
# Canada's TSX to Surge to Record High This Year, Then Stall in 2019: Reuters Poll

Feb. 28, 2018

By Fergal Smith

TORONTO (Reuters) - Canada's main stock index will climb to a record high by the end of the year as the prospect of higher global inflation boosts the appeal of its resource shares, a Reuters poll found, but a rising recession risk will cap the index's rise in 2019.

The median forecast from the poll of over 30 portfolio managers and strategists was for the Toronto S&P/TSX composite index <.GSPTSE> to rise 5.5 percent from Monday's close to 16,580 by the end of 2018, nearly matching the 6 percent gain in 2017.

Toronto's market, which is weighted 30 percent resource shares and 35 percent financials, is then expected to dip to 16,450 by the end of 2019.

"The Canadian market is a textbook late cyclical play," said Matt Skipp, president of SW8 Asset Management. "If commodities have bottomed, if the U.S. and global economy are in a late stage recovery, then Canada should start to benefit from inflationary pressures even if they prove to be transitory".

Cyclical shares, such as energy, materials and financials, tend to outperform as stronger growth pushes up the prices of commodities and as higher inflation boosts the yields investors demand to hold bonds.

In January, the IMF raised its forecasts for global growth and inflation, while the price of oil has rebounded more than 140 percent from its February 2016 trough to about $64 a barrel.

"With (interest) rates going higher that should help the cyclicals complex in Canada work better, which should help Canada outperform," said Greg Taylor, a portfolio manager at Redwood Asset Management.

"There is going to be a rotation away from the defensive sectors that have worked in the past, like the telcos, utilities and staples."

The TSX posted a record high in January of 16,421.42 before retreating as increased volatility pressured global financial markets. It has fallen 3.1 percent since the start of the year.

But a sustained rise in volatility could give investors an opportunity to shift money into the TSX's cyclical sectors at cheaper levels.

"Financial stocks should rebound alongside renewed inflation expectations and steeper yield curves," said Candice Bangsund, portfolio manager, global asset allocation at Fiera Capital Corporation.

Earlier this month, Canada's 10-year yield touched its highest since May 2014 at about 2.40 percent. Higher bond yields reduce the value of insurance companies' liabilities and increase the net interest margins of banks. Still, an uncertain outlook for the North American Free Trade Agreement could weigh on the shares of auto parts, railroad and energy companies that depend on trade with the United States.

**"Valuations for Canada are cheaper than for the U.S. but NAFTA renegotiations are a wild card," said Ben Jang, a portfolio manager at Nicola Wealth Management. "Until that is settled, multiple expansion is tough to envision."**

Multiple expansion occurs when investors are willing to pay a higher price for each dollar of a company's earnings.

U.S. President Donald Trump has threatened to withdraw from the NAFTA trade agreement with Canada and Mexico if he cannot rework it in favor of the United States.

Other potential challenges for Canada's economy could include the uncertain impact of tighter mortgage rules, which took effect at the start of January on a once red-hot housing market, and past interest rate hikes on highly indebted consumers.

The Bank of Canada has raised its benchmark interest rate three times since July to 1.25 percent. Money markets expect two further rate hikes this year.

Investors worry that rising global interest rates will hurt growth and weigh on the valuation of equities.

"I think there is going to be more of a fear of recession coming to the U.S. market (in 2019), that's going to cause more multiple contraction," Redwood Asset Management's Taylor said.