Canadian Stocks: “The Urge Should Be to Buy, Not to Sell”

Description

While most stock markets around the world are firmly entrenched in correction or bear territory, the gloom is especially prevalent in the Canadian market. The combination of a sagging oil price and slumping currency has exacerbated the situation.

Canada-specific ills

Compounding this is the fact that Canada’s stock market has always been relatively undiversified compared to a market like the United States, with three sectors dominating: resources, materials, and financials. Then add in the usual situation of “home country bias” and the typical Canadian investor has to be hurting at this juncture.

While registered portfolios are no longer constrained by the foreign content limit (which over the years went from 10% to 20% and finally 30% before being dropped altogether), that legacy suggests many investors still have less U.S. and global exposure than prudence might have dictated. And in our non-registered portfolios, the dividend tax credit on qualifying Canadian dividends has long enticed Canadians to overweight domestic stocks.

As I write, the S&P/TSX is around 12,200, well below the all-time high of 15,657.63 reached in September 2014. Currently, it is down 17.5% from a year ago: in January 2015 the TSX was at 14,798.

Reason for optimism

Still, we are well up from the 8,000 level or so that was reached during the global financial crisis of 2008-2009, and some say the worst is already over. This week, BMO Capital Markets’ chief investment strategist Brian Belski predicted that the TSX will rally by more than 20% by year-end, past 15,300, as Canadian stocks become more correlated with the American economy.

In fact, if emerging markets and commodity prices start to recover, Belski sees the S&P/TSX outperforming the U.S. for the first time since 2010.

Buying in a bear market…

One market watcher itching to buy more Canadian stocks on the dips is Norman Rothery, publisher of StingyInvestor.com. Most of the Big Six Canadian banks are paying dividend yields of between 4% and 6%. "I'd say the banks are potentially good value provided the real estate market doesn't crack," Rothery said in an interview. "And at some point oil will turn back up again: then all this pain reverses itself."

Recent dividend yields of the banks include **Toronto-Dominion Bank** at 4%, **Royal Bank of Canada** 4.8%, **Canadian Imperial Bank of Commerce** 5%, and **National Bank of Canada** is close to 6%. Just last week Rothery bought **Power Corporation of Canada**, which has a dividend well north of 4%.

"Now we're in an official bear market, the urge should be to buy, not to sell," Rothery said, "There's not much debate that in a bear market you should be putting money in."

But wary of energy

Rothery is still cautious about Canadian energy stocks, however: "Personally, I'm willing to hold off a bit. Generally I stay away from resource companies." That said, **Suncor Energy Inc.** has a 3.8% yield. **Potash Corporation of Saskatchewan Inc.** has a whopping 9.5% yield, but for Rothery that's a red flag. "It's suspicious. You have to figure the market doesn't believe they can pay out the 9%."

Nor would Rothery counsel going the route of a Canadian energy ETF. "If you're going ETFs, I'd go with just the plain-vanilla index type and wouldn't worry about the energy exposure."

This being the season for topping up tax-free savings accounts and RRSPs, the depressed levels of the TSX should actually be good news for long-term investors.

Record cash hoard

Even so, a report from CIBC World Markets noted that Canadians are sitting on a record $75 billion in excess cash in their portfolios, with many investors paralyzed by "an ocean of fear" that's coursing through financial markets around the world. It said the negative sentiment surrounding Canada has "overshot fundamentals" and that our stock market "has been unjustly painted with the same brush as emerging markets."

Holding large cash positions that yield virtually nothing after taxes and inflation is bound to hurt long-term investment returns.

Personally, and as I have noted elsewhere, one conservative way to step back into the market is through low-volatility ETFs. For TFSAs and RRSPs, a good Canadian candidate here is the **BMO Low-Volatility ETF** (TSX:ZLB). ZLB uses a rules-based methodology to zero in on the 40 lowest-beta Canadian stocks out of a universe of 100 of the largest most liquid securities in the market. The average dividend yield of the portfolio is 3.0%, beta is 0.78, P/E ratio is 22.3, and price/book ratio is 2.7.

If nothing else, scrutinizing ZLB's portfolio could yield a few ideas for individual stock. The top 10 includes **Intact Financial Corporation**, **BCE Inc.**, **Emera Inc.**, and **Empire Company Limited**. Wading in gradually in either the ETF or some of its top holdings would be a low-risk way to become reinvested.

In fact, like Rothery salivating on the sidelines for still more bargains to materialize, you should welcome further declines as an opportunity to add more.

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