



August 29, 2016

The Gretzky Way

Where's the puck going?

- Walter Gretzky ingrained in his son the idea that the key to success was going not where the puck had been, but rather where the puck was going to be. While the concept is easy to understand, in practice it involves a number of highly unpredictable variables that make implementation and success much more challenging.
- The world of investing follows a similar pathway to Mr. Gretzky's advice. That is, where markets are or have been is likely much less important to long-term success than figuring out "where the puck is going to go."
- Sector weights in the S&P/TSX offer an interesting picture as to where the puck has been and where it currently sits. Dominated by Financials, Energy, and Materials, the TSX has become a true anomaly amongst global developed markets with nearly double the weighting in these three sectors than any of its peers and conversely less than one-third the exposure to Consumer, Health Care, and Technology than the average of other developed market indices.
- We continue to believe that the puck is heading in Canada's direction over the next 12 to 18 months. However, we have longer-term concerns that some of the dominant themes over the next decade will eventually lead the puck elsewhere.

All values in Canadian dollars unless otherwise noted.

Priced as of prior trading day's market close, ET (unless otherwise stated).

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Where's the puck going?

Although well-traveled in Canadian annals, Wayne Gretzky, perhaps the greatest player to ever play any professional team sport (for those who would go Michael Jordan, we note that Gretzky's records completely transcend those of anyone else who played the game of hockey), was taught by his father not to skate to where the puck was, but rather to skate to where the puck was going. A somewhat simple concept to be sure, but much more difficult in practice, as it requires not only reading the minds of other players but also considering the vagaries of deflections, board angles, and ice speed.

The world of investing carries somewhat similar characteristics. That is, investing based on where the market has been is much less effective in the long run than investing based on where the market might be going. Of course, like Walter Gretzky's advice to his young son, the theory is easier than the implementation.

Where the puck has been

As a launching off point, we thought it would be interesting to look back over the past three-plus decades to observe how the make-up of the S&P/TSX has changed. In the moment, it may have seemed like such and such sector, which reigned supreme, would do so ad infinitum into the future, but history has tended to bear out something different.

Exhibit 1: Financials, Energy, and Materials have consistently dominated the TSX

TSX sector weights ranked by size in five-year intervals

1980	1985	1990	1995	2000	2005	2010	2015	Current*
Materials 30.4%	Materials 21.1%	Materials 25.9%	Materials 29.7%	Tech. 24.3%	Financials 32.3%	Financials 30.7%	Financials 33.6%	Financials 35.3%
Energy 20.5%	Financials 18%	Financials 21.6%	Financials 17.8%	Telco. 15.7%	Energy 19.5%	Energy 27.3%	Energy 21.7%	Energy 19.7%
Financials 15.3%	Energy 11.4%	Industrials 12.5%	Energy 10.7%	Financials 15.6%	Materials 16.3%	Materials 18.9%	Materials 12.3%	Materials 14.2%
Industrials 10.9%	Industrials 10.7%	Telco. 9%	Cons. Stap. 8.2%	Materials 11%	Cons. Disc. 6.5%	Industrials 5.7%	Industrials 8.5%	Industrials 8.8%
Telco. 6.2%	Cons. Stap. 10.5%	Cons. Stap. 8.8%	Industrials 8.1%	Cons. Disc. 10%	Tech. 6.3%	Cons. Disc. 4.5%	Cons. Disc. 5.9%	Cons. Disc. 6.2%
Utes 5.7%	Telco. 10.4%	Energy 7.9%	Telco. 7.7%	Energy 8.1%	Industrials 6.2%	Telco. 4.4%	Telco. 5.2%	Telco. 5.6%
Cons. Stap. 5.3%	Cons. Disc. 7.6%	Cons. Disc. 7.5%	Cons. Disc. 6.8%	Industrials 7.7%	Telco. 5.4%	Tech. 3.6%	Health Care 4.2%	Cons. Stap. 4.2%
Cons. Disc. 3.8%	Utes 6.2%	Utes 3.9%	Tech. 5.5%	Cons. Stap. 2.9%	Cons. Stap. 4.6%	Cons. Stap. 2.9%	Cons. Stap. 3.8%	Tech. 2.9%
Tech. 1.8%	Tech. 4%	Tech. 2.6%	Utes 4.4%	Utes 2.6%	Health Care 1.6%	Utes 1.7%	Tech. 2.5%	Utes 2.5%
Health Care 0%	Health Care 0.2%	Health Care 0.3%	Health Care 1.2%	Health Care 2.4%	Utes 1.5%	Health Care 0.5%	Utes 2.3%	Health Care 0.8%

