5 Reasons Why the TSX Composite Is Underperforming to Start 2018

Description

The TSX is off to bad start in 2018, down 5.3% since January 1, which is unfortunate in its own right, but when you consider that the S&P 500 is up slightly, the Canadian market looks even worse.

While it may not be time to panic just yet, now is probably a good time to understand why the Canadian market has so persistently been in the red to start the year, and if the current trend is likely to plague stock market performance throughout the rest of the year.

Central bankers are finally taking away the "punch bowl"

After nearly a decade of historically low interest rates, which, at one time, saw the rate on a Government of Canada 10-year bond fall below 1%, central bankers both at home and abroad are decidedly making a push to raise benchmark interest rates to more "normal" levels.

While this has obvious implications for borrowers and will have more significant ramifications for Canadians, which rank among the world's most indebted people, higher rates have broad implications for how all asset classes are priced.

Essentially, a higher benchmark rate implemented by the Bank of Canada — or a higher rate at which savers can earn a return on their money — makes other investments look worse by comparison, including dividend-paying stocks such as **Enbridge Inc** (TSX:ENB)(NYSE:ENB) and **TransAlta Corporation** (TSX:TA)(NYSE:TAC).

Higher rates are good for banks, but who are the banks going to lend to?

Higher interest rates are good for savers but are even better for banks. The problem for the banks is that most Canadian households are already stretched thin in terms of how much money they can borrow.

Defaults have remained low in Canada, despite rising debt levels — this could indicate the market is safer than many have assumed up to now, or it could be a sign that the worst is yet to come.

Canadian energy producers are underperforming their American peers

Together, the financial and energy sectors make up a large percentage of the overall Canadian market.

And while the financial sector is facing risks of saturation, the energy market has its own problems to deal with.

While the price of WTI crude oil has been on a tear for the past few months, this hasn't translated to success for the Canadian market with recent constraints on transportation levied by the U.S. government following an oil spill in South Dakota, resulting in an abnormally wide spread between the U.S. price of oil and the price oil that Canadian producers have been able to realize.

Fears around NAFTA re-negotiations

One of the biggest issues facing the Canadian economy today is the threat that American president Donald Trump will pull the U.S. out of the North American Free Trade Agreement.

At present, Canada sends about 75% of its total exports to the United States. If negotiators can't come to an amenable agreement, it could very well have knock-on consequences for the Canadian economy and its stock markets.

People tend to panic when they see others selling

This last point is the most important, as it creates great opportunity when others are fleeing the markets.

One person decides the market is too risky, and they decide to hit the sell button, which triggers fear in others, who think that person knows more than they do, so they follow in the same footsteps.

What results is the type of herd mentality that creates wild swings in the markets, and that can understandably test even the most Foolish investors' nerves at times. Meanwhile, these types of environments almost always tend to offer the best opportunities to find great companies to buy and hold for the long term.

The markets have enjoyed a nearly historic run over the past year, and so, naturally, people have become anxious about when the next shoe is going to drop.

But with the U.S. economy looking better than it has in years, now is probably a better time to be swimming upstream, looking for those once-in-a-lifetime opportunities to buy great companies at even better prices.

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Date
2025/10/01
Date Created
2018/02/07
Author
jphillips