



Market Rally: Why Record Highs Are Closer Than You Think

Description

Someone recently described today's market rally as the most hated bull market of all time — a sentiment I fully agree with.

Despite the **TSX Composite Index** surging some 3,000 points off lows set in the later part of March — that's more than a 25% move to the upside — many investors are convinced this market rally is just a head fake. They're certain the market will test new lows once investors realize how bleak the economic picture has become.

I disagree with this assessment. In fact, I think the [TSX Composite Index](#) could surpass 18,000 points again sooner than we all think, even as soon as the latter part of this year. Although I think new all-time highs in 2021 are more likely.

Here's why I think we're only at the beginning of a historical market rally.

Stimulus money

I've got to give Prime Minister Justin Trudeau loads of credit. He and his ruling Liberal Party are throwing all sorts of cash at various stimulus programs. The government is helping out most everyone, including [plans for laid-off workers](#), various sizes of businesses, students, charities, and even Alberta's energy sector.

This stimulus money will help this recent market rally in two ways. It'll create massive demand when the economy reopens, since people won't have to decimate their savings to stay afloat. And many investors will take their stimulus money and put it to work in what they view as undervalued stocks.

Many people are arguing these stimulus programs are bad for stocks, since they could create inflation. But remember, we had big stimulus packages in 2008-09, and they didn't lead to runaway inflation. Besides, I'd argue Canada's commodity-heavy stock market would perform better than most in an inflationary environment. Many investors will look to commodity exposure in that type of world.

Pent-up demand will drive this market rally

Naysayers insist the economy re-opening won't do much if people still feel unsafe. I think it'll go much smoother than that. In fact, I predict the economy opening up will be the very thing that will encourage people to go out and spend money again.

After months of essentially being locked in our homes, people will be excited to start shopping, eating out, and traveling again. Businesses will quickly recover, and we can start to put all this behind us.

This is already happening in Asian markets like China and South Korea. It'll happen here, too.

Dirt-cheap stocks

The logic is simple. If you believe the world returns to normal within a year or two, today's stock market valuations are incredibly cheap. Especially when we consider current interest rates.

This reversion to the mean will be a big reason why today's market rally will continue.

Take a utility stock like **TransAlta Renewables** ([TSX:RNW](#)), a company that owns environmentally friendly power-generation assets. Despite the fact the power generation business will easily survive this crisis, shares are down some 25% compared to recent 52-week highs. Shares have participated in the recent market rally and are up compared to lows set in March, but the stock is still cheap.

Renewables should earn between \$300 and \$330 million in free cash flow in 2020. The stock has a current market cap of \$3.7 billion. That puts the company at approximately 12 times free cash flow, which is pretty cheap. That gives us an earnings yield of more than 8%. Compare that to a government bond — an asset that doesn't even pay 1% annually.

The company also offers a safe dividend yield of 6.7%. With interest rates so low, that yield should be much lower.

There's another reason to be bullish on stocks like TransAlta Renewables. The company has a lot of debt, which is par for the course for a utility company. The potential to refinance that debt exists, savings that will go straight to the bottom line.

The final word on this new market rally

I think today's bull market is just getting started. A combination of returning the economy to normal, demand created by stimulus money, and dirt-cheap stocks will ensure the Toronto Stock Exchange keeps marching higher. And remember, the stock market looks forward. That means as long as the economy continues to improve, record highs will happen again ... maybe even as soon as 2021.

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2. Energy Stocks

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1. TSX:RNW (TransAlta Renewables)

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