



Is the S&P/TSX Composite Overvalued? Say it ain't so ...

Description

With the **S&P/TSX Composite** (^GSPTSE) showing an impressive one-year return of 11.6%, 2 year return of 14% and 5 year return of 65%, some investors are beginning to feel nervous. Let's delve a little deeper and see how the different segments of the market have done over the last couple of years. The following table breaks down returns for the market's 10 sectors:

Index	Return	
	1 year	2 year
S&P/TSX Composite	11.60%	14.10%
Consumer Discretionary (^GSPTTCD)	44.00%	55.00%
Consumer Staples(^GSPTTCS)	28.20%	46.80%
Financials (^SPTTFS)	27.20%	44.40%
Industrials (^GSPTTIN)	40.00%	41.00%
Information Technology (^SPTTTK)	34.80%	36.30%
Healthcare (^GSPTTHC)	33.10%	33.50%

Real Estate (^GSPTTRE)	4.00%	8.80%
Energy (^SPTTEN)	8.00%	-4.30%
Utilities (^GSPTTUT)	-3.20%	-7.70%
Materials (^GSPTTMT)	-30.10%	-37.50%
<i>Source: Yahoo! Finance</i>		

What stands out to me is that there are 4 sectors with a 2-year return north of 40%. While this is certainly something to celebrate, it does beg the question – have these sizeable moves brought the market into dangerous territory?

To formulate an educated opinion on this matter let's consider some economic fundamentals and market valuation.

From an economic perspective, mixed signals have flashed in a number of areas. Recent employment, housing, and general economic growth data have all sent mixed messages of late. Strong data has been followed by weak in all three.

Less mixed is the financial condition of the consumer. Debt levels continue to rise, and according to an analysis by TransUnion, the average consumer debt load, excluding mortgages, increased 2.2% compared to last year to \$27,355. Record debt levels are being supported by a [prolonged period of low interest rates](#). But households cannot continue to carry these heavy debt loads forever.

With mixed messages being sent from key economic indicators, and a heavily leveraged consumer, it seems like a disconnect between the Canadian stock market's recent returns and the reality of our economy may exist.

Let's take a closer look into the specific sectors to see if a similar scenario exists. We'll start with the over-indebted consumer.

Consumer Discretionary

The consumer discretionary index has had a 2 year return of 55% which makes it the top dog in terms of sector performance in the Canadian market over this period. Does this move mean the sector is now overvalued? The following table outlines some valuation related metrics for each of the top ten companies in the sector.

CONSUMER DISCRETIONARY INDEX					
		EPS growth		P/E	PEG

Top 10 Constituents	2013e	2014e	2013e	2014e	2013e
Magna (TSX: MG)	10.50%	15.80%	13.7	11.8	1.3
Thomson Reuters (TSX: TRI)	-1.60%	9.10%	21.4	19.6	nm
Tim Hortons (TSX: THI)	9.70%	12.90%	21	18.6	2.2
Shaw Communications (TSX: SJR.b)	1.80%	2.40%	14.6	14.3	7.9
Cdn Tire (TSX: CTR.a)	5.70%	6.70%	14.5	13.6	2.6
Dollarama (TSX: DOL)	18.10%	21.20%	25.4	21	1.4
Gildan (TSX: GIL)	16.70%	9.60%	16.3	14.9	1
Aimia (TSX: AIM)	-51.70%	81.90%	25.9	14.2	nm
Cineplex (TSX: CGX)	-7.30%	29.40%	27.3	21.1	nm
Quebecor (TSX: QBR.b)	11.40%	17.50%	15.9	13.6	1.4

A couple of clarifications before we break down the table. Earnings estimates are consensus expectations and the PEG ratio is the P/E ratio divided by earnings growth. The lower the better!

For a somewhat cyclical space (up and down with general economic trends), several of these stocks have rather generous valuations. Given the potential for the economic issues presented above to impact this space, to pony up and pay a multiple to earnings north of 20 times seems expensive.

In addition to this, these expectations might be considered overly optimistic, once again, if we consider the aforementioned economic issues. Actual earnings in 2014 could end up below what's currently expected.

One of the specific issues facing this group is that in recent years, growth has been fueled by low interest rates, which in turn have driven the increase in consumer debt, and have now left the consumer stretched.

Magna (TSX:MG, NYSE:MGA) is a prime example of a company that's benefitted from this economic environment. Results have been strong so far this year, with a 13% increase in sales but Magna has

benefitted from the global impact that historically low interest rates have had.

Tim Hortons (TSX:THI) is another on this list that appears richly valued. The company has been struggling with same store sales growth. Year to date, same store sales growth has been a meager 0.6% in Canada and 0.5% in the U.S., and its expected same store sales growth target was recently lowered. A multiple of 21 for such meager growth looks rich.

And **Dollarama** ([TSX:DOL](#)), is another that we can highlight. The stock trades at a 25 times 2013 expected EPS, even though recent results have been below expectations as well. In the latest quarter, traffic declined 0.9% and same-store sales rose 3.7%, which was below expectations. Such a lofty multiple does not fit with these figures.

Bottom Line

That disconnect that we noticed with the market in general seems to carry through into the consumer discretionary sector. Returns have been strong, valuations are high, and with an iffy macro environment looming, something's gotta give. My thoughts are to tread with caution in this group. In our next post, we'll take a closer look into the Consumer Staples space.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:DOL (Dollarama Inc.)
2. TSX:MG (Magna International Inc.)

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