

Canadian Strategy Snapshot

Contrarian Positives Amid Canadian Equity Apathy

Bottom Line

While it is clear investors have been apathetic toward Canadian stocks especially when compared to their US counterparts, we believe negative equity flow headwinds will transpire into a clear contrarian *positive* in the second half of 2024. We believe this shift will be driven by foreign and domestic investors alike, demonstrating a renewed interest in Canadian equities given the increasing positive fundamental attributes of the overall North American equity markets. In fact, our works shows that not only were foreign investors record net sellers of Canadian equities in 2023, but domestic investors (both retail and institutional) slowed equity flows as they increased their overall cash positions. From our perspective, this proliferation of cash positions across the Canadian investor universe, coupled with record net foreign investor outflows, have been a key headwind for Canadian equity performance over the last year, and we believe will become a key tailwind when these trends stabilize and ultimately reverse. Indeed, our work shows the TSX can post some of its strongest absolute performance after troughs in net foreign flows and after troughs in broad trading volumes. As such, we believe as equity flows begin to stabilize, trading volumes (which decelerated sharply throughout 2023) will begin to *increase* which we believe will portend to above-average Canadian equity performance.

Please see our [2024 Market Outlook](#) for our fundamental view on Canadian Equities.

Overview:

- **Foreign Outflows Reach Extreme in 2023 = Contrarian Positive for 2024**
- **Investors Chasing Yield = Strong Cash Position for Retail Investors = Contrarian Positive for 2024**
- **Institutional Cash Position and Depressed Volumes = Another Contrarian Positive for 2024**

Implementation Strategies: Canadian focused portfolios that will benefit from broad multi-year normalization process.

[Canadian Small Cap portfolio](#)

[Canadian Equity PLUS portfolio](#)

[Canadian Ex Big Three portfolio](#)

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CDN Strategy – S&P/TSX Targets

S&P/TSX Price Target	
2024 Calendar Year End	23,500

S&P/TSX EPS Target	
2024 Calendar Year End	\$1,500

Source: BMO Capital Markets Investment Strategy.

CDN Strategy – Recommended S&P/TSX Sector Weightings

Sector	Opinion	Tgt. Wgt.
Communication Services	OW	4.5%
Consumer Discretionary	OW	4.5%
Consumer Staples	UW	3.5%
Energy	MW	18.0%
Financials	OW	31.5%
Health Care	UW	0.0%
Industrials	UW	12.0%
Information Technology	OW	9.0%
Materials	MW	11.0%
Real Estate	MW	2.0%
Utilities	MW	4.0%

Source: BMO Capital Markets Investment Strategy.

