THE CASE FOR CANADA

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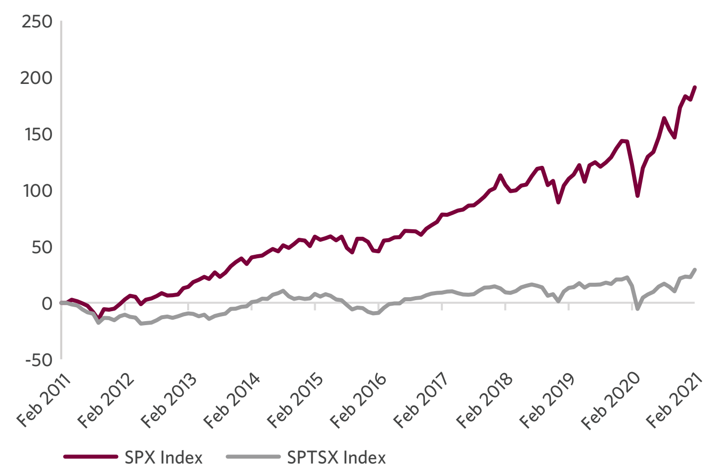
Key takeaways

1. The set-up is currently positive for Canada.
2. Immigration boom—Canada is the fastest growing developed country in the world due to immigration (influx of well-educated, well-to-do and entrepreneurial immigrants, which creates more jobs than it removes).
3. TSX has underperformed the S&P for 9 of the last 10 years. The S&P has tripled while the TSX is up 30%.
4. The stronger loonie makes U.S. returns for Canadians less attractive.
5. Canadian energy is not dirty carbon; the renewable sector for Canada is 3% of TSX. The energy sector is the cleanest oil producer in the world when looking at carbon emissions.
6. Many emerging and established growth companies are going public in Canada.
7. All the big global tech companies have offices in Canada.
8. Small cap companies and the TSX overall are primed for an M&A super cycle, which we anticipate.

In its February 2005 federal budget, the Federal government scrapped the 30% foreign content limits for RSPs and pension plans. Proponents of the plan touted the opportunities for Canadians to invest in global markets and access over 95% of the world's economic prospects which were blocked by these restrictions. Commensurate with these changes, Canadian pension plans and RSPs started to look outside of Canada's borders for investment opportunities. Investment management firms clamored to build out global capabilities and compete for Canadians' investment dollars in what became a rapidly growing market. As of the fourth quarter of 2020, there is about $307B invested in international and global strategies and $177B in Canadian equity strategies, according to eVestment. During the last 15 years, we've also seen the number of firms and products specializing in global equity increase dramatically.

Clearly, looking at historical performance, we can see the benefits that accrued to Canadian investors who looked beyond our borders. The S&P 500 has outperformed the S&P/TSX in 9 of the last 10 years. In 2020, U.S. large-cap growth was the best performing style while Canadian large-cap value was the biggest laggard when compared to global markets. Since the bottoming of the Global Financial Crisis in March of 2009, the S&P 500 has outperformed the S&P/TSX by over 300%.