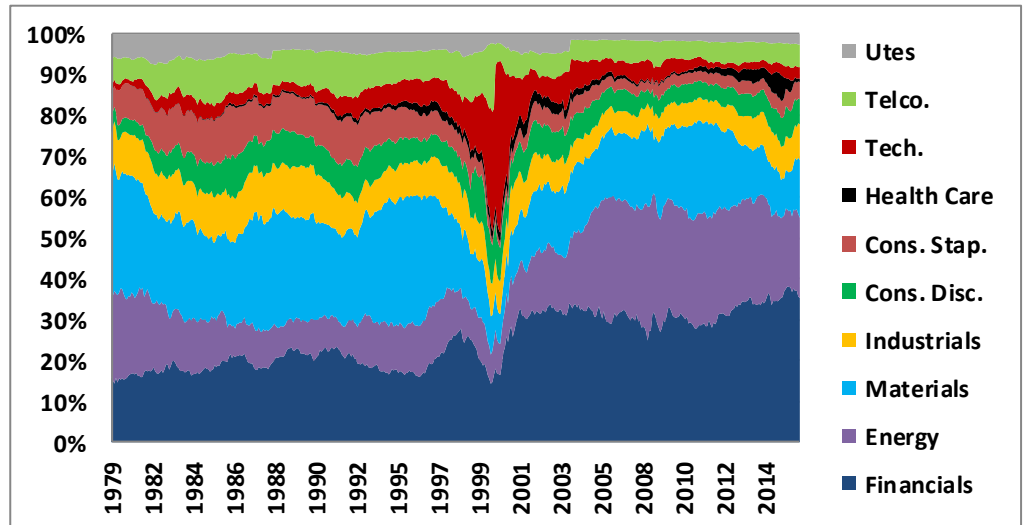
Source: RBC CM Quantitative Research. *Through July 31, 2016

At first glance, the movements in the TSX seem relatively consistent. Financials have been among the top two or three sectors weights for the past 35 years, while Energy and Materials can mostly make the same claim. In fact, save for a brief period in the midst of the Tech bubble when Technology and Telecom briefly held the top two spots, Financials, Energy, or Materials have been the largest weights in the index since 1980.

However, if we frame sector weights in two different ways, we get a somewhat different picture.

Exhibit 2: Financials, Energy, and Materials have consistently dominated the TSX

TSX sector weights over time



Source: RBC CM Quantitative Research. Through July 31, 2016

Here we get a better picture of the trend higher in the weight of Financials over the past 15 years. Part of this is a function of the sharp decline in the weight of Tech and Telecom from 2000 to 2002; however, the weight of Financials has continued to trend higher in recent years as the commodity cycle has rolled over, driving down the weights of first Materials and then Energy. In fact, the weight of Financials (38% in late 2015) recently approached the peak levels of Technology in 2000 (42%).

Exhibit 3: Percentage changes over time show a constantly moving puck

Percentage changes in TSX sector weights over time

Year	Energy	Materials	Industrials	Cons. Disc.	Cons. Stap.	Health Care	Financials	Tech.	Telco.	Utes
1985	-44%	-31%	-2%	100%	96%	850%	18%	121%	67%	9%
1990	-31%	23%	17%	-1%	-16%	32%	20%	-35%	-14%	-37%
1995	36%	14%	-36%	-10%	-8%	372%	-18%	114%	-14%	13%
2000	-25%	-63%	-5%	47%	-65%	102%	-13%	343%	102%	-42%
2005	141%	48%	-19%	-35%	60%	-34%	107%	-74%	-66%	-42%
2010	40%	16%	-8%	-30%	-38%	-70%	-5%	-43%	-18%	14%
2015	-21%	-35%	50%	30%	35%	802%	9%	-31%	18%	38%
Since 2015	-9%	15%	3%	5%	10%	-82%	5%	17%	7%	7%

Source: RBC CM Quantitative Research. Through July 31, 2016

In a similar fashion, where the puck has been with regard to the prior five-year period's biggest gainers in terms of sector weights tends to tell us very little about how the next five years will play out. If one had taken just the trend of 2010 to 2015 and assumed that the "puck" would continue to sit in roughly the same spot from the beginning of 2015 through the end of July of this year, one would have underweighted the two biggest percentage gainers in terms of sector weights over the period (Materials and Technology) and overweighted the biggest percentage decliner (Health Care).