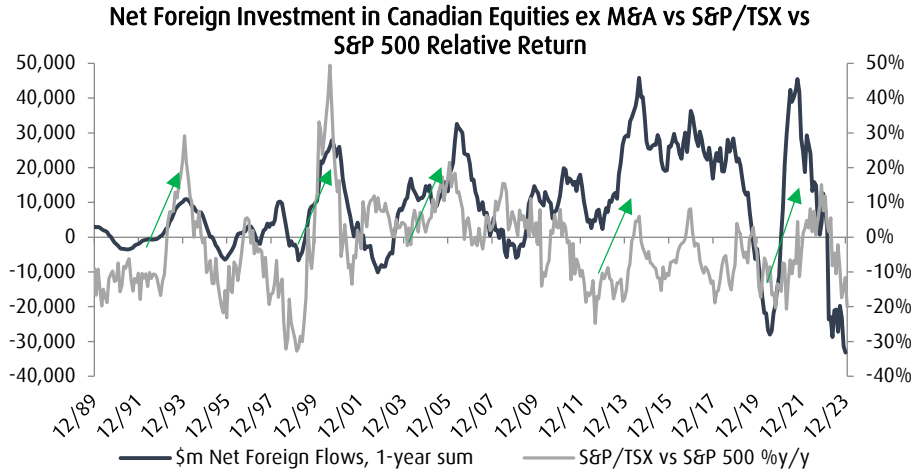
OW: Overweight

MW: Market Weight

UW: Underweight

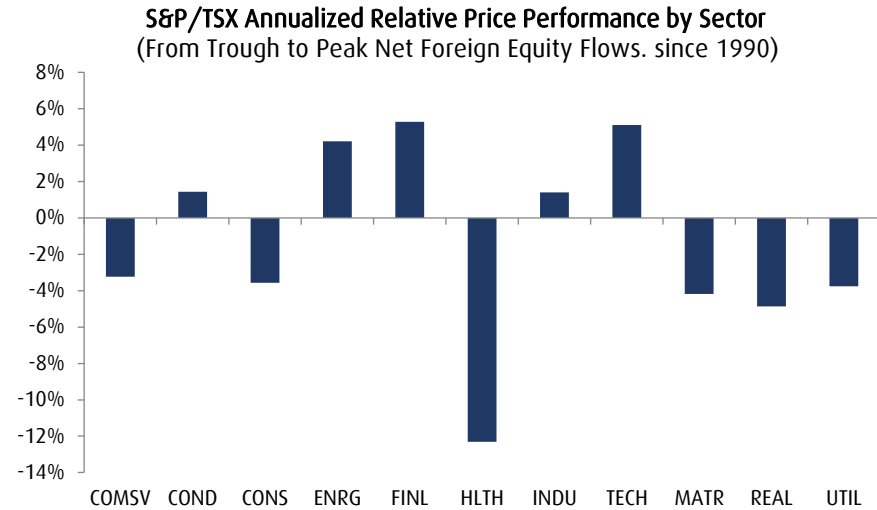
Foreign Outflows Reach Extreme in 2023 = Contrarian Positive for 2024

Foreign Outflows Have Been a Key Headwind, Returning Flows Will Be Key Tailwind



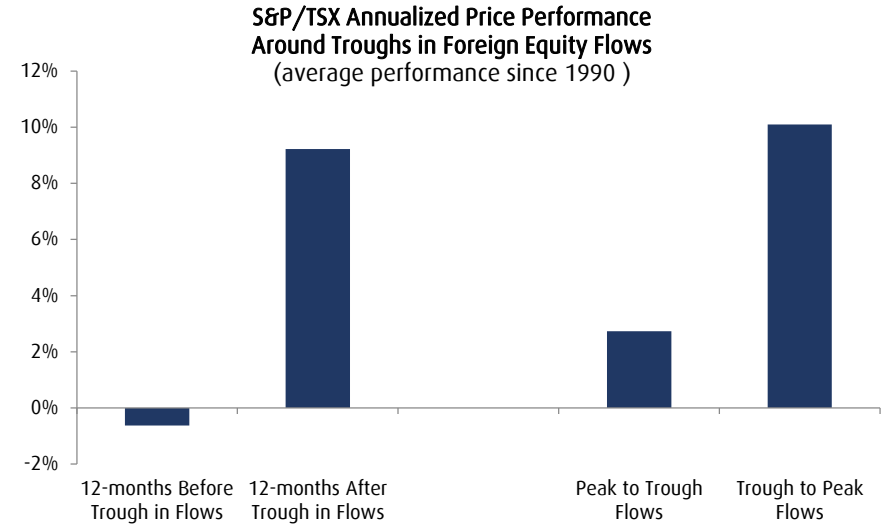
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, Statistics Canada.

