CANACCORD Genuity
Wealth Management

To us there are no foreign markets.™

December 3, 2017

Weekly Note

Investment Team

Robert Jukes
Global Strategist
T: 44.207.523.4594
robert.jukes@canaccord.com

Michael Quach
Senior Research Analyst
T: 44.207.523.4528
michael.quach@canaccord.com

Ian LeCroy
Research Analyst
T: 416.867.2643
ian.lecroy@canaccord.com

Money For Nothing

Another month, another positive return from equities, but is this money for nothing or hard-won gains? The FTSE All World Index (developed plus emerging markets) is up 1.1% in November and 16.0% YTD in local currency terms, while the US continues to lead the way in terms of performance among the major developed markets. The S&P 500 Index is up 2.8% in November and 18.3% YTD in local currency terms.

These positive returns continue to be driven by coordinated positive global growth momentum and the expectation of a further stimulus from tax cuts in the US. It is hard to remain anything other than positive on equities going forward given the still accommodative global monetary policies, the positive global economic momentum and earnings growth. That said, we understand that valuations remain a concern for many investors, so we examine the composition of multiples this week, and conclude that earnings growth continues to explain the bulk of equity returns.

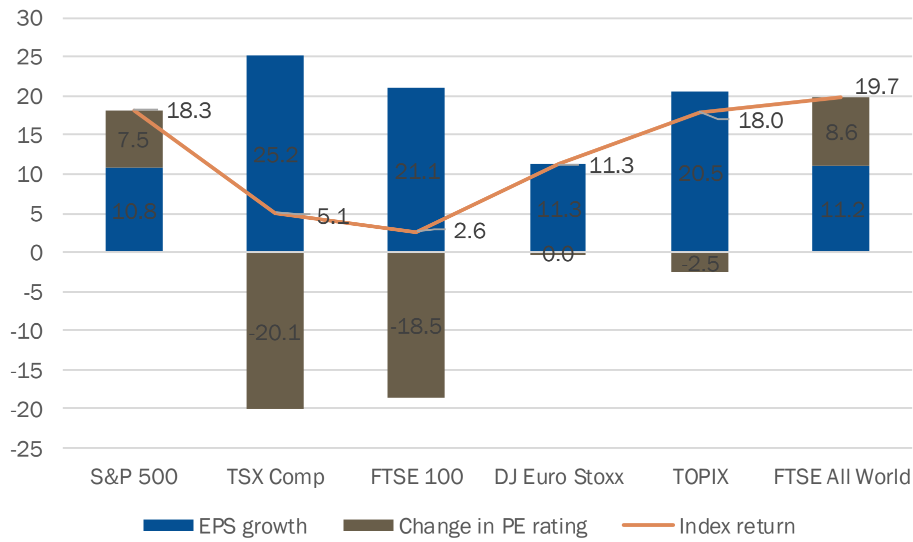
There is a general presumption that much of the S&P 500 Index performance so far this year has been a result of higher valuations. If we decompose equity returns into earnings growth and a change in the PE rating, however, it is clear to see that earnings growth has accounted for more than half of the US market performance since the start of the year. Of the 18.3% YTD return in the S&P 500 Index, earnings growth made up 10.8 percentage points with an upward re-rating in the PE valuation accounting for just 7.5 percentage points (Figure 1). Similarly, approximately 60% of the FTSE All World Index YTD return can be attributed to earnings growth, with approximately 40% attributed to the change in the PE rating. Markets are not being irrational in our view, they are simply pricing for a better earnings environment with the expectation that this will continue into the foreseeable future.

Not only that, there are markets where all the returns this year have been accounted for by earnings growth such as the Japanese TOPIX and the DJ Euro Stoxx indices. Perhaps even more interesting is that earnings growth in both the Canadian and the UK markets (which admittedly have been distorted by the resource sector) has outstripped their respective market performance YTD. That is, earnings have grown faster than returns leading to a de-rating of both these markets (figure 1) so that on a PE basis they have become cheaper.

If we extend the analyses to the past three years, most of the S&P 500 Index returns have come from a PE re-rating (returns outstripping earnings growth) with the same true of the TSX Index and the FTSE 100. In contrast, earnings growth has been the major driver of the World market return over the past three years, while the European and Japanese markets which have de-rated or become better value.

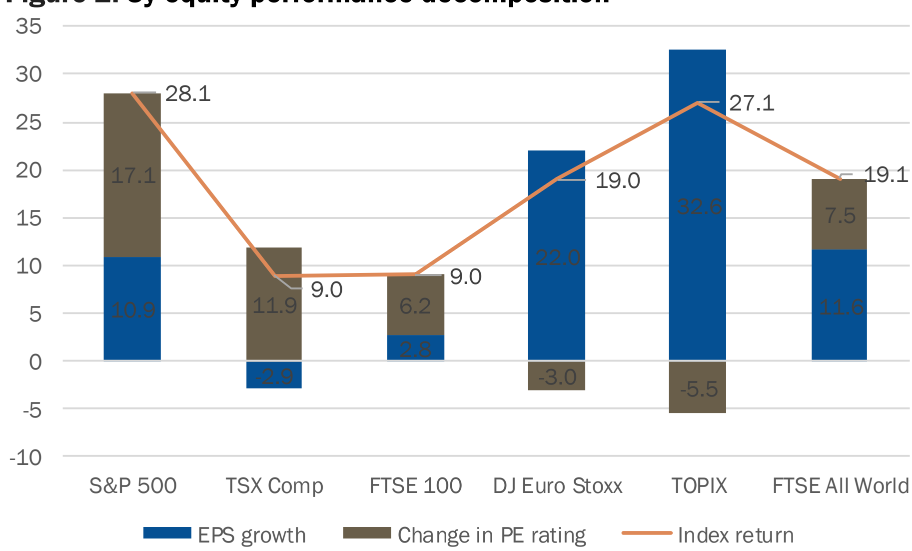
So while the US, Canada and UK equity markets had delivered returns ahead of earnings over the past three years, that's not been the case this year. This year returns have been driven predominantly by improving earnings. Indeed we expect somewhere close to 10% earnings growth from the US next year so there should be scope for further equity returns under that scenario.

Figure 1: YTD equity performance decomposition



Source: Datastream, Canaccord Genuity Wealth Management

Figure 2: 3y equity performance decomposition



Source: Datastream, Canaccord Genuity Wealth Management

All information is given as of the date appearing in this document and Canaccord Genuity Wealth Management (CGWM) does not assume any obligation to update it or to advise on further developments related. All this information has been compiled from sources believed to be reliable, but the accuracy and completeness of the information is not guaranteed, nor in providing it do CGWM assume any liability.

All views expressed in this document are provided for informational purposes only and does not constitute an offer or solicitation to buy or sell any securities. The statements expressed herein are not intended to provide tax, legal or financial advice, and under no circumstances should be construed as a solicitation to act as a securities broker or dealer in any jurisdiction. All views are intended for general circulation to clients and do not have any regard to the specific investment objectives, financial situation or general needs of any particular person.

Forward-looking statements and past performance are not guarantees of future results. To the fullest extent permitted by law, neither CGWM nor its affiliates or any other person accepts any liability whatsoever for any direct or consequential loss arising from any use of the information contained in this document. Canaccord Genuity Wealth Management in Canada is a division of Canaccord Genuity Corp. Member – Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada.