

The year so far

After putting together a streak of six straight years (2005-2010) of outperformance against the S&P 500, the **S&P/TSX Composite Index** (^GSPTSE) has gone into a relative funk. The U.S. market has been on a tear for the past couple of years, and this trend continued into 2013. The TSX's first-half return of -2.4% (per S&P Capital IQ) sorely lagged the S&P 500's rather stellar 12.6% return.

It certainly didn't help that one of our market's biggest sectors, Materials, was by far the worst performer, down a whopping 31.5% in the first half. Making the most significant contribution to this decline was the Metals & Mining group, which was down 40.2%. Leading this group lower was the Gold subgroup, which was down 43.3%.

If you own any stocks in this area of the market, dear Fool, I feel your pain. I arrived to the party a tad "early."

It didn't help that the two other big sectors in our market, Energy and Financials, checked in with rather lacklustre respective returns of -0.9% and 2.6%, respectively.

These figures appear worse when compared to the returns that each sector achieved in the U.S.

market. U.S. Energy and Financials stocks were up 8.6% and 18.4%, respectively.

Canadian energy companies are struggling due to a lack of takeaway capacity for their product. The pipelines are full, and this is impacting the price producers receive. And the Canadian Financials space is dominated by the big banks, which, until the fears about a rout in our housing market subside, are likely to be capped. In contrast, U.S. banks are benefitting from a revival in the housing market there, as well as an improving economy.

Stock thoughts

Two of the sectors that were up a material amount during the first half were Healthcare and Information Technology. The thing is, these sectors are very thin and don't have much of an impact on the overall Index.

In Healthcare, the big driver was **Valeant Pharmaceuticals** (TSX:VRX), which surged 52.8%. Valeant has been one of the Canadian market's darlings since mid-2010 as the company has embarked on an acquisition-fueled growth strategy that's hard to fathom. The stock has climbed by more than 500% over this period and the acquisitions just keep coming. The first half was punctuated by the biggest one yet, the $8.7 billion purchase of Bausch + Lomb.

In a nutshell, Valeant's aggressive tack has this Fool concerned. These deals have been completed at the expense of the balance sheet. Valeant's debt has it sitting in an awfully precarious position. Should rates rise, or a purchase not work out as planned, or worse yet, the debt mountain continue to grow, Valeant's owners could be one very disappointed group at some point down the line.

Tech

First came Nortel. Then it was Research In Motion. Now the big name on Canada's tech blog, with its $9 billion market cap (vs. Apple at $400 billion!) is **CGI Group** (TSX:GIB.A). Even though it's much smaller, CGI and its 30%+ first-half return did manage to handily outperform the U.S. giant's -16% showing.

CGI shares really caught a lift after it reported better-than-expected quarterly earnings back in April. This surge was likely fueled by the fact that CGI had a rather large outstanding short position relative to the liquidity of its stock.

CGI has demonstrated an ability to consistently generate free cash flow in the $500-$600 million range. However, the company lacks much in the way of organic growth and with the stock trading at roughly 16 times the mid-point of that free cash flow range, with no yield and a reasonable amount of debt, there's likely to be a better time to buy this Canadian "tech-heavyweight."

Stocks to watch

Let's go back to considering the big three sectors — specifically, the worst of the bunch.

While Materials was by far the biggest loser in the first half, could it be the big winner in the second? It comes down to China. Strong Chinese growth drove these names up – and contributed mightily to the dynamic run of outperformance that the TSX achieved. More lethargic yet still robust growth has dragged them down.

If second-half economic numbers in China show even a hint of stabilization, and if the country is able to avert any further indications of an imminent financial collapse, the Materials group could rip higher given the depressed metrics at which they currently trade.

If you're trying to bottom-feed in the Materials space, do yourself a favour and stick to the names that have relatively clean balance sheets. This at least implies that if things do get worse, the company, and your capital, are not completely on the line and you'll at least have a fighting chance for a comeback once the tide does eventually turn.

Out of the 55 names in the Materials space, 14 currently trade below 0.75 times their book value (which allows for some write-downs, and still leaves them trading at a discounted multiple) and with a total debt/equity that was less than 40% at the end of the last quarter.

Several of the bigger cap names included in this list include **HudBay Minerals** (TSX:HBM) and **Teck Resources** (TSX:TCK.B). To be clear, even though their balance sheets look good, and they're cheap, neither stock has much chance of moving higher in the short-term if Chinese concerns continue to weigh. We'll keep tabs on both as the year progresses and be sure to make note in our year-end round up.

Bold prediction

And what's a look-ahead without one bold prediction? Here goes: By the end of 2013, **Barrick Gold** will no longer exist as a stand-alone entity. We'll be sure to check in on this one as well!

The Foolish Bottom Line

Previews and predictions can be fun, but the truth is, nobody knows what awaits us in the second half of 2013 or beyond. Here's what we do know. Buying past winners doesn't always work. And in some cases, it can be an absolute disaster, particularly when they are tied to an inferior business model or are highly leveraged. Evaluate each new opportunity with eyes pointed squarely toward the future and give no regard to how the stock has previously performed. Future winners aren't necessarily born from the past.

'Til next time … happy investing and Fool on!

Sincerely,

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The Motley Fool Canada

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