CANADA ON THE BRINK:

Is it Still Safe to Buy Stocks?

Motley Fool Pro Canada

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By Jonathan Chevreau

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Mark Twain famously quipped October was a dangerous time to buy stocks, along with September and the other ten months of the year. But with the decade-long bull market getting long in the tooth and the Trump rally seemingly running on fumes, is there still a case to be made for buying stocks, and in particular Canadian ones?

For this report, we polled some of our favourite experts, ranging from well-known stock pickers like Norman Rothery and Patrick McKeough, to investment counsellors and financial planners, some of whom prefer a passive "basket" approach to investing, usually through exchange-traded funds (ETFs).

Some predictably warned against any exercise that smacks of market timing, momentum or sector rotation, favouring a long-term strategic allocation to Canadian equities in the form of a broad-market index fund and rebalancing when necessary. One veteran broker, whose firm doesn't let him speak publicly, boils it all down to the essentials by pointing out the best time to buy stocks is when you have the money, and the best time to sell is when you need the money.

Those caveats aside, we here at the Motley Fool still believe investors who are prepared to do the legwork can do well acting on their own research on particular economic sectors and identifying the best individual stocks within each, all while cutting out the costs of using "professional" assistance.

From retirees to millennials – what to do based on age

Personally, I buy ETFs and quality individual stocks at a discount broker, but use a fee-for-service financial planner and rely on experts like the ones cited here, including Motley Fool research and its podcasts.

Of course, in this late stage of my career, I'm gradually moving from the wealth accumulation phase to the decumulation phase, and have taken the opportunity of recent highs to sell modest amounts of stocks both domestic and foreign.

I agree with the former chief portfolio strategist for TD Wealth, Bob Gorman, who recently told the *Globe & Mail* that he invests his own retirement funds rather aggressively – 90% in equities and only 10% in fixed income. That's an aggressive asset allocation for a retiree, even one as knowledgeable as Gorman, but even then the stocks he owns are primarily "large-cap dividend growth stocks that combine growing tax-advantaged income with lower-than-average volatility."

You may be able to mimic this approach with low-volatility ETFs like the **BMO Low Volatility Canadian Equity ETF**, or you could cherry-pick from the holdings list of the obvious household names – like the big domestic banks and telecommunications players – perhaps double-checking them against Motley Fool Canada recommendations.

But what if you're a much younger investor, still far from retirement? Based on Gorman's example, you could make the case that any millennial should be 100% in equities, perhaps with more focus on growth and less on stability and dividend income.

Brandon Hill is a millennial, life coach and certified financial planner for Toronto-based, A Life of Wealth. He says, "It's always a good time to buy" if your time horizon is 20 or more years. Hill points out that merely owning the Canadian market through an ETF tracking the S&P/TSX Composite Index would have generated a 20% return from this part of your portfolio in 2016 – tough to beat that.

Hill believes in a low-cost, passive investing approach to domestic or international markets:

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Hill uses the robo-adviser Wealthsimple to implement his trades. A spokesperson for Wealthsimple says, "We believe that a position in the broad-based TSX Composite Index is an essential part of an internationally diversified portfolio for Canadian investors. It's low-cost, tax efficient and has minimal currency risk."

Buy Canada, the world, or both?

I would concur that it may make sense to delegate the picking of foreign stocks to money managers, mutual funds or just buying the world through index funds/ETFs directly, but I also feel the Canadian market is small enough and so familiar to most Canadians that it's not that tough picking out some large-cap household names. As we'll see in what follows, it's tough to go wrong with the big Canadian banks and some other domestic blue chips.

"Is today a good time to invest in Canadian blue-chip stocks? Absolutely," says author and financial planner Tim Paziuk, president of Victoria-based TPC Financial Group Ltd., "Great Canadian companies will continue to make money both domestically and abroad regardless of what Mr. Market has to say."

"Is today a good time to invest in Canadian blue-chip stocks? Absolutely," says author and financial planner Tim Paziuk, president of Victoria-based TPC Financial Group Ltd., "Great Canadian companies will continue to make money both domestically and abroad regardless of what Mr. Market has to say."

The question arises as to just how much Canadian securities Canadians should own, given that our market makes up just 4% of the global stock market.

Like the citizens of many other nations, Canadians tend to succumb to a hefty amount of home country bias. Given currency and tax considerations, much of this is justified. But as investment coach Aman Raina (founder of Toronto-based, Sage Investors) points out, "We are truly in some extraordinary times. While there are some domestic stories (real estate, oil recovery, surging dollar), it appears the direction of Canadian equities will be determined by what happens elsewhere in the world."

