TSX Index: Is It Getting Ahead of Itself?

Description

The year 2020 will be one to remember. The COVID-19 pandemic led to the fastest crash in market history. In early March, the **TSX Index** lost approximately 35% of its value in only a few short weeks, effectively putting an end to the record bull run which began in 2009.

The drop was so drastic that several blue chip companies were trading at levels not seen since the 2008 Financial Crisis. A decade's worth of growth disappeared in a matter of days. A bear market was upon us, or was it?

Since touching lows, the **S&P/TSX Composite Index** has been on a steady rise.

Although the Index is still down by 10.50% in 2020, optimism is abound as markets try to make a full recovery. Since May 13, the TSX Index is up by 5.3% and investors are left wondering if they will get another chance to buy stocks on the cheap.

TSX Index is getting ahead of itself

If we let the numbers do the talking, then investors should not worry – another buying opportunity will present itself. The reality is that the recent performance of the TSX Index may be a little too optimistic.

This quarter, companies are pulling guidance and conserving cash by reducing CAPEX and cutting the dividend. This is not a sign of a healthy economy. In fact, we are already likely in a recession. A recession is typically classified as a period in which gross domestic product drops in two consecutive quarters.

Germany recently joined Japan as the first G8 countries to have officially entered into a recession. In the last quarter, GDP dropped by 2.2%, the worst since the Financial Crisis. It expects annual GDP to drop by 6.3%, the worst since the last World War.

By the time you read this, Canada will have reported first quarter GDP results. The expectation is for -2.6% growth. Looking forward, the forecast is for -3.0% growth in the second quarter and -1.5% growth in the third quarter. We are a long way from a return to normal.

Given this, it is surprising to see such optimistic action on the TSX Index.

The economic reality will set in

In terms of performance, this quarter has been littered with mixed results. What investors are failing to take into account, is that quarterly results reflect only a fraction of the COVID-19 impacts. The full brunt of the financial fallout will not be known until the next set of quarterly results.

Optimism is also reflecting a gradual return to normal and not taking into account any potential setbacks. Unfortunately, we are a long ways from normal and a second wave may once more hit the economy. More shutdowns, more financial hardship. Eventually, the TSX Index will reflect the current economic reality.

Stay defensive

Until then, investors are best to protect their portfolio against a second wave. Now is not the time to be chasing high-flying stocks trading at record valuations. One way, is to ensure you have exposure to gold. One of my favourite stocks in the industry is **Franco-Nevada** (TSX:FNV)(NYSE:FNV).

As a streamer, it has fewer expenses and is less reliant on the price of gold. In fact, in the multi-year bear market, Franco-Nevada was a star. Since the end of the gold bull market in mid-2012 until the beginning the recent bull market (mid-2019), Franco-Nevada's stock gained 126.7% – far outpacing the 38.3% returns by the TSX Index.

This outperformance is accelerating in the current gold bull market. The company's stock is up 42.35% YTD as the price of gold is being supported by Federal stimulus. The Feds will likely continue pumping the economy with cash in the months ahead, which bodes well for gold stocks such as Franco-Nevada.

On top of growth, Franco-Nevada is also the only Canadian Dividend Aristocrat in the gold industry. In early May, it announced another dividend raise extending the dividend growth streak to 13 years. This is the type of stock you will want to build around in the even the TSX Index suffers another setback.

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