Sector shifts have made the TSX a “unique animal”

It is no secret that the S&P/TSX is a bit of an anomaly in terms of developed market indices. That is, the sector weights of the TSX differ dramatically from those of other global indices with significantly more weighting in Financials, Energy, and Materials.

Exhibit 4: The TSX's combined weight in Financials, Energy, and Materials is ~30% greater than the next highest index

% sector weights

Financials	Energy	Materials	Telcos.	Utes	Industrials	Cons. Stap.	Tech.	Cons. Disc.	Health Care
S&P/TSX 34.8%	S&P/TSX 20.4%	S&P/TSX 13.8%	NKY 9.4%	FTSE 4.6%	NKY 21.1%	FTSE 19.6%	S&P 500 20.9%	NKY 21.6%	DAX 15.8%
FTSE 19.2%	FTSE 13.3%	DAX 13.1%	DAX 5.7%	CAC 4.5%	CAC 16.4%	CAC 12.1%	NKY 14.7%	DAX 19.7%	S&P 500 14.9%
DAX 16.1%	CAC 10.5%	CAC 7.9%	S&P/TSX 5.4%	S&P 500 3.3%	DAX 13.1%	S&P 500 10.1%	DAX 10.6%	CAC 16.2%	FTSE 11.7%
S&P 500 15.9%	S&P 500 7.1%	NKY 7.9%	FTSE 5.4%	S&P/TSX 2.8%	S&P 500 10%	NKY 9%	CAC 3.4%	S&P 500 12.3%	CAC 11%
CAC 15.2%	NKY 0.3%	FTSE 7.5%	CAC 2.8%	DAX 2.7%	S&P/TSX 8.8%	S&P/TSX 4.2%	S&P/TSX 2.8%	FTSE 9.4%	NKY 10.3%
NKY 5.4%	DAX 0%	S&P 500 2.9%	S&P 500 2.6%	NKY 0.4%	FTSE 7.4%	DAX 3.3%	FTSE 2%	S&P/TSX 6.1%	S&P/TSX 0.9%

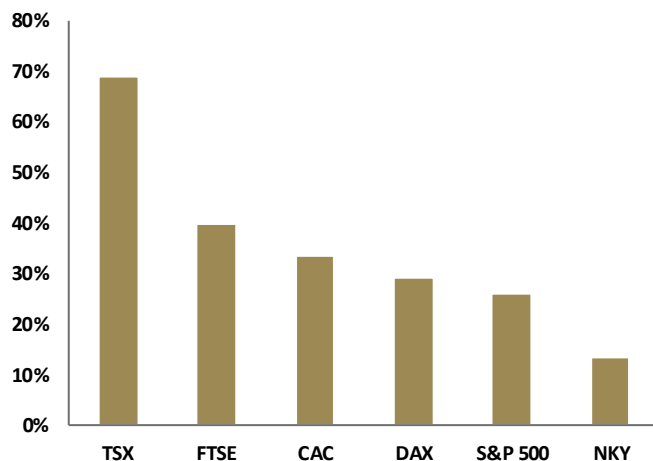
Source: Bloomberg, RBC CM Quantitative Research. Weights as of July 31, 2016

The TSX now has nearly a 70% combined concentration in Financials, Energy, and Materials, with Financials comprising roughly half of this weight. This dwarfs any other developed market index, with the FTSE the next closest at ~40% combined weighting in these three sectors.

Conversely, the TSX has a combined weight of only ~14% in Consumer Staples, Technology, Consumer Discretionary, and Health Care. The other developed indices average ~50% in these four sectors, with the S&P 500 averaging more per sector (~15%) in these four sectors than the combined total of the TSX.

Exhibit 5: Financials, Energy, and Materials dominate the TSX...

