Will the TSX Overtake the S&P 500 in 2017?

Description

The TSX entered 2016 on a five-year streak of underperformance versus the MSCI World Index thanks to low commodity prices and fears of stagnant global growth.

However, as a recent report from **Royal Bank of Canada** (TSX:RY)(NYSE:RY) points out ("2017 Year Look-Ahead: Canadian Equities"), as 2016 unfolded, it became clear that index valuations had reached lows not seen since the late 1990s, and growth concerns began to subside as governments around the world embarked upon fiscal expansionary policies.

As of December, the TSX has climbed over 30% year to date on the back of a resurgence in commodity prices and sharper than expected U.S. Fed interest rate path. But is the rally going to continue in 2017? The answer is "yes," according to RBC, as the firm has an 18-month price target on the TSX of 16,300, or a 12% premium to current levels.

RBC based its bullish thesis on the following assumptions: a united American government, continued rallies in the commodity sector and oil prices, and a steeper yield curve.

A united American government bodes well for the TSX

Historically the TSX has generated a return of 13% when the American government has been united under a single party. Following Trump's victory in November and the Republican control of both houses of congress, RBC expects the TSX to outperform the S&P 500 (as it has done during the last 20 out of 29 united governments) on the back of the United States's pro-growth policies, reduced regulations in the energy and financial sector, and a liberalized energy policy of pipelines and production.

Commodities will continue to rally

RBC believes that the commodities rally still has legs. Due to price levels still being depressed and the looming increase in U.S. demand coupled with supply deficits (in the case of copper), RBC believes that 2017 will see a further recovery in commodity prices.

A +10% gain in oil is to be expected in 2017

RBC based its forecast of $60/bbl oil in 2017 based on an OPEC supply cut, which has since been realized. Moreover, in the last 20 years in which oil rallied by more than 10%, the TSX outperformed the S&P 500 by an average of 14% (currency adjusted).

Steepening yields are bullish for the financial sector

As we all know, lifecos and financials weigh heavily on the TSX's overall performance. That being said, Canada's financial sector is set to benefit from a steeper than expected U.S. interest rate path as inflationary pressures build under Trump's fiscal policies.

According to RBC, the lifecos are more attractive than the banks on a valuation basis (relative and absolute) with **Sun Life Financial Inc.** (TSX:SLF)(NYSE:SLF), **Manulife Financial Corp.** (TSX:MFC)(NYSE:MFC), and **Great-West Lifeco Inc.** (TSX:GWO) deriving the most revenues from the U.S.

Caveat emptor: two key assumptions

RBC's forecast is contingent on two key assumptions: one, the U.S. actually embarks upon policy shift from monetary to fiscal expansion, and two, Donald Trump actually makes good on his pro-growth policies. If these two conditions are met, RBC recommends that investors stay overweight the TSX in 2017.

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