

The TSX Earnings Recession Ends with a Bounce

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Last year was the best in nearly three decades for Canadian stocks. How much of that momentum may carry over into 2010 will become clearer in coming days as the TSX Q4 reporting season shifts into full gear

As in the US, the forthcoming reports will mark the end of the earnings recession, after four down quarters. "Bottom-up" expectations are for an increase of 43% in TSX operating earnings on the year (Chart 1). That's the first positive print since 08:Q3 and compares with an expected 189% increase for S&P 500 stocks. The gain for the TSX looks like a tough wall to climb, but will in fact benefit hugely from an easy comparison with a year earlier, when both the Canadian and global economies sank into recession, dragging commodity prices and profits down. In sequential terms, TSX earnings will have to rise by only 5-6% from the previous quarter to meet expectations.

Insurers, Mining Expected to Drive Q4 Earnings Gain

Performance in two TSX segments in particular is expected to show striking year-to-year improvement (Chart 2). Insurers lost over \$1 billion in the year-earlier quarter as a result of adjustments on segregated funds and some of their other assets and liabilities. That sector is expected to see a well-over \$3 billion positive swing in profitability. The diversified mining group, meanwhile, is expected to

Chart 1
TSX Earnings Recession Ends

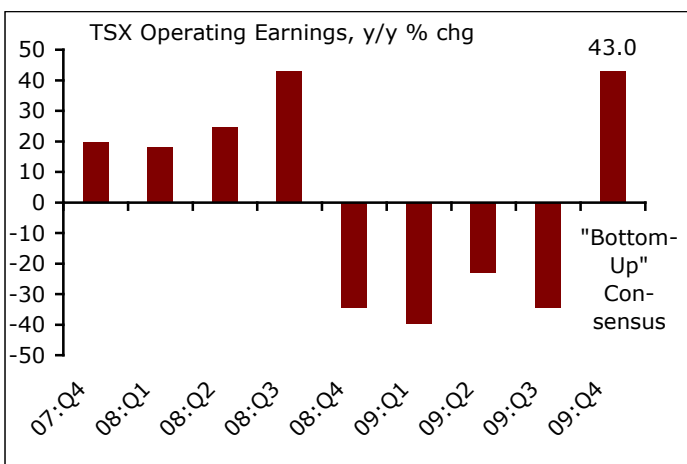
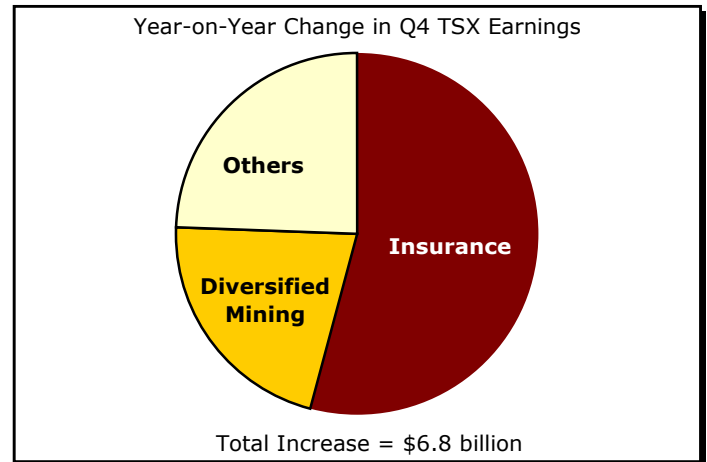


Chart 2
Better Results From Insurers, Metal Miners to Drive Q4 Results



see a \$1.5 billion improvement on a year earlier. Gains in those two segments will account for about three quarters of the total year-on-year rise in earnings.

Earnings in seven of ten major TSX market sectors are expected to show improvement on the year (Table 1). Next to the two areas identified above, health care, info tech and utilities stocks are expected to show the largest increases. Q4 expected 43% rise would nevertheless

Table 1

yr/yr % change	TSX Composite			S&P 500
	2009:Q3	2009:Q4	2009	2009:Q4
	Actual	Consensus	Consensus	Consensus
Cons. Discr.	-19.4	-2.7	-18.3	67.4
Cons. Staples	11.9	7.6	12.2	3.6
Energy	-68.3	-3.6	-49.9	-29.1
-E&P Firms	-68.8	-32.5	-57.1	19.8
Financials	-4.4	101.5	2.2	NM
-Banks	13.8	-2.9	2.6	NM
-Insurance	-24.8	NM	-1.3	NM
Health Care	-11.8	105.0	13.8	-7.3
Industrials	-10.0	-18.1	-22.3	-12.7
Info Tech	15.5	23.7	19.7	32.4
Materials	-48.6	4015.4	-27.9	136.9
-Gold	12.8	13.1	7.0	205.0
-Diversified Mining	-21.8	NM	-0.7	NM
-Chemicals	-83.6	-66.4	-72.6	99.8
Telecom	16.4	5.6	7.6	-70.2
Utilities	-154.2	58.6	160.5	-15.4
Total, All Sectors	-34.4	43.0	-26.0	188.5