Financials and the More Cyclical Sectors Tend to Outperform When Flows Are Improving



Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

TSX Can Post Strong Performance After Foreign Flows Trough



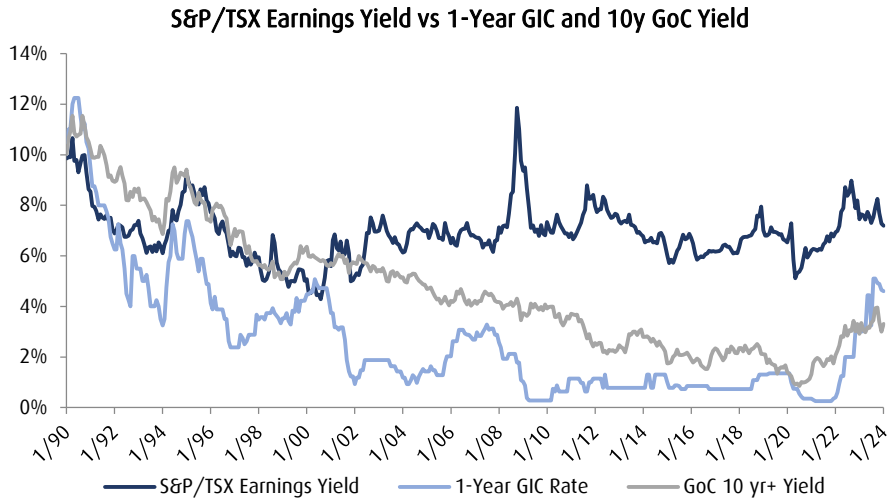
Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

Canadian equities saw the sharpest net foreign outflows on record, easily surpassing the 2020 low. From our perspective, while this helps to explain much of the recent underperformance versus other global markets, we believe it is also a strong contrarian positive for 2024. In fact, our work has shown that once these headwinds subside, rebounding flows (even just a moderation of outflow pressure) can be a strong tailwind for TSX relative performance. Furthermore, looking at individual sector performance shows Energy, Financials and the more cyclical sectors tend to outperform when flows begin to improve from trough levels. As such, we believe troughing net foreign outflows from Canadian equities is a contrarian positive for the second half of 2024.

- Troughs in net foreign investment in Canadian equities are highly correlated with troughs in S&P/TSX relative performance.
- In fact, the TSX can post some of its strongest absolute performance after a trough in foreign equity flows and tends to post double-digit returns on average from the trough in foreign flows to the next peak.
- According to our work, Consumer Discretionary, Energy, Financials, Industrials and Technology tend to outperform while foreign flows are rebounding.

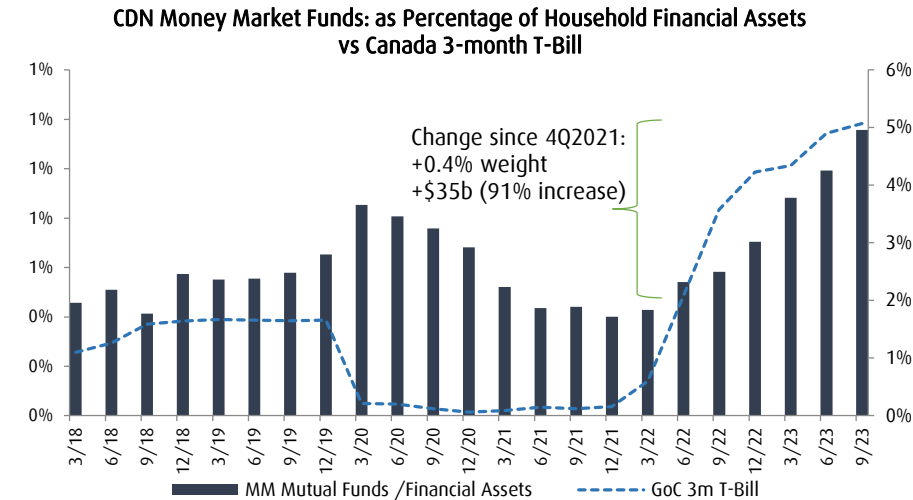
Investors Chasing Yield = Strong Cash Position for Retail Investors = Contrarian Positive for 2024