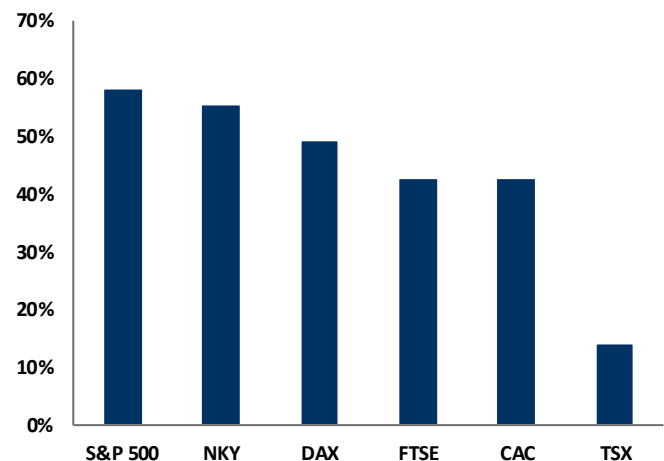
Combined % weighting in Financials, Energy, and Materials



Source: RBC CM Quantitative Research. Weights as of July 31, 2016

Exhibit 6: ...at the expense of Consumer, Health Care, and Tech

Combined % weighting in Tech, Health Care, Consumer Staples, and Disc.



Source: RBC CM Quantitative Research. Weights as of July 31, 2016



Where's the puck going in the near term?

In the near term, we have a positive disposition toward the S&P/TSX. Our overweight recommendation and year-end 2017 price objective of 15,800 (representing a ~11% total return from current levels) are predicated on a number of different pillars centred around stimulative monetary policy and the potential for global fiscal stimulus (for more on our view, please see [here](#)). In other words, we believe the puck is heading toward outperformance in commodities over the next 12 to 18 months, which is in stark contrast to the trends of the past few years.

Exhibit 7: We believe the puck will continue to head in the direction of commodities over the next few quarters

Annual total returns of S&P/TSX sectors ranked by performance

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016*
Materials 39.8%	Infotech 48.2%	Cons. Stap. -6.1%	Financials 45.6%	Health Care 57%	Health Care 50.4%	Health Care 24.7%	Health Care 72.1%	Cons. Stap. 49.1%	Infotech 15.6%	Materials 62.9%
Infotech 27.3%	Materials 30.3%	Utes -20.5%	Infotech 44.3%	Materials 36.5%	Telcos 24.9%	Cons. Stap. 22.6%	Cons. Disc. 43%	Infotech 35.1%	Cons. Stap. 12.4%	Utes 20.8%
Telcos 20.1%	Telcos 19.9%	Telcos -24.8%	Energy 39.5%	Cons. Disc. 25.3%	Cons. Stap. 6.8%	Cons. Disc. 22.1%	Industrials 37.5%	Health Care 30.3%	Telcos 3.6%	Telcos 19.9%
Financials 19.2%	Utes 11.9%	Industrials -25.1%	TSX 35.1%	Telcos 22.4%	Utes 6.5%	Financials 17.6%	Infotech 37.3%	Cons. Disc. 29.1%	Cons. Disc. 1.5%	Energy 18.8%
TSX 17.3%	Industrials 10.5%	Materials -26.5%	Health Care 34.4%	Utes 18.4%	Industrials 4.2%	Industrials 15.3%	Financials 23.7%	Industrials 21.9%	Financials -1.7%	TSX 14.1%
Cons. Disc. 15.7%	TSX 9.8%	Health Care -30.2%	Materials 34.2%	TSX 17.6%	Financials -2.9%	Telcos 11.5%	Cons. Stap. 23.6%	Utes 16.1%	Utes -3.5%	Industrials 13.4%
Industrials 14.7%	Energy 8.2%	TSX -33%	Industrials 27%	Industrials 16.9%	TSX -8.7%	TSX 7.2%	Energy 13.6%	Telcos 15.5%	TSX -8.3%	Financials 8.7%
Utes 7%	Cons. Disc. 4.2%	Energy -33.9%	Utes 19%	Energy 13.3%	Energy -9.9%	Utes 4%	Telcos 13.1%	Financials 13.8%	Industrials -11.1%	Cons. Stap. 8.1%
Energy 6.1%	Financials -1.6%	Cons. Disc. -35.4%	Cons. Disc. 15.1%	Financials 10.5%	Cons. Disc. 15.5%	Energy -0.6%	TSX 13%	TSX 10.6%	Health Care -15.6%	Cons. Disc. 5.7%
Cons. Stap. 5.5%	Cons. Stap. -5.3%	Financials -36.4%	Cons. Stap. 8.1%	Cons. Stap. 10.3%	Materials -21.2%	Infotech -2.9%	Utes -4.1%	Materials -2.6%	Materials -21%	Infotech 3%
Health Care 0.7%	Health Care -24.2%	Infotech 54.2%	Telcos 6.6%	Infotech -11.6%	Infotech -52.5%	Materials -5.7%	Materials -29.1%	Energy -4.8%	Energy -22.9%	Health Care -70.6%

Source: RBC CM Quantitative Research. *Returns through July 31, 2016

We believe these trends will be positive for the TSX not only on an absolute basis but also on a relative basis.



