

Keys to the market

What happened last week

October 28, 2022

The Bank of Canada slowed the pace of its rate hikes on Wednesday, when it raised interest rates by just 50 basis points, instead of the 75 that the markets had priced in. It also acknowledged the need for a balanced approach and the risks of excessive tightening. Bond yields were down significantly on the news. The European Central Bank was also more measured in its comments as it raised rates by 75 bps, and the equity markets welcomed the seemingly more dovish tone from monetary policymakers. In the United States, GDP rebounded by 2.6% in the third quarter driven by exports, but domestic spending slowed. In Canada, third-quarter GDP was resilient, but cracks are appearing. As the economic outlook softens and we near the end of the rate hiking cycle, we note that fixed income is valued attractively relative to equities, which would seem to indicate a good entry point.

S&P 500: Equity Risk Premium
Using 12-Month Fwd Earnings and U.S. 10 Year Rate



Canada's 10- and 2-year government yields fell by about 35 bps after the Bank of Canada's decision, widening their spreads vis-à-vis Treasuries with equivalent maturities. US fixed income was hit harder at week's end by surprisingly high CPI prints in Europe, suggesting consumer prices in the US may also be more difficult to tame. Everyone will be watching the US Fed next week for any signs of easing up on its current hiking cycle. The associated language will be scrutinized to see whether its thinking has changed.

With corporate earnings season well under way, IG spreads in the US were little changed despite some weakness in reported results, while HY shrugged off everything and sank below 500 basis points, with investors picking away at value. We think credit spreads will remain range bound as we head toward year-end but will widen in 2023 as slowing economic conditions become more entrenched.

Highlights

- The Bank of Canada revised its outlook for the Canadian economy and surprised markets with a 0.50% rate hike, a smaller move than expected.
- US third quarter GDP rebounded, but domestic spending slowed.
- The markets are expecting the central banks to be more dovish in the coming quarters.

On our radar

- In Canada: October's Manufacturing PMI and unemployment rate
- In the United States: Fed rate decision, ISM manufacturing data and non-farm payroll

Third-quarter results switched into a higher gear this week with more than 40% of the S&P 500 companies reporting. All eyes were on the technology mega-caps (MSFT, AMZN, GOOG and AAPL), whose results came in mostly below expectations. Their soft-ish earnings underlined how difficult it is for such behemoths to reduce operating expenses in a rapidly slowing environment, thereby driving a disappointing profitability outlook. We think the reported results generally confirmed that the economy has started to slow because consumer and business demand were also below expectations.

Looking ahead, we will focus on the coming Fed meeting. Any indications of a pivot or a more dovish stance, such as what we have seen lately from the Bank of Canada and the Bank of Australia, coupled with the earnings results we witnessed this week, could signal that interest rates have plateaued and lead to a stock market rally as we close the year.

Markets

(Total Return, in \$CAD)

As of October 27, 2022	WTD %	MTD %	YTD %	1Y %	3Y %	5Y %
Equity						
S&P 500	-0.24	4.56	-13.41	-6.95	11.04	11.07
S&P/TSX	2.67	5.11	-6.60	-4.89	8.88	7.14
NASDAQ	-2.71	0.36	-26.61	-21.41	12.98	13.56
MSCI ACWI	0.77	4.43	-15.28	-10.92	7.16	7.21
MSCI EAFE	3.14	4.36	-17.24	-15.34	0.28	1.12
MSCI EM	-2.30	-3.39	-23.17	-24.20	-2.35	-1.38
Commodities (USD)						
Gold	0.34	0.16	-9.07	-7.43	3.40	5.49
CRB	-0.17	-0.29	-3.54	-1.77	12.60	5.43
WTI	4.74	12.06	18.44	7.77	16.28	10.57
Fixed Income						
FTSE TMX Canada Universe	2.95	-0.73	-12.42	-10.91	-2.43	0.25
FTSE TMX Canada Long	5.77	-2.75	-23.13	-20.41	-6.35	-0.98
FTSE TMX Canada Corporate Overall	2.20	-0.64	-11.33	-10.11	-1.37	0.89
Currency						
USD trade-weighted index	-1.27	-1.36	15.59	17.89	4.17	3.10
USDCAD	-0.55	-1.91	7.34	9.76	1.28	1.16
USDEUR	-1.03	-1.63	14.14	16.45	3.60	3.10
USDJPY	-0.92	1.07	27.12	28.52	10.42	5.18
USDGBP	-2.26	-3.42	16.98	18.79	3.51	2.57

Source: iA Investment Management, Bloomberg

	CA	US
Bond yields		
2Y	3.80	4.27
5Y	3.32	4.06
10Y	3.19	3.92
30Y	3.32	4.08
Credit spreads		
IG corporate bonds	183	168
HY bonds	394	476

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ROOTED IN HISTORY. INNOVATING FOR THE FUTURE.

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