Equity Earnings Yield Has Narrowed Sharply vs. 'Risk-Free' Assets



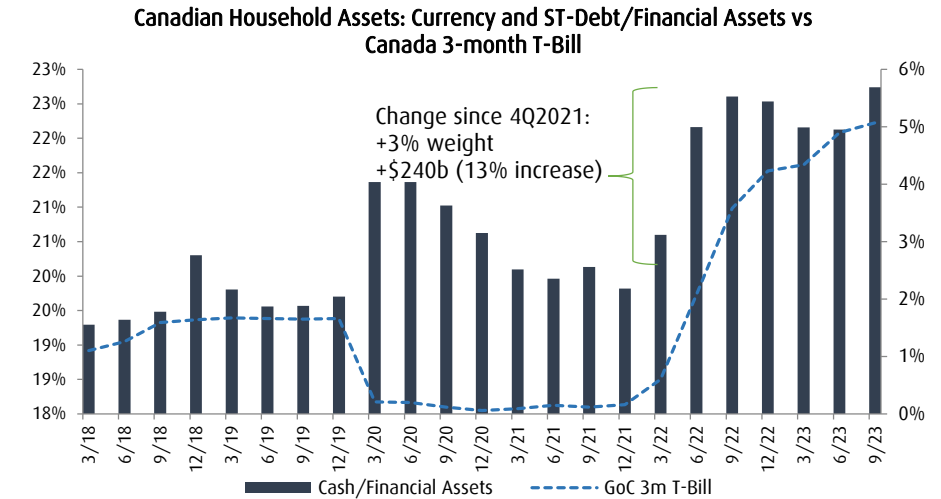
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, Statistics Canada.

Allocation to Money Market Funds Also on the Rise



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, Statistics Canada.

Household Cash Position Has Increased as Equity Yield Spread Compressed



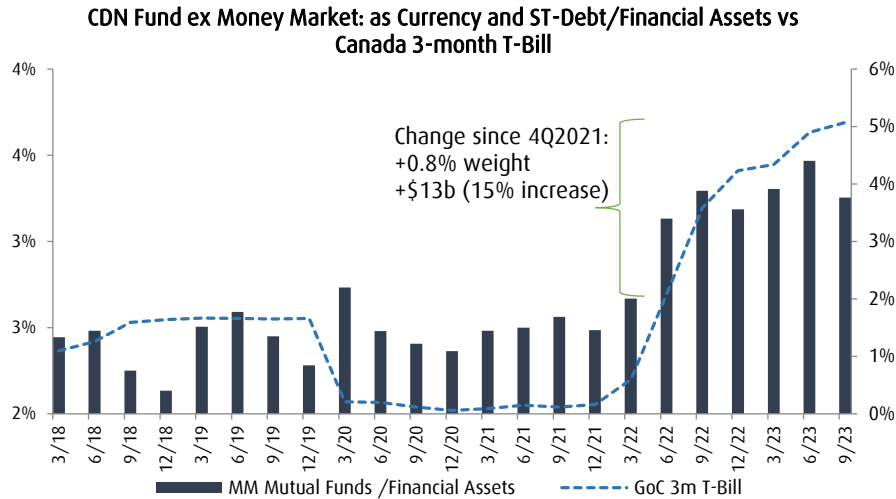
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, Statistics Canada.

While net foreign outflows shoulder a significant amount of the blame for softer TSX performance versus other global markets, we have also seen a clear increase in cash preference among retail investors as the spread between the Equity earnings yield and GIC rates have compressed to multi-decade lows. Indeed, this has led to a nearly 4% increase in overall cash holdings of the household balance sheet since the beginning of 2022. This represents over \$270 billion increase in net cash over the last two years. From our perspective, this suggests retail investors have a strong cash position, and a mere stabilization of these cash weights should be a contrarian positive for equities in 2024. To be clear, this does not mean we expect cash levels to be drawn down, just a slowing of allocation should be supportive of other assets classes, namely equities.

