TSX Stocks: Will the Markets Continue to Rally?

Description

Investors often ask me if the current market rally is justified. The distrust is certainly not out of context as we are still not out of the pandemic yet. Stocks have been making new all-time highs consistently this year, and many stocks have tripled or even quadrupled since last year's crash. However, many economic indicators tell a different story. Besides, there are only around 5% of the global population that's fully vaccinated.

Market rally: Can stocks sustain gains?

Well, there is a flurry of market indicators that show a disturbing bearishness. For example, the famous Warren Buffett indicator for the U.S. market is close to 200%, significantly higher than in 2007. If the ratio is close to those levels, you are playing with fire, as the Oracle of Omaha once warned.

It is a metric that shows whether the markets are overvalued or undervalued. It is calculated as the total stock market cap divided by the country's gross domestic product. For Canada, the ratio is approximately 167%.

Are the markets overplaying the recovery card?

No, because some of the bullish indicators still seem to dominate. As markets are forward-looking and run a couple of quarters ahead, the impending economic growth appears encouraging.

Driven by prudent stimulus and infrastructure spending, people will likely spend aggressively once they are allowed to. There will be pent-up demand across segments, which might last for a prolonged period. Additionally, lower interest rates should help revive the corporate investment cycle, which will likely aid employment.

Corporate earnings growth will be a key driver for stocks in 2021 and beyond. A recent streak of corporate earnings has notably exceeded analysts' expectations. The trend can well continue for the next few quarters on higher demand amid re-opening.

How should you play the market rally?

However, amid the broad market rally, it can still be difficult to pick outperforming stocks. The stocks at large are rallying, but the one you have picked up is underperforming by a large margin. What can one do to avoid such a situation?

Investors can consider index funds.

Index funds are a group of stocks that give broad market representation. If you want to invest in the **S&P 500 Composite Index**, consider **iShares Core S&P 500 Index ETF** (TSX:XSP). This is like indirectly investing in top companies of the S&P 500 Index such as **Apple**, **Amazon**, **Facebook**, etc.

Index funds are low risk and offer diversification. Warren Buffett's **Berkshire Hathaway** has also invested in the S&P 500 index funds for a long period. Even if one stock underperforms, it does not significantly affect the funds' performance because of the low concentration. This way, investors' stock-specific risk gets minimized.

If you want to bet on Canadian markets at large, **iShares S&P/TSX 60 Index ETF** (TSX:XIU) could be an attractive bet. It offers long-term capital gain with exposure to the country's top 60 stocks.

XIU's top three holdings include **Royal Bank of Canada**, **Shopify**, and **Toronto-Dominion Bank**, which form around 7.8%, 6.8%, and 6.4%, respectively, in the fund.

Betting on index funds amid the ongoing market rally could be a smart move. It will generate decent returns in the long term without losing peace of mind.

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