

Corporate Bond Yields Indicate Exceptional Value for Canadian Stocks

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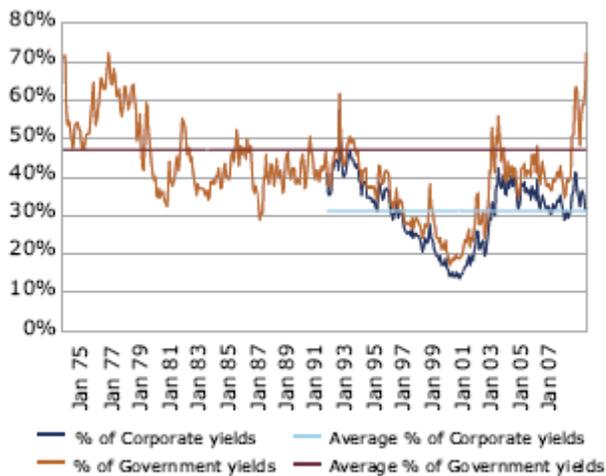


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As a follow-up to our previous analysis of equity dividend yields in relation to government bond yields, we note that in the past few months corporate bonds have been hit hard, sending prices plunging and yields soaring. We noted in our last research piece that equities are attractive compared to treasuries<sup>1</sup>; are equities still attractive when compared to corporate bond yields?

- The S&P 500 is inexpensive as measured by the comparison of dividend yield vs. government bond yields
- The same can not be said when dividend yields are compared to corporate bond yields. Against corporates, valuation of stocks is close to average.

Historical S&P 500 dividend yields as % of U.S. Bond Yields



- The S&P/TSX looks cheap when dividend yields are compared to either government or corporate bond yields

<sup>1</sup>Source: "Are stocks cheap based on dividend yields?", MFC Global



Historical S&amp;P/TSX dividend yields as % of Canadian Bond Yields



As shown in the charts, the ratio of S&P 500 dividend yields relative to U.S. corporate bond yields has historically been highly correlated to the ratio of dividend yields to Treasury yields. As of July 2008, the two measures diverged for the first time and the spread has continued to widen. Stocks look cheap vs. government bonds, but are close to their long-term average when compared to corporate bonds. In contrast, Canadian stocks are the cheapest we've ever seen them. The ratios of TSX dividend yields to both corporate and government interest rates have achieved unprecedented levels, indicating exceptional value in the Canadian stock market.

- Dividends are latest quarter annualized; current dividend is as of November 18, 2008.
- Payout ratios are based on lesser of 2008 / 2009 estimated consensus earnings

Sources: Bloomberg, TD Waterhouse, Citigroup's Salomon Brothers, Scotia Capital Universe

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