Bay Street Disconnects From Main Street. Or Does It?

"Why Is The Stock Market Rallying When The Economy Is So Bad?" asked the Wall Street Journal in their Markets section on May 8, 2020. It is a fair question. In just the past three months, unemployment in Canada has spiked to 13% and roughly, 6.7 million Canadians have applied for financial assistance under the Canadian Emergency Response Benefit as the economy has ground to a near halt. In the face of all this, how is it that the TSX Composite Index was able to recoup a large portion of earlier losses in April and May, reducing the year-to-date decline to a relatively benign 13%[1]?

The answer lies in the composition of market indices, revealing how common benchmarks can be skewed by major moves in a single subset of stocks, or by a big move in a single large constituent. This year has been one like no other, with a small slice of companies suddenly well-positioned to capitalize as families hunker down to eat, work and shop from home. These stocks have been well rewarded by investors, making the aggregate picture look much better than it actually is. Other companies in other industries, from mortgage lending to oil production to auto manufacturing, have not been treated nearly so kindly.

Company	2020 Return
Royal Bank of Canada	(19%)
Shopify, Inc. Class A	109%
Toronto-Dominion Bank	(24%)
Enbridge Inc.	(14%)
CN Rail	(1%)
Barrick Gold Corporation	57%
Bank of Nova Scotia	(32%)
Brookfield Asset Management	(17%)
TC Energy Corporation	(14%)
BCE Inc.	(9%)

Source: FactSet

The table at left shows the stock performance of the ten largest companies in Canada this year; two stocks very clearly stand out. The first is Shopify, an online commerce company assisting small businesses with website creation, inventory management, payment processing and more. With the pandemic closing virtually all physical store locations, having an online presence has never been more critical for small retailers, many of whom are turning to Shopify for help, prompting the stock to double.

The other notable stock is Barrick Gold. The main factor supporting the stock price here is a surge in investor demand for bullion, a reflection of nervousness about other investment alternatives and the economy generally. We can also see this phenomenon in other gold stocks among the fifty largest companies in Canada, with Franco Nevada up 53%, Wheaton Precious Metals up 66% and Kinross Gold up 65%. With a combined weight of approximately 15% in the index, the dynamic duo of Shopify and Gold has bolstered TSX Composite Index performance and masks the weaker underlying tone.

The table to the right lists some other household Canadian names that give a better sense of the current economy. Shares in major Energy and Financial companies Suncor and Manulife, retailer Canadian Tire, and auto parts leader Magna, all reflect material business headwinds. Even normally staid businesses such as dairy producer Saputo and telecommunications provider TELUS are feeling the pressures of the downturn.

Company	2020 Return
Suncor Energy	(40%)
Manulife	(39%)
TELUS	(11%)
Rogers Communications	(13%)
Magna	(23%)
Saputo	(26%)
Canadian Tire	(28%)
Air Canada	(65%)

Source: FactSet

The stocks in chart 2 above show a more accurate representation of the broad weakness currently spanning the Canadian economy. Clients should be mindful of this when reading headlines about frothy stock markets not reflecting reality, a function of a small portion of stocks benefiting from these unique circumstances. Below the surface, the larger stocks on Bay Street reflect the realities of Main Street; for now, they remain obscured by the handful that are making waves.

[1]All figures provided as of May 21, 2020.