

Keys to the market

What happened last week

January 27, 2023

The financial markets started the week amid positive risk sentiment. We saw better inflows into high-grade credit and equities, particularly European and emerging market stocks. In the United States, GDP came in above expectations for the fourth quarter of 2022. Taking a deeper look, however, we see impending stress on the U.S. economy as inventories inched higher, exports fell faster than imports and investment slowed, especially in the residential sector. The Bank of Canada delivered what is supposed to be its last rate hike of this tightening cycle, taking the policy rate to 4.5%, a level last seen in 2007. The Bank will now pause as it takes in economic data over the next few quarters. Nonetheless, we do not expect it to start cutting rates any time soon. The rally in bonds and equities could be overhyped because it is driven mainly by short covering and retail investors. Furthermore, disappointing guidance from large corporations raises the stakes of an earnings recession that could prove to be more severe than what the markets are pricing in.

Bank of Canada: Overnight Rate

As at 2023-01-26



Bond Market

Bond yields traded within a 10-basis-point range during the week, as all eyes were focused on rate decisions from a number of key central banks, above all the U.S. Fed, which has a quarter-point hike priced in by the futures market. With only one more 25-basis-point hike priced in after that, the futures market does not see the Fed's overnight rate going above 5%, which contrasts with recent statements by a number of central bank officials and suggests the language of next week's decision will most likely matter more than the move itself. Spreads for both IG and HY narrowed a touch on the week as the market kept gobbling up supply with little in the way of new issue concessions,

Highlights

- Positive market sentiment fuelled a rally in the stock and bond markets
- Even though some central banks are delivering their last rate hikes, a near-term pivot still seems far-fetched

On our radar

- Canada: November GDP, S&P Manufacturing PMI and December building permits
- United States: A busy calendar with FOMC decisions, January Manufacturing and Services ISM and non-farm payroll

indicating that the market may be getting a little ahead of itself, particularly if economic conditions continue to slow.

Stock Market

On the equity front, earnings season is in full swing. So far, 36% of the S&P 500 market cap has reported earnings for the fourth quarter of 2022. Thus far, 63% has beaten on the bottom line, 74% on the top line and 50% on both, which proved to be better than the historical average. It is important to note, however, that fourth-quarter estimates typically fall 4-5% before earnings season and increase 2-3% once reports are released. For the fourth quarter, estimates declined by 8.1% before the start of the earnings season and have fallen by an additional 50 basis points since then, as a result of lower-than-average beats and further downward revisions for companies that have not yet reported. As for the 2023 outlook, it's important to note that Microsoft and Intel have warned that their customers are cautious about spending and that demand is weakening.

Next week, the focus will be on Thursday's earnings releases, with Google, Amazon and Apple reporting. We also think the next jobs report will be a decisive factor for the direction of the stock market in the weeks to come.

Markets

(Total Return, in \$CAD)

As of January 26, 2023	WTD %	MTD%	YTD%	1Y%	3Y%	5Y%
Equities						
S&P 500	1.79	4.43	4.43	0.47	9.59	10.86
S&P/TSX	1.05	7.01	7.01	3.69	8.87	8.23
NASDAQ	3.29	8.69	8.69	-9.98	10.28	13.22
MSCI ACWI	1.50	5.35	5.35	0.32	7.31	7.84
MSCI EAFE	0.72	6.83	6.83	2.49	4.03	3.54
MSCI EM	1.14	8.62	8.62	-4.90	1.27	0.62
Commodities (USD)						
Gold	0.16	5.77	5.77	6.02	7.07	7.42
CRB	0.64	1.37	1.37	-3.23	11.25	5.03
WTI	-0.37	0.93	0.93	-7.26	14.34	4.14
Fixed Income						
FTSE TMX Canada Universe	0.15	3.51	3.51	-5.34	-1.84	1.09
FTSE TMX Canada Long	0.30	6.13	6.13	-10.95	-5.26	0.25
FTSE TMX Canada Corporate Overall	0.20	3.17	3.17	-4.33	-0.83	1.75
Currencies						
DXY	-0.17	-1.63	-1.63	5.56	1.34	2.72
USDCAD	-0.45	-1.72	-1.72	5.14	0.45	1.59
USDEUR	-0.33	-1.71	-1.71	3.20	0.41	2.68
USDJPY	0.48	-0.69	-0.69	13.59	6.02	3.70
USDGBP	-0.10	-2.62	-2.62	8.51	1.75	2.67

Source: iA Investment Management, Bloomberg

	CA	US
Bond yields		
2Y	3.63	4.18
5Y	2.97	3.59
10Y	2.86	3.49
30Y	2.94	3.64
Credit spreads		
IG corporate bonds	167	126
HY bonds	374	424

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