NM=not meaningful, -ve yr ago

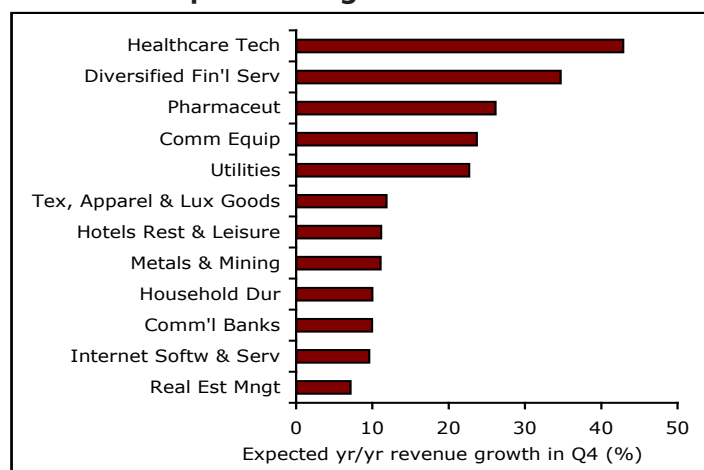
translate into a 26% drop for the year as a whole. That's a sizeable setback, although still better than the 80% decline in earnings in the early 1990s recession, when commodity prices sank even lower.

Analysts on both sides of the border have been ratcheting up their near-term expectations for earnings, in response to improvements in the economy and commodity prices. In Canada, positive revisions have accounted for 53% of all revisions for the quarter ahead recently, compared to a normal ratio of 42%. South of the border the ratio is an even loftier 73%. That suggests more of the positive news may already be priced into stock valuations than a few quarters ago, limiting the potential for stocks to rally strongly on the upcoming reports (Chart 3).

Revenues in Some Sectors Should Do Well

Revenue growth continues to be a key focus on both sides of the border. Canada's inflation rate cooled to 1.3% in the 12 months through December. That suggests a lack of pricing power, and by extension revenue performance remains a concern for some firms. Steep job cuts, especially in the US, have led to fears that recent profit growth is being fueled excessively by cost cutting rather than "organic" revenue growth, and that companies are effectively improving today's performance at the expense of tomorrow's. While such concerns remain, some sectors should show fairly good top-line momentum. That includes resource industries like mining, leveraged to hot emerging-market demand, as well as high-tech firms and others selling differentiated products, limiting their sensitivity to priced-based competition. It also includes firms facing favourable sales demographics like health

Chart 4
Some Sectors Could See Good Revenue Growth Despite Pricing Headwinds

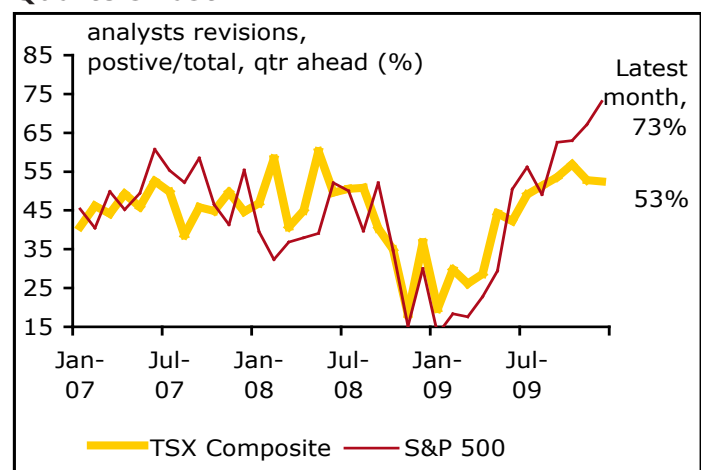


equipment and services (Chart 4).

Pressure on Firms to Meet 2010 Expectations

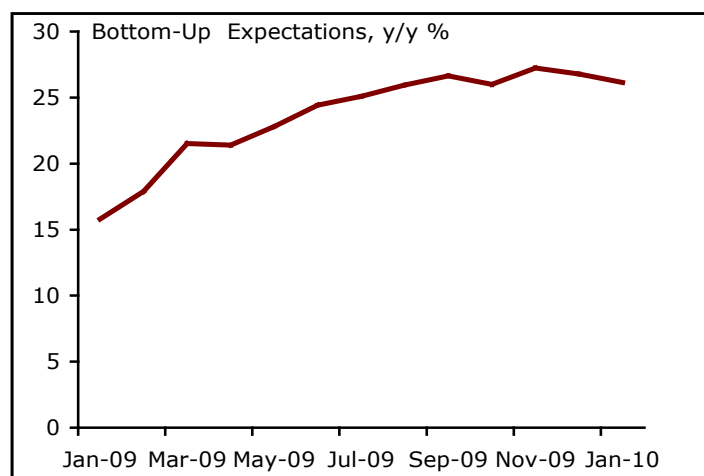
While meeting expectations this quarter may not prove in the end to be overly difficult for many firms, Composite members could have a greater challenge validating expectations for a 26% rise in 2010 (Chart 5). Although such increases have occurred after past recessions, that has generally been in the context of stronger economic recoveries than we expect this time, given the drag from a scaling back of fiscal stimulus programs in both Canada and the US. The currency, moreover, has seldom been as large a drag as it is at present. Commodity prices, another recent profit driver, are unlikely to advance quite as much this year as they did in 2009, when prices rose by the most in three decades.

Chart 3
Less Room for Upside Surprises Than in Quarters Past?



Source: Thomson Reuters, CIBC

Chart 5
2010 TSX Earnings Growth Expectations



Source: Thomson Reuters, CIBC