Exhibit 8: Similarly, we believe the TSX, which was out of favour heading into 2016, will continue its outperformance into 2017

Annual returns in USD

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016*
DAX 35.9%	WTI 57.2%	Gold 5.5%	WTI 77.9%	Gold 29.7%	Gold 10.2%	DAX 31.4%	NASDAQ 38.3%	NASDAQ 13.4%	Nikkei 8.6%	WTI 27.9%
CAC 30.9%	GSCI 40.7%	HF Index -23.3%	MSCI EM 74.5%	PE Index 25.9%	WTI 8.2%	PE Index 24.4%	DAX 30.7%	S&P 500 11.4%	NASDAQ 5.7%	Gold 25.3%
MSCI EM 29.2%	MSCI EM 36.5%	Nikkei -28.7%	PE Index 51.8%	TSX 20.6%	GSCI 2.1%	CAC 17.3%	PE Index 30.5%	HF Index -0.6%	S&P 500 -0.7%	TSX 19.9%
FTSE 25.9%	DAX 35.2%	S&P 500 -38.5%	TSX 51.5%	GSCI 20.4%	S&P 500 0%	NASDAQ 15.9%	S&P 500 29.6%	Gold -1.5%	DAX -1.6%	GSCI 16.5%
Gold 23.0%	Gold 31.3%	NASDAQ -40.5%	GSCI 50.3%	NASDAQ 16.9%	NASDAQ -1.8%	MSCI EM 15.1%	Nikkei 29.1%	TSX -1.8%	CAC -2.6%	MSCI EM 13.1%
PE Index 22.7%	TSX 25.1%	GSCI -42.8%	NASDAQ 43.9%	MSCI EM 16.4%	FTSE -6.0%	S&P 500 13.4%	CAC 22.9%	MSCI EM -4.6%	HF Index -3.6%	S&P 500 6.6%
TSX 14.2%	CAC 12.0%	DAX -42.9%	FTSE 35.3%	WTI 15.1%	HF Index -8.9%	FTSE 10.7%	FTSE 16.6%	PE Index -5.5%	PE Index -7.1%	PE Index 5.3%
S&P 500 13.6%	NASDAQ 9.8%	CAC -45.1%	DAX 27.0%	S&P 500 12.8%	Nikkei -12.8%	Nikkei 9.0%	WTI 7.2%	Nikkei -5.8%	FTSE -10.1%	NASDAQ 4.4%
NASDAQ 9.5%	FTSE 5.2%	TSX -46.8%	CAC 25.4%	Nikkei 11.2%	TSX -13.1%	TSX 7.1%	HF Index 6.7%	FTSE -8.5%	Gold -10.5%	DAX 1.6%
HF Index 9.3%	HF Index 4.2%	FTSE -49.5%	Gold 24.0%	DAX 8.5%	DAX -17.4%	Gold 7.0%	TSX 2.3%	DAX -9.6%	MSCI EM -17.0%	Nikkei 1.5%
Nikkei 5.7%	S&P 500 3.5%	WTI -53.5%	S&P 500 23.5%	FTSE 5.2%	CAC -19.6%	HF Index 3.5%	GSCI -2.2%	CAC -12.4%	TSX -25.3%	HF Index 0.9%
GSCI 0.4%	Nikkei -5.3%	MSCI EM -54.5%	Nikkei 16.1%	HF Index 5.2%	MSCI EM -20.4%	GSCI 0.3%	MSCI EM -5.0%	GSCI -33.9%	GSCI -25.5%	CAC -1.3%
WTI 0%	PE Index -13.8%	PE Index -66.5%	HF Index 13.4%	CAC -9.7%	PE Index -23.3%	WTI -7.1%	Gold -28.3%	WTI -45.9%	WTI -30.5%	FTSE -2.4%

Source: Bloomberg, RBC CM Quantitative Research. *Returns through August 26, 2016; HF Index denotes HFRX Global Hedge Fund Index; PE Index denotes S&P Listed Private Equity Index