Investment counsellor Graham Bodel, president of Vancouver-based, Chalten Fee-Only Advisers Ltd., says, “We always expect it to be a good time to invest in Canadian stocks. We always expect investors to be rewarded for taking risk and for seeking exposure to not only market risk but value stocks and small-cap stocks (despite the recent Canadian market experience).”

The average total return on the S&P/TSX Composite Index from 1957 through 2016 was 9.1%, Bodel says. A dollar invested in 1957 would have been worth $181 at the end of 2016. Even so, over those 60 years, the actual return was between 7% - 11% only six times while in 17 of the 60 years the return was negative.

But there have been only eight 3-year periods where the average return was negative, one 5-year period where the average return was negative and zero 10-year periods where the average return was below zero.

Is there an advantage to choosing “Value” or “Growth” stocks, which can be filtered via ETFs?

Well, the MSCI Canadian Value index has outperformed the MSCI Canadian Growth index by an average of 3.8% since 1982, according to Bodel.

How about large-cap versus small-cap? “The return differential between large cap and small cap in Canada has been negligible over the long run but has favoured large-cap stocks over the past 10 to 20 years.”

Home country bias, and how to avoid falling into the trap

While I’m as patriotic as anyone, there is danger putting *all* of your capital to work exclusively in Canadian stocks. The Canadian economy and stock market is famously concentrated in terms of the relative size of the top three sectors (Financials, Energy and Materials) and indeed the relative size of the largest stocks.

Couple that concentration risk with our high level of home country bias, and it’s arguable that Canadians shouldn’t put *all* their eggs in the domestic equity basket. Historically, global diversification has led to both higher returns and lower volatility for Canadian investors. That said, there are significant tax advantages for Canadians to hold Canadian dividend-paying stocks outside registered portfolios.

So, he’d go along with Canada making up anywhere between 67% to 75% of the equity portion of a portfolio, using the non-Canadian allocation to diversify in the US and abroad, beyond the big three Canadian sectors. Otherwise, all-Canada investors will be grievously underweight technology, health care, industrials and consumer stocks.

As for currency considerations, the Canadian dollar (aka “loonie”) has already had a sizeable move from $0.72 to $0.80 relative to the US dollar. The average over the last two and a half decades for the C$ has been $0.84 cents, McKeough says, so “It’s close to the midrange and not a bad place to be buying.”

Abundance in Emerging Markets

However, while Canadian stocks may indeed be a good buy, the case for global equities – and especially Emerging Markets – is far stronger, argues Tyler

Mordy, president and chief investment officer of Kelowna-based Forstrong Global Asset Management Inc.

"Since 2010, US and Canadian stocks have soared while emerging market equities have gone nowhere. Like the biblical Joseph interpreting dreams for Pharaoh, our Investment Committee has declared this seven-year famine over. It is time for abundance."

Emerging Markets underperformed developed markets through much of the 1990s, but after 2000 they outperformed for 10 of the next 12 years. And history may be repeating itself, as Emerging Markets stocks are outperforming Canadian stocks by some 20 percentage points this year.

"For the first time in a decade, all 45 countries tracked by the OECD are poised for growth this year," Mordy says. Emerging Markets business cycles are just entering a broad-based expansion phase, with no inflation on the horizon, so monetary policy will remain accommodative and profits have plenty of room for improvement. "In short, the conditions that North America has enjoyed over the last seven years have arrived in Emerging Markets."

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Sector plays – where to look in Canada?

Still, it's a rare investor who would have more money overseas than in the stable Canadian market and dollar. The question is which sectors have the best potential going forward.

Matthew Ardrey, vice president and wealth advisor with Toronto-based TriDelta Financial, says his firm uses a model for conservative investors that overlays quantitative analysis of cash flow, return on equity, dividend yield and dividend growth with fundamental and technical analysis. Currently this model "is favouring stocks in the Canadian Financials and Utilities sectors. Energy stocks do not rank well in the process, and, fundamentally, we think the Energy market has more downside in the near term."

Financials overall are fairly valued relative to their historical range and cheap when compared to the overall market, Ardrey says. Meanwhile, Utilities continue to outperform after their relative strength versus the market bottomed in February 2017. However, utilities valuations are still stretched when compared to historical levels.

Parting miscellaneous thoughts

One route is to look buy the ten large-cap Canadian stocks in the TSX 60 index that sport the lowest price/earnings ratios.