- On a purely yield basis, cash is now at the most attractive spread versus equities since 2000, with the spread between the S&P/TSX Earnings Yield and the 1-Year GIC rate at the narrowest level since 2000.
- After a post-COVID-19 drawdown in cash, Canadian households have rebuilt their cash weight to the highest level since 2008.
- Furthermore, money market mutual funds have grown 91% over the last two years as attractive yields have returned to the industry.

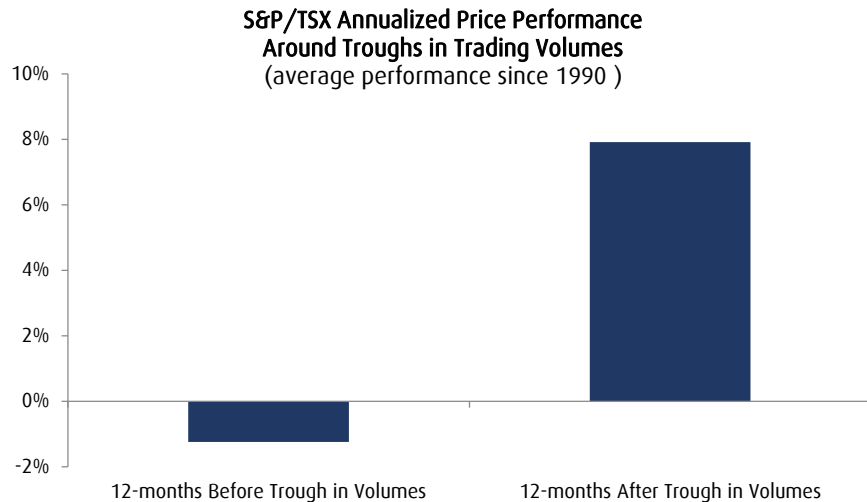
Institutional Cash Position and Depressed Volumes = Another Contrarian Positive for 2024

Institutional Cash Position Is Elevated



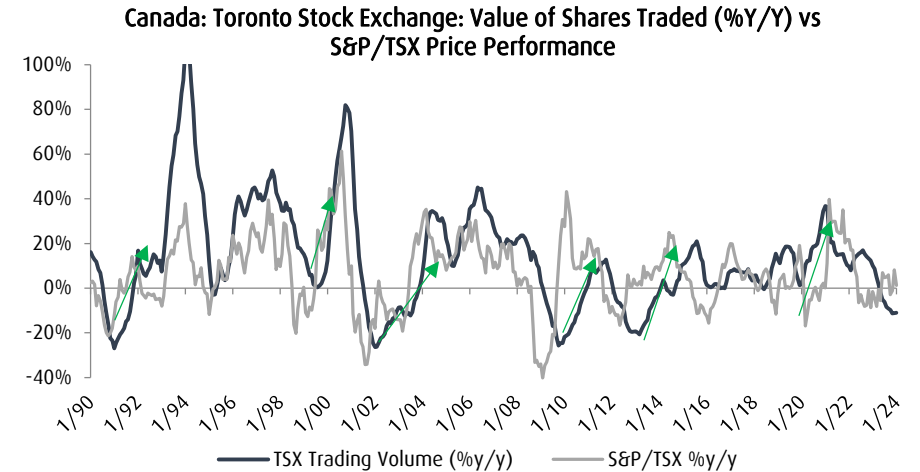
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, Statistics Canada.

TSX Can Post Strong Returns Heading Out of Troughs in Trading Volumes



Source: BMO Capital Markets Investment Strategy Group, FactSet, Compustat, IBES.

Canadian Equity Value Traded Decelerated Sharply in 2023, Rebound Should Be Positive for Equities



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, Statistics Canada.

In addition to net foreign equity outflows and slower retail inflows, institutional funds have also seen an increase in cash allocation by almost 1% over the last two years. From our perspective, the rise in cash positions across the Canadian investor universe and net foreign investor outflows have been a key headwind for Canadian equity performance over the last year, and we believe will become a key tailwind when these trends stabilize and ultimately reverse. In fact, trading volumes have decelerated sharply through 2023 as equity flows have eased. As such, we believe as equity flows begin to return, trading volumes will begin to increase which our work shows are highly correlated with improving equity performance.

