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Canada may continue to underperform

Keith Richards

The S&P/TSX Composite stock market index, like its predecessor, the TSX 300, is typically seasonally bullish into the spring. At ValueTrend, we have bought a few Canadian stocks and stock sectors in light of this potential, but we are taking a short-term view on most of those positions.

In this article, I'd like to highlight the challenges facing investors who have a longer-term view on Canada – and the Canadian dollar. I will highlight a few of the potential opportunities we at ValueTrend have been buying, with the caveat that readers understand our philosophy mimics the Canadian band Trooper's famous line: "We're here for a good time, not a long time."

At the end of the day, we remain convinced that Canada will continue to be an underperforming market – as it has been since 1999. Let's start with our currency, and the challenges unique to business in Canada.

The loonie

The chart on the following page shows you a trading zone that the loonie gets stuck in once in a while. Take a look at the adherence to that trading zone by the loonie after the 2008-09 crash, again in 2015, and again since July of last year.

The Canadian dollar likes to reside in the US$0.77 to US$0.78 area at the low end, and go up to the US$0.83 area at the high end. If the exchange rate breaks out of that zone, up or down, then the loonie tends to move aggressively in the direction of the breakout.

Right now it is flirting with US$0.77, which is right at the bottom of the trading range. In fact, as I write this article, the loonie has broken US$0.77 and looks bearish.

However, the currency may find some legs and get back above US$0.77. If that happens, and US$0.77 holds—we can expect a move back up to the low US$0.80s.

If it continues to break down below US$0.77, look for it to fall to US$0.74 or so. By the time you read this, you will probably know the actual outcome of these two potentials.

The Canadian dollar and oil

Approximately 14 per cent of Canada's GDP comes directly or indirectly from the energy industry. This means oil and gas exploration, production, and refining.

Add to that other industries affected by the energy industry like Canadian banks (as lenders), the transport industries (rail, pipelines, etc.) as well as distribution, and you're looking at a huge part of the Canadian economy. Thus, the Canadian dollar is influenced by the price of oil.

Seasonally, oil tends to do well from this time of the year until spring is well underway. That usually helps the loonie. It may again this year. Working against this are the anti-business policies of Canada's extreme left-wing governments (provincially and federally). Carbon taxes, corporate tax pressure, and new employment laws make new investment difficult for this industry – and others.

For example, the biggest oil company in Canada, **Suncor Energy Inc.** (SU-TSX, $43.07; SU-NYSE, US$32.96), recently announced that these imposing government policies have forced them to sideline new investments and projects for the foreseeable future.

This means that, despite a potentially rising oil price, our major producers are not going to invest in as many projects, and our economy may be isolated from what is usually a positive development (rising energy prices). The Canadian energy business is not on a level playing field with the other oil-producing countries.

At ValueTrend, we do have a position in a few energy producers in Canada such as **Vermilion Energy Inc.** (VET-TSX, $40.51; VET-NYSE, US$30.98) and **NuVista Energy Ltd.** (NVA-TSX, $7.33). We have a relatively short-termed view on holding these stocks. So far, they have been unprofitable since our en-

try point in late 2017.

Again, the words of Trooper echo in our heads when we view these holdings. "Profit or get off the pot" is our philosophy in domestic oil and gas – and we do wonder if there will be much profit to be had, given the latest government restrictions.

Other sectors are also restricted by the growing demands of new employment laws, along with higher corporate and individual taxes that current governments have brought in. These factors have and will, in addition to a steadily rising deficit, translate into a lower loonie.

Is steel a steal?

In mid-February, the U.S. Commerce Department proposed a potential 24 per cent tariff on aluminum and steel imports coming from foreign countries. Canada does have significant exposure to steel producers via **Stelco Holdings Inc.** (STLC-TSX, $25) and **Russel Metals Inc.** (RUS-TSX, $29.25).

The U.S. is by far the largest customer for Canadian steel. However, the American proposal was a "surgical option", which reduced the impact on major U.S. allies like Canada.

The fate of the industry in Canada will become clearer as the NAFTA talks develop. Say what you will about the wild tweets and bizarre soundbites from U.S. President Donald Trump, the man is a shrewd negotiator who has pushed his country's economy and stock market to huge new highs through favourable tax policies and now favourable trade negotiations.

During the same period, Canada's "tax, restrict, and party like it's never gonna end" governments have created flat economic growth and negligible stock market returns. For this reason, I am wary of being too bullish on the outcome of the NAFTA talks.

However, if the trade situation becomes more positive, I would be more inclined to be bullish on these otherwise healthy stock chart patterns. Notably, seasonal investing experts like Don Vialoux, Jon Vialoux and Brooke Thackray suggest that steel (and metals) do well into the spring normally.

We bought a very small piece of Russel Metals just after the U.S. announced that it would not impose tariffs on Canada's steel. For now, we are cautious but willing to place a small contrarian's bet on the outcome.

Keith on BNN

Keith appears regularly on BNN's MarketCall to answer viewer questions on the technical analysis of stock trends, and to provide unique insights on the factors of technical analysis used in successful investment management.

His next appearance will be at 1 p.m. on Monday, April 2.

If you have questions about the technical analysis of stock trends for individual stocks, be sure to phone in with your questions for Keith during the show.

Call toll-free at 1-855-326-6266 or email your questions ahead of time (specify they are for Keith) to marketcall@bnn.ca.

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