Norman Rothery, publisher of StingyInvestor.com, says this strategy has worked well the last 20 years. Currently, this list would include **CIBC, Power Corp., Sun Life Financial, Cenovus Energy Inc., Magna International, Barrick Gold, Teck Resources, Husky Energy and Encana Corp.**.

A back test to the end of 2016 shows that after being rebalanced annually, buying those ten low P/E stocks beat the index by 11.1 percentage points, Rothery says. Most of the stocks on the list have P/E ratios of no more than 11.5, with 10 being classic Benjamin Graham value. So that excludes some of the popular telecoms like **BCE** (P/E 18), **Rogers** (32) or **Telus** (21.) But the other big banks aren't that far away: **BMO, National Bank** and **ScotiaBank** are in spitting distance.

Pat McKeough's newsletters, including *Canadian Wealth Advisor*, still recommend all the big Canadians banks. He's less sure about the life insurance companies, since they could get hurt more by rising interest rates.

In telecom, he prefers BCE over Telus, while Rogers is "not something we ever recommended much." **TransCanada** is still a buy, and he prefers it over **Enbridge**. He's not a buyer recently of the oil sands stocks.

Take a look at the disclosures in my bio below and you'll see I own basically what amounts to a giant index fund of Canadian stocks, plus a decent amount of foreign index exposure.

So, Foolish investor, what's the next step you should take?

You may have already heard of *Motley Fool Pro Canada*, but if you haven't, just know it's the Fool's premium tier investing solution specifically created by Canadian investors, *for* Canadian investors.

We gave our top analysts here in Motley Fool Canada $250,000 of very own capital, and asked them to do whatever the heck they needed to in order to make money on that portfolio and manage it in the sharpest way possible. All while Canadian Fools could observe this entire real-money portfolio process step-by-step, and even directly mimic it if they so choose.

Every stock buy and sell recommendation – many of which you'll find nowhere else in Motley Fool Canada, or even The Motley Fool in general – as well as precisely *how much* you should be buying OR selling as a percentage of your portfolio. *Every* options trade, to fully weaponize your portfolio for added income and leveraged upside. And *every* single thought our Canadian pros have along the way, so you always know precisely where they stand with each and every position in the *Pro Canada* portfolio.

Unfortunately, because *Pro Canada* is indeed both our only Canadian real-money portfolio AND our most exclusive, highest-tier service in all of Motley Fool Canada, we only open up the doors to new members a very limited number of times per year… maybe once per quarter, *if that*. And the doors are currently closed.

Fortunately, though, we will be fully opening up *Motley Fool Pro Canada* to new members in just a few days, at which time you'll have a very limited chance to join *Pro Canada* as a full-fledged member, if you like what you see from the 100% free *Pro Canada* content we'll be offering during that exciting window of time.

Even better, you've already been added to our *Motley Fool Pro Canada* "VIP advanced interest list" – which will make it possible for you to be among the very first investors we alert when *Pro Canada* re-opens to new members again in a few days' time, as well as claim a highly exclusive *Pro Canada* VIP-only bundle.

That said, this will indeed be the FINAL full reopen period of *Motley Fool Pro Canada* at our most advantageous price point for the remainder of 2017, so make sure to be on the lookout for upcoming communications from us about *Pro Canada*, coming up any day now.

In the meantime, you can discover a little bit more about *Pro Canada*'s specific investing philosophy by **clicking here** to download a copy of our special free report titled **"The Motley Fool Pro Canada Insider Playbook: 6 "Pro" Strategies for This Crazy Market."**

It will shine a little more light on the unique, sophisticated, yet unbelievably easy-to-follow strategies that *Pro* employs to make money in a market as uncertain as this one – including some strategies you've probably never even considered before that could end up giving you a leg up on the market you never previously thought possible.

Just click here to download your free copy now!

Performance and market figures/calculations are as of 9/1/2017.

The Motley Fool recommends shares of Enbridge Incorporated and Magna International Incorporated.

Jonathan Chevreau is founder of the Financial Independence Hub and co-author of Victory Lap Retirement. He can be reached at jonathan@findependencehub.com. Either through ETFs or directly, he or members of his family own most of the securities mentioned in this piece, including XFN, ZLB, and individually all the big banks, insurance companies and telecom stocks mentioned. He also has small positions in Enbridge, TransCanada, Power Corp. and Husky but does not currently own Cenovus, Magna, Teck, or Encana

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