The Market Rally on the TSX Is Hot! Here’s Why it Could Implode

Description

The market rally on the TSX might be significantly overbought here. As the pandemic crisis unfolds, Canada could see some of the worst economic data since the Great Depression. Yet how can the markets rally so much?

What is up with the TSX market rally?

One reason is because the economic crash is due to a pandemic crisis, not necessarily a malfunction in the economy (although that is becoming a secondary consequence).

Investors are choosing to simply write off 2020 and look forward to 2021. Stock markets generally are future-looking. The problem is, nobody knows what that the future looks like. Will our past “normal” be the same “normal” in the future? Likely not.

This market rally could implode

David Rosenberg, a well-known Canadian economist, recently stated on BNN Bloomberg that Q2 of 2020 could create a “detonation in the economy.” Economic growth could be subdued for quarters, perhaps even years. While Rosenberg is not known for his optimistic outlook, his caution is important. We are only now absorbing Q1 earnings. Q1 results are rosy, because companies had yet to realize the effects of the pandemic. Q2 is where things could be ugly, and markets could spook again.

The fact is, until the world discovers a cure/vaccine for the coronavirus, markets and economies cannot return to “normal.” The recent market rally is thrilling and optimistic, yet there are real downside risks. Corporate earnings could take years to recover back to 2019 levels.

Maybe we won’t retest the March lows, but we could. The TSX right now is only sitting 15% below its all-time record highs. One could argue that valuations were pretty stretched then. With some tough 2020 earnings to come, valuations now are arguably very stretched.

The TSX is not cheap, so be cautious

All this is to say, be cautious TSX investors. Don't put all your spare cash on the line by hoping for another long-term bull market rally. A return to normal could take much longer than we hope.

Instead, take the overall pullback to allocate defence to your portfolio. Look for stocks that have very strong balance sheets, pay solid dividends, and operate regardless of the pandemic conditions. Below are three defensive names to hold if this market rally were to collapse.

Defence in renewables and utilities

The first defensive stock is **Algonquin Power**. It has 65% exposure to regulated utilities and 35% exposure to renewable energy. Its regulated utilities are diversified through water, natural gas, and electric. These are very consistent and stable businesses. Likewise, considering global warming concerns, the renewable power segment has some very favourable growth opportunities.

Algonquin has a $9.2 billion growth pipeline that should fuel 15% adjusted EBITDA CAGR over the next five years. The company pays a well-funded 4% dividend, which should grow in line with its cash flow expansion. It has defence and offence, so it is a strong long-term hold.

Defence in telecoms

BCE is another stock to own if the market rally stalls out. BCE is Canada's largest telecom with three diversified businesses: wireline, wireless, and media. BCE is a great stay-at-home stock. As many Canadians work and play from home, demand for fast, reliable broadband (as well as media and entertainment options) can only increase.

It will benefit from the transition to 5G and the long-term expansion in usage of data, Wi-Fi, and the Internet of Things. Its cash flows have a long, steady growth runway. That also means growing dividends. BCE pays a well-covered 5.8% dividend that should grow 5-10% per year for many years to come.

Defence in e-commerce

Granite REIT is the final stock to consider if the market rally collapses. Granite is Canada's largest industrial REIT with properties in Canada, the U.S., and Europe. While Granite's portfolio is exposed 35% to **Magna International**, 58% of its properties are state-of-the-art logistics buildings. These are tenanted to solid e-commerce giants like **Amazon**, **Wayfair**, and Samsung. The REIT has reported very limited consequences from the pandemic so far.

This REIT has a strong growth pipeline, a cash-rich balance sheet, and a solid 4.5% payout. The REIT is trading at 25% discount to market value, so it has some nice future upside.

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