



## Why the TSX Could Return 10% From Current Levels (and How to Profit)

### Description

It has been a long time since TSX investors have experienced solid returns. The TSX underwent an impressive bull run starting in 2009, but in August 2014 the TSX began trading in a flat but volatile range before entering into a 23% decline beginning in April 2015.

This decline destroyed long-term returns for shareholders the five-year return on the TSX is currently -2.7%, meaning investors holding an index ETF over the past five years would have little to show for it. This performance is dismal compared to the 54% the U.S. S&P 500 posted in the same period.

There are signs now, however, that things may finally be looking up for TSX investors, and most analysts seem to agree, with the big banks largely predicting TSX outperformance in 2016. Here's why.

### Oil prices are showing signs of strength

It's no coincidence that the underperformance of the TSX that began in August 2014 coincided with the decline in oil prices that began at roughly the same time. It is also no coincidence that the TSX is up 14% from the lows set in mid-January (which is one of the largest rebounds in more than seven years for such a short period).

This rally that began in mid-January (after a period of extensive declines) coincided with oil prices that began bottoming at the same time. After rallying in January, the TSX pulled back again in February and formed a new bottom on the exact same day that oil prices hit their low, and both have been rallying in tandem since.

According to analysts at **National Bank**, this connection between the TSX and oil prices is real. In fact, the correlation between the TSX and oil prices is currently at the highest it's been at any point in history (and Canadian bank stocks are also mirroring oil prices).

If this correlation persists, the TSX should do well as oil prices continue to improve. Oil prices have risen from US\$26 per barrel in February to about US\$40 per barrel now, and the majority of analysts see oil ending up between US\$50-70 per barrel. The only difference is on timing; some analysts see these prices occurring in 2016, and others see them occurring in 2017. These prices are necessary to

meet long-term demand growth.

### **The Canadian economy is also improving**

The Canadian economy surprised investors in January by posting monthly GDP growth of 0.6%, which equates to an impressive annualized rate of 7.2%. It is important to note that is, of course, simply one quarter, which in and of itself could be a fluke.

The strength out of the Canadian economy, however, is not limited to just January. January followed three months of consecutive monthly gains and a Q4 that grew by an annualized rate of 0.8%. January would be the sixth increase in the past seven months, and economists estimate that Q1 is tracking to grow at an impressive annualized rate of 3.7%.

Most importantly, these gains were spread across many different sectors of the economy, which shows the strength is widespread. These results are good news for the TSX.

With improving oil prices and solid GDP acting as tailwinds, how can the TSX be expected to perform this year? Currently, the TSX is trading at 13,544, and according to National Bank, earnings as of March 28, 2016, were \$750, which works out to a price-to-earnings ratio of 18.05.

One year from now, earnings are expected to be \$850, which would work out to a forward P/E ratio of 15.93. The long-term average is 17.9, which means that even if the TSX trades at 17.5, it would still be expected to grow to 14,875, which is about 10% above current levels.

If you're looking to profit from this growth, names such as **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) or **Suncor Energy Inc.** ([TSX:SU](#))([NYSE:SU](#)) should do well. Rising oil prices will assist Suncor, and Canadian banks will also do well as oil prices improve. Banks such as Bank of Nova Scotia should outperform since they have high concentrations of oil and gas loans.

### **CATEGORY**

1. Bank Stocks
2. Energy Stocks
3. Investing

### **TICKERS GLOBAL**

1. NYSE:BNS (The Bank of Nova Scotia)
2. NYSE:SU (Suncor Energy Inc.)
3. TSX:BNS (Bank Of Nova Scotia)
4. TSX:SU (Suncor Energy Inc.)

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