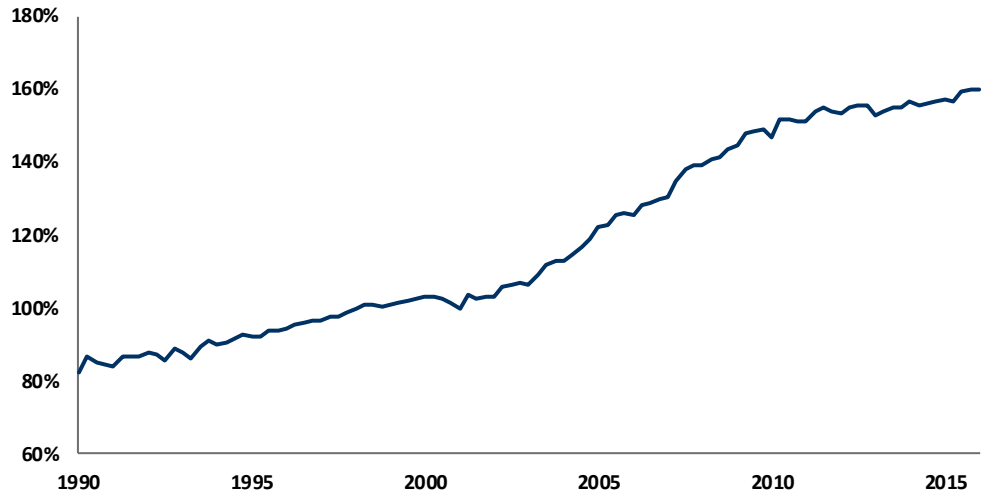
Where are the long-term tailwinds?

While we like the setup for Canada through 2017, we have longer-term concerns primarily stemming from the composition of the index. Commodities enjoyed a powerful tailwind from 2000 to 2012 (or thereabouts) on the back of the industrialization of China. This dynamic has clearly shifted, and while we are in a window of somewhat significant Chinese monetary stimulus, our Asia team is [of the view](#) that the China dividend is unlikely to “pay off” over the next decade to any sort of degree approaching the 2000–12 period.

Similarly, Canadian Financials and more specifically Canadian banks have been an enormous beneficiary of the “leveraging up” of the Canadian population.

Exhibit 9: You can only lever your population once

Canadian consumer debt as a percentage of disposable income

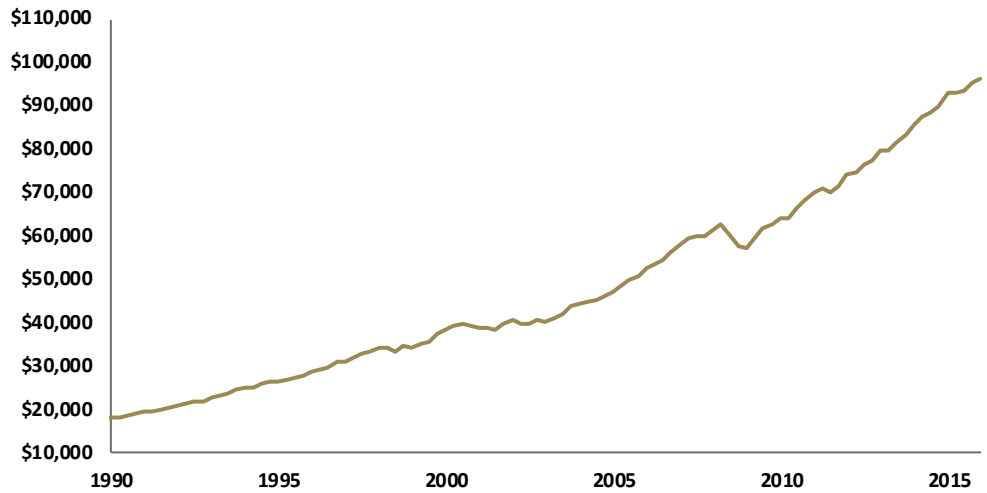


Source: Haver Analytics

Now, it's important to focus on the above not just in isolation but rather as part of a mosaic, which includes a very healthy consumer balance sheet driven by strong asset appreciation.

Exhibit 10: The balance sheet remains strong

Canadian consumer assets minus liabilities (in billions of Canadian dollars)



Source: Haver Analytics

That said, you may only get one opportunity to leverage your population (unless you adopt the U.S. model from 2002 to 2006, which did not end well), and based on Canadian debt levels, our economists expect the rate of debt accumulation to slow markedly in the years to come.

Rather, with the combination of an aging global demographic and the advances occurring in Health Care and Technology, the puck may be heading more toward those global markets that offer significantly more selection in these areas.



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