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Why we can expect a decade of TSX outperformance. Plus, big banks offer tempting 'special' GIC rates

BofA Securities equity and quantitative strategist Ohsung Kwon provided some welcome news for domestic investors, arguing compellingly that the S&P/TSX Composite will outperform the S&P 500 for the coming decade.

An ongoing regime change, where deflation, low rates and globalization give way to inflation, de-globalization and higher commodity prices, is the biggest reason Mr. Kwon expects Canadian stocks to outperform. "The expected upcycle in inflation and commodities should translate to the TSX outperforming over the next decade," he wrote in a research report.

The domestic benchmark is cash rich and dividend-heavy, making it more resilient to market volatility. Adjusted for market capitalization, the TSX is yielding twice as much as the S&P 500 for the first time. Canadian equities also carry more cash than U.S. stocks once market cap is considered.

The Bank of Canada has front-loaded interest rate hikes to a greater extent than the Federal Reserve, leaving U.S. stocks confronting more hikes ahead. BofA also believes that when all is said and done, the domestic policy rate will stop at 4.5 per cent relative to U.S. rates at 5.0 per cent. This would leave monetary conditions looser and more conducive to growth in Canada.

S&P/TSX Composite valuations are more attractive than south of the border. Mr. Kwon calculates that based on the TSX's current price to earnings ratio, investors can expect 6.5 per cent annual returns on average, plus 3.4 per cent in dividends, over the next ten years. This compares favourably to the implied S&P 500 annual total return near 8.0 per cent. (He cautions, however, that valuation levels are a poor indicator of shorter-term returns.)

BofA also sees the domestic stock market as better prepared for a potential recession. Based on the equity risk premium (ERP, essentially the difference between the earnings yield and the risk-free bond yield), the TSX reflects an 80 per cent chance of recession. Mr. Kwon estimates that the S&P 500′s ERP represents only 5.0 per cent preparation for recession.

Canada should also benefit from the expected trend of de-globalization. As manufacturing capacity returns from the developing world, Canada's status as America's largest trading partner could attract new investment.

The military conflict and energy shortage in Europe underscore Canada's attractiveness as an investment destination based on current trends. Mr. Kwon wrote, "Canada is uniquely positioned with both energy and food security, as well as political stability, which we believe is critical in the 2020s".