Q. Reference: Dr. Booth Evidence, Appendix D, Page 12, Lines 20-21

Please provide the average annual return for the TSX Index and the TSX Utilities Index since 2000. Do these average annual returns suggest to Dr. Booth that investors in utility stocks in Canada have earned significantly lower returns than investors in the broad Canadian market?

A. Since January 29, 1998 the monthly returns[1] on the TSX utilities index, the TSX Composite and the Government of Canada long bond have been as follows:

	Arithmetic Monthly Return	
	Entire period	Since 2000
Utilities	0.81%	0.93%
Composite	0.73%	0.56%
GOC long bond	0.72%	0.56%

On December 31, 1997 the 30 year long Canada bond had a yield of 6.81% so the monthly returns on the GOC bond reflect its decline to 2.33% at the end of August 2018. As interest rates decline bond prices go up giving bond investors a higher than expected return. The fact that bond investors have earned essentially the same return as the TSX equity investors led many to conclude that the (equity) market risk premium was non-existent or at least very low, not the 5.0-6.0% that I use. Arnott and Ryan[2], for example, stated

> More important still, our 3.2% outlook for real returns falls short of the real return available in inflation-indexed government-guaranteed bonds. For the first time in U.S. capital markets history, the equity risk premium is probably negative, barring some very aggressive assumptions regarding economic growth and the share of that growth that makes its way to the investor in today's enterprises.

My judgement is that they failed to understand what drives equity and bond returns and drew the wrong conclusions from a relatively short time period, as I discuss in my Appendix B.

Further. it is impossible to draw conclusions from utility realised returns versus those on the TSX Composite, since they have also been driven by these interest rate declines as

[1] Annual returns would be these rates compounded or approximately 12X the monthly return.
[2] The death of the risk premium, Journal of Portfolio Management, Spring 2001.

defensive/interest sensitive investments. As Maureen Howe the utility analyst referenced by Dr. Booth at page 4 of Appendix C stated, Canadian utilities are

> "like convertible bonds. When interest rates are low, as they currently are, the companies trade on their bond value and are supported by tax-efficient dividend yields. When the 10-year GOC yield rises above 6%-6.5%, the Canadian companies trade on the basis of their underlying earnings and P/E."

So Canadian utility investors have essentially been investing in supercharged bonds that are taxed like equities.