The $75 Billion Mistake That Canadian Investors Are Making

Description

CIBC Economics released a report back in January that offered a startling conclusion—that Canadian investors are currently sitting on a record $75 billion of excess cash. What does this mean? Essentially, cash position growth has followed a fairly steady upward trend-line since 1992, but recent extreme volatility in markets over the past several years has led current cash positions to diverge from where the trend-line suggests they should be by $75 billion.

It is important to note that this adjusts for inflation and population growth. CIBC stated that in the past year alone, cash positions grew by 11%, which would be the fastest pace since 2012, and the rise in cash positions is due to the terrible performance of the TSX in 2015.

The major problem is as follows:

In previous market crash scenarios (1987, 2001, and 2008), Canadians failed to deploy cash in time for the recovery (and, in fact, continued adding to their cash positions as the market recovered). This often meant missing out on double-digit returns. With the TSX rallying by 8% since CIBC published this report, Canadian investors could very well be victims of this pattern once again.

Holding cash can be costly

The CIBC report indicated that about 35% of wealth for those 35 and under is being held in cash; 15-20% of wealth for those 35 and older is held in cash. This can be a costly error. The CIBC report, for example, found that people typically move into cash as volatility spikes (like when markets decline rapidly). Unfortunately, in the 90 days following such rapid declines, the market posted average returns of 9%.

However, the cost of holding cash lasts far beyond the 90 days following a rapid decline. For example, on the U.S. S&P 500 Index (the TSX likely shows similar results), after 14 significant market lows since 1950, the index returned an average of 33% in the one year after the low and an average of 45% in the two years after the low.

This means that by divesting as the market begins to perform poorly, significant returns will be missed out on. Even missing out on a week or two can be costly. A Mackenzie study found that $10,000 invested between 1995 and December 2015 would have grown to $28,237. Missing the five best weeks would take this return down to $17,234—an $11,000 loss. Most likely, these best weeks occurred shortly after the worst declines.

The Canadian economy is looking up

There is no doubt the Canadian economy still has major headwinds—weak oil prices, an overleveraged consumer, and a potential real estate bubble. There are signs the economy is improving, however.

GDP for example, grew by a huge 0.6% in January (double expectations). This would be the biggest monthly gain in five years. Of course, one monthly gain could easily be a fluke, which is why it is important to point out that the January gain followed very impressive gains in both December and November. This would also be the sixth increase in the past seven months.

The gains were mostly spread through every sector, which shows the strength is not concentrated in one area. Even more importantly, exports are showing strength after growing for three months straight (and fairly steadily for the past year). This strength is a good sign for the TSX.

The end result? Canadian investors should consider getting back in the market. **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) are excellent ways to do it. The analyst consensus is that oil prices will stage a rebound in late 2016 and 2017 (since current prices are unsustainable to encourage the supply growth that is necessary to meet projected demand growth).

Suncor is a direct play on this growth (although it's low risk since the company's refining operations provide diversification). TD should benefit indirectly as Canadian GDP improves and as loan losses decrease with rising oil prices, which will be a tailwind for earnings.

CATEGORY

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