10-Year cumulative percentage price performance

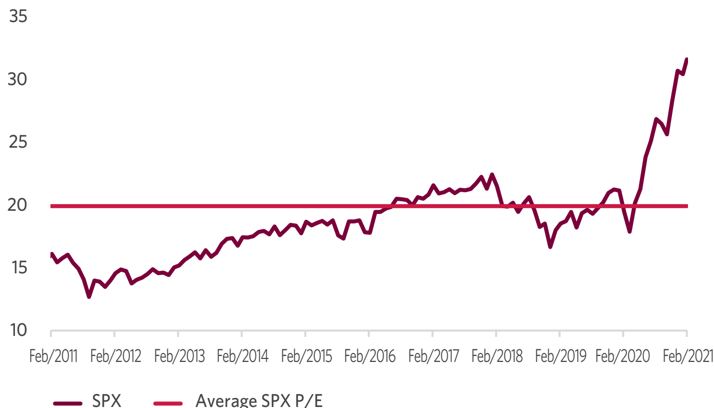


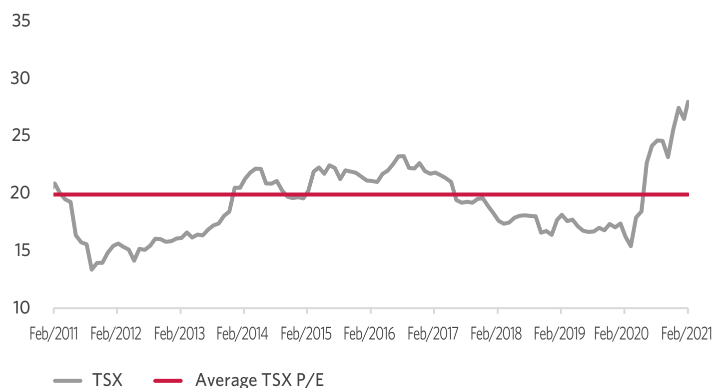
Source: Bloomberg

While hindsight is 20/20, it's important to remember that simply chasing performance is not a winning strategy in the long run. The set-up for Canada to outperform global markets is the strongest it's been since the oil sands boom. This is due to the valuations and growth prospects for Canadian stocks as well as corporate diversification and the globalization of the Canadian economy.

Valuations

Price Earnings Ratio





Source: Bloomberg

Both the S&P 500 and the S&P/TSX are trading well above their long-term averages, and for good reasons: low interest rates, monumental stimulus efforts by governments and central banks, and pent- up demand from a consumer waiting to return to normal—but the magnitudes of the divergences are quite different. The S&P 500 is trading at about 10x higher P/E than its 25-year average, versus a premium of about 6x higher for the S&P/TSX. Furthermore, the variance between the two indices is about as wide as it's been since the latter stages of the tech bubble in 2001.

Growth

Growth prospects go hand in hand with valuations. Once we get past this COVID chapter, and the world begins to reopen and commerce ramps up again, we'll be facing a massive case of global synchronized growth the likes of which we haven't seen in generations. We'll likely have all major pistons of the global economy firing at the same time, which has historically been good for commodities and the cyclically sensitive TSX. Given these prospects, our economics team projects Canada's GDP growth will modestly outpace the U.S. over the next 10 years with an average growth rate of 2.8%. This will likely be front-loaded due to the recovery efforts. We expect this strong global growth to be good for commodities that Canada produces, such as oil and gas. With the current prudent focus on Environmental, Social & Governance issues, it's important to highlight Canada's world-leading standards for carbon production and reduction. While it's important for the world to reduce its use of fossil fuels, it would be too disruptive for that to happen all at once. It's preferable that society source its needed energy and barrels of oil from a country like Canada where environmental precautions and adherence to socially responsible practices are followed. When considering carbon emissions, the energy sector in Canada is the cleanest oil producer. Canada is also diversifying its energy production into renewable forms of energy and, as of 2020, renewable energy made up about 3% of the S&P/TSX and has been growing.

An often overlooked case for Canada is population growth, but Canada's aging population doesn't immediately come to mind when one thinks of population growth. But once you add immigration, which will surely start to return to prior peak levels, this more than compensates for our birth rate and moves Canada to the top of the population growth charts among developed OECD nations. Many of the people migrating to Canada are coming on compassionate grounds, fleeing persecution from their homelands. But a significant portion are choosing to come to Canada as their best opportunity for their families' future prospects. While the latter group brings more immediate economic prosperity, both groups are bringing strong work ethics, higher education, and entrepreneurial spirits that are translating into more jobs and more prosperity for our great country. Canada is currently on pace to add 40% of its immigration goal in the first two months of 2021 alone.[1]

Sector Diversification

Although the TSX is still heavily weighted in financials and energy, it's starting to broaden out in sectors like technology. Although Shopify is the largest company on the TSX, there are lots of growth companies moving into Canada and setting up technology hubs across the country. This broadens technology exposure in Canada, beyond just Shopify, Opentext, CGI or Constellation. With generationally low interest rates and lots of money sitting on the sidelines, the theme of corporate consolidation and growth should benefit Canadian companies. It's not just Canadian companies being targeted by larger foreign entities—we're also seeing some of our global champions like The Brookfield group, Intact Financial and Alimentation Couche-Tarde establishing themselves as global leaders competing on the world stage.

[1] Source: https://www.bnnbloomberg.ca/trudeau-s-immigration-pivot-spurs-jump-in-permanent-residents-1.1568701

Conclusion

As we look across the investment landscape in 2021, we see great opportunities for Canadian equities in terms of their growth potential, their relative valuations and the relative stability of the Canadian economy. Over the last 15 years, we've seen investment flows moving outside of Canada in search of higher growth and diversification. The current backdrop of a strong ESG commitment in our energy industry, OECD leading population growth and the broadening of our economic base, should set Canada up very well for 2021 and beyond.

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