

# Canadian Market Outlook

An expected jump in profitability on the one hand and a drop in equity valuation multiples in line with rising interest rates on the other present investors with a likelihood of moderate Canadian equity returns in the high single to very low double digit range in 2010. However, we believe the prospects for great longer-term returns look most promising.

Consensus estimates call for 24.8% and 17.9% growth in earnings for the S&P/TSX Composite Index for calendar 2010 and 2011. Growth is expected to be strong across all ten sectors. In order to project the return potential of the Canadian equity markets for the calendar year, however, investors need to recognize that returns are not likely to match earnings growth. As global central banks begin to raise interest rates some time in or around mid-2010, market multiples are expected to contract.

Based on 2010 consensus estimates, our market is trading at a price-earnings (P/E) multiple of 15 times, slightly less than one standard deviation below the long-term average. The last time the market traded

at such a low multiple for a significant period of time was over 20 years ago.

But by how much will the P/E multiple shrink? In similar situations in 1990, 1995 and 2001, market valuations contracted by four points and this is the maximum we would expect this time. Even with a four-point contraction, the Canadian equity market should be able to reward investors with high single-digit or low double-digit returns over the coming year with the inclusion of dividends.

This forecast hinges prominently on the economy avoiding a double-dip recession. However, should the economy survive the reduced stimulus and the impact of central bank tightening, we may enter 2011 with the prospects of above-average growth in earnings, stronger consumer confidence and a market multiple that, based on historic evidence is dirt cheap. Investors should prepare themselves for moderate returns in 2010, but potentially more significant returns thereafter.

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