What Is Behind the “Lost Decade” for the TSX Index?

Description

The S&P/TSX Composite Index dropped another 24 points on Tuesday, November 13. The TSX is now down 6.6% in 2018. Its long-term performance has been even more depressing.

The TSX Index briefly reached above 15,000 points in mid-2008 before the financial crisis drove it below 8,000 points in early 2009. Investors are now entering the final months of 2018, and the TSX sits at 15,131 as of close on November 13. This is painful for those who’d bought into a TSX-tracking index fund in the middle of 2008.

Compare this performance to the S&P 500, which dropped below 700 points in early 2009 and currently sits above 2,700 points — nearly double its mid-2008 peak. What has caused this “lost decade” for the TSX? Should Canadian investors expect different results over the next decade? Let’s explore some of the reasons for the decade-long stagnant performance in Canada’s stock market.

Energy and materials heavy

Canada is a massive resource-rich country, so it stands to reason that its stock market would be heavy in energy and materials. The energy sector accounts for approximately 19% of the index and is led by **Suncor Energy**, the top constituent by index weight. The materials sector accounts for roughly 10% of the TSX index and is heavily populated with mining and agricultural companies. Financials remains the most heavily weighted sector at 34%, led by **Royal Bank of Canada** and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD).

Indeed, Canadian financials have been a bright spot over the 10-year period. TD Bank stock has soared 167% over a 10-year period as of close on November 13.

Compare this to the S&P 500, a much more balanced index where the energy and materials sector combined make up a less than 10% weighting. Fast-growing industries like information technology and health care make up 40% of the overall weighting of the S&P 500. Financials comes in at just over 13%.

This heavy weighting meant that the oil price shocks of 2014-2015 hit the TSX particularly hard. Energy stocks have suffered from volatility ever since, while the materials sector has also slowed with metals prices slumping in recent years.

Conservative monetary policy

The Bank of Canada and U.S. Federal Reserve both elected to drop interest rates to historic lows during the financial crisis, but monetary policy of the central banks has differed in the years since. The United States embarked upon three rounds of quantitative easing (QE), the most ambitious asset-purchasing program in history.

Purchases were officially halted in October 2014 after the Fed had accumulated over $4.5 trillion in assets. The Bank of England, European Central Bank, and Bank of Japan also embarked on large asset-purchasing programs that gave a boost to asset prices. All have rolled back on these programs in recent years.

The Bank of Canada, however, elected to stay its hand during the recovery. Governor Stephen Poloz has said that QE is an instrument it could choose to use in the future, but it is highly unlikely to be unveiled as it has committed to its rate-tightening path.

Canada falling behind the competition

Canada has suffered from significant investment outflows in 2018. TD Securities was the top domestic equity underwriter in 2018, reporting $4.4 billion in stock sales for the fiscal year. In fiscal 2017, TD Securities reported $7.7 billion in sales — a 61% year-over-year decline. A recent report from the C.D. Howe Institute revealed that Canadian businesses will make capital investments equal to $13,900 per worker in 2018 compared to the average of $19,700 per worker across OECD countries and well below the $23,200 reported in the United States.

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