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EQUITY RUN ISN'T DONE

Dean DiSpalatro / January 3, 2014

2013 was a good year for U.S. markets, and many investors are worried there isn't much left in the tank. They want out.

This is a mistake, says David Taylor, portfolio manager at IA Clarington Investments. "It's a lazy man's way of doing analysis," he says, to assume the market will drop off simply because it's hit new highs. He expects markets to advance along with continued economic growth in 2014.

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"I think people are going to be surprised with how long the current cycle is going to last," Taylor says. He notes a normal cycle is about nine years, and it's been four and a half since the last recession. "At this point in the cycle you'd expect to see higher interest rates, higher inflation, more leverage and more speculation. We do have pockets of speculation but we don't see the things we would typically see four-and-a-half years out of a recession."

He has three key themes for 2014: U.S. financials, consumer discretionary and industrials. He singles out the auto sector, suggesting "it still [has] a long way to go because Europe hasn't even begun to turn."

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He notes the Fed has started tapering and that means rising rates. "I don't think that's a problem as long as [they] don't rise too quickly." While many are concerned about equity prices, Taylor says the real concern should be with the effect higher rates will have on bonds.

BACK OFF

Dan Bastasic, also a portfolio manager at IA Clarington, says Capitol Hill is stifling the U.S. economy's growth potential.

"We still haven't gotten the government to step out of the economy, and if they did we'd have much better growth," he says. "I think we'd be over 3% instead of the 2% to 2.5% we're dealing with.

"When you break down GDP… the private side of the U.S. economy is growing at over 3% and it's been at that number for the last two to three years. So someone's subtracting something, and it's the government."

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Bastasic says overall growth of 3% will push companies' earnings growth towards 5%. When dividend increases and share buybacks are factored in, "you're talking 7% to 8% total returns in the equity markets."

He's focusing on these dividend-paying stocks with growth potential for the next 12 months. "A good part of your portfolio should have exposure to [these] stocks. Ours [has] about 25% in that camp," Bastasic says, adding it makes more sense "to be at or above the market returns on a stable dividend with some growth than hoping for economic growth of 5%."

On our side of the border, Bastasic likes telecoms. "After the sell-off over the summer we found some pretty good valuations, and in particular BCE. It's as boring as it gets with [an] almost 5% dividend yield and we think it's growing at 5% or 6% over the next number of years."

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He's avoiding materials, which he's been negative on since 2010. Valuations are unimpressive and investment in China will likely remain sluggish—a headwind for the sector.

Bastasic also likes consumer discretionary and industrials. He's holding steady on Canadian banks. "[They're] much more expensive now than they were months ago….We're not adding but we've made some pretty good money and we're not quite ready to exit." He agrees with Taylor that U.S. financials offer better opportunities.

REITs are on his radar screen but valuations aren't yet where he wants them. "That's a story for the end of 2014," he suggests.

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Utilities have taken a beating but Bastasic doesn't presently see them as a buy opportunity. Valuations are generally fair and they have 3% to 4% embedded growth rates. Divided yields are decent and if the need arises they're a good inflation protector.

“I’m not suggesting we’re interested in utilities; they’re on our radar screen as REITs are,” he says, adding that when buying in this space, “you have to be specific and have a good bottom-up selection process.”

Over the next six months, expect market disruption in response to Fed tapering. But Bastasic isn’t worried; in fact, he’ll be ready to benefit from others’ knee-jerk sell-offs. “I think [it] will last a month or two and then you start to pick up some of these cheaper stocks.”

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