- Institutional non-money market mutual funds have grown their cash position 15% over the last two years and is now at the highest cash position in over five years.
- Canadian equity value traded decelerated sharply in 2023 as domestic retail and institutional investors increased cash positions and foreign investors saw net outflows.
- Our work shows troughs in trading volumes are highly correlated with troughs in equity price performance.

Recent Canadian Strategy Research Reports

Date	Title
Canadian Strategy Snapshots	
2/15/2024	Canadian Strategy Snapshot: Canadian YARP Opportunities
2/7/2024	Canadian Strategy Snapshot: Our Overweight Canadian Consumer Discretionary
1/11/2024	Canadian Strategy Snapshot: Strong Fourth Quarter Provides Hints for 2024
12/13/2023	Canadian Strategy Snapshot: Notes From the Road – Canadian Year Ahead Edition
10/30/2023	Canadian Strategy Snapshot: Canada Well Positioned for Normalization
10/18/2023	Canadian Strategy Snapshot: Canadian Small Cap Opportunities
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9/21/2023	Canadian Strategy Snapshot: Divergent Growth Outlook Is Oversold
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8/16/2023	Canadian Strategy Snapshot: Four Observations From Q2 Earnings Season
8/10/2023	Canadian Strategy Snapshot: Cash Generation Key Source of Strength & Stability
7/26/2023	Canadian Strategy Snapshot: The Canadian Value Proposition
7/13/2023	Canadian Strategy Snapshot: Spotlight on Key Revision Trends in the TSX
6/29/2023	Canadian Strategy Snapshot: 2023 Mid-Year Update for the TSX
6/21/2023	Canadian Strategy Snapshot: Overweight Financials With Heightened Selectivity
6/13/2023	Canadian Strategy Snapshot: Hidden Strength and Opportunities Within the TSX
6/5/2023	Canadian Strategy Snapshot: Upgrading Technology to Overweight
5/17/2023	Canadian Strategy Snapshot: Factor Performance Observations of the TSX
5/10/2023	Canadian Strategy Snapshot: Downgrading Consumer Staples to Underweight
4/26/2023	Canadian Strategy Snapshot: Canadian GARP Opportunities
4/19/2023	Canadian Strategy Snapshot: Three Sparsely Mentioned TSX Observations
4/12/2023	Canadian Strategy Snapshot: Increasing Our Cyclical Tilt in Canadian Small Cap
3/22/2023	Canadian Strategy Snapshot: Our Materials Weight Remains Focused on Gold
3/14/2023	Canadian Strategy Snapshot: Highlights From Fourth-Quarter Earnings Season
2/22/2023	Canadian Strategy Snapshot: Stable Cash Flow and Distribution Strategies
2/9/2023	Canadian Strategy Snapshot: Technology Showing Signs of Fundamental Inflection
Monthly Reports	
2/2/2024	Canadian Strategy: Canadian Chartbook – February 2024
2/2/2024	Canadian Strategy - Canadian Factor Profiles – February 2024
Investment Strategy Snapshots and Special Reports	
11/27/2023	2024 Market Outlook: The Year Ahead for the US and Canada
US Strategy	
<i>Please call or e-mail us to be added to our standalone US Strategy research</i>	

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Rating category	BMO rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	StarMine Universe~
Buy	Outperform	49.1 %	16.4 %	44.0 %	55.1 %	56.9 %	57.7%
Hold	Market Perform	48.3 %	19.8 %	52.4 %	43.3 %	41.7 %	37.5%
Sell	Underperform	2.4 %	18.2 %	2.4 %	1.5 %	0.9 %	4.8%

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http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf

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The recommendation contained in this report was produced at February 27, 2024, 11:19 ET. and disseminated at February 27, 2024, 11:19 ET.

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