

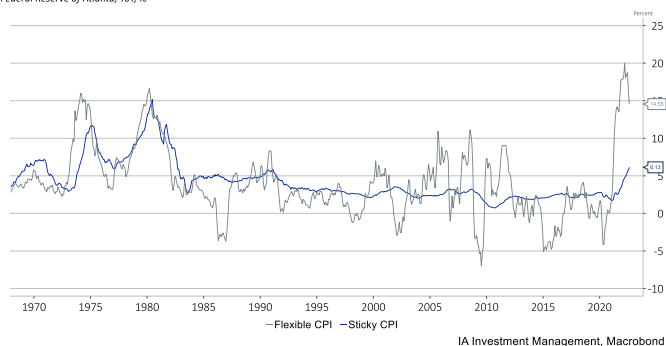
Keys to the market

What happened last week

September 16th, 2022

Stronger inflation in the US took global investors by surprise on Tuesday, causing a rout in both equity and bond markets. This was the worst daily sell-off since June 2020. US inflation is proving to be stickier and with more breadth than anticipated. Tight labor market conditions are also giving strong support to retail sales with both beating expectations this week. We now anticipate the Federal Reserve to zero-in on that sticky component of consumer prices. The market repriced the Fed fund rate path higher, now with a peak at 4.5% in the US before a pivot in 2023; whereas the Fed had indicated 4% by year-end before stabilizing next year. The increase in real yields should be a headwind for equity markets; as will a rallying US dollar on earnings.

U.S.: Flexible vs Sticky CPI
Federal Reserve of Atlanta, YoY, %



While the CPI surprise was the biggest driver for bond markets, the response was not as pronounced as it was in the equity markets. In a notable outperformance, corporate spreads did not move much on the news. On the week, 10-year US treasuries yields rose by 20 basis points, finishing above 3.4%. In Canada, 10-years yields initially followed suit but eventually retraced about 10 basis points to close around 3.15%. The yield curve flattening was the order of the day with 2s-30s US yield curve plunging to around -40 basis points. In addition to bond investors anxiously awaiting the next US Fed rate decision on September 21, which we believe will be a 75 basis point hike, the market in Canada will be watching for its CPI print on Tuesday to see if there is a similar high side surprise.

Ahead of the CPI release, equity investors had been hoping for inflation to come down a little quicker than what we saw, which would have lowered the pressure on the Federal Reserve to raise interest rates. The sharp sell-off

Highlights

- US inflation shocked the markets, proving to be stickier and with a deeper breadth than anticipated
- Worse daily market sell-off since June 2020
- While equity risk premiums are still low, foreshadowing further market correction, there are now pockets of the market that are priced attractively.

On our radar

- FOMC rate decision on September 21st in the US
- CPI numbers in Canada

that ensued was exacerbated later in the week by a big profit warning from Fedex. Even though Fedex is no longer the economic bellwether it used to be, it is yet another indication that the economy might be rapidly slowing down. Investors are now nervous that Fedex's announcement is the canary in the coal mine for the upcoming Q3 earnings season. They've now turned their focus to the Fed meeting next week. While we don't expect the central bank to surprise the market, we will attentively listen to the press conference to get any hints on their next move. There should not be any changes in Powell's hawkish stance. Thus, we don't expect the rate announcement to be a potential positive catalyst for equity.

Despite the correction in the stock market thus far this year, its valuation is still not cheap historically and the equity risk premium is also too low to act as a support to valuation. On a more positive note, the S&P 500 valuation is expensive only due to its 10 largest names, as the remaining stocks are trading below their historical averages. This shows that there are opportunities for a good stock picker and underscores the added value of active portfolio management.

Markets

(Total Return, in \$CAD)

As of September 15, 2022	WTD %	MTD %	YTD %	1Y %	3Y %	5Y %
Equity						
S&P 500	-2.86	-0.44	-13.44	-7.70	10.76	13.09
S&P/TSX	-0.98	1.36	-5.92	-2.69	8.65	8.44
NASDAQ	-4.08	-1.99	-23.59	-19.68	14.64	16.66
MSCI AWCI	-2.17	-0.43	-15.12	-12.13	7.08	9.02
MSCI EAFE	-0.56	-0.89	-17.36	-18.35	0.30	2.57
MSCI EM	0.09	-2.63	-16.44	-19.71	0.36	1.61
Commodities (USD)						
Gold	-3.01	-2.68	-8.97	-7.19	3.81	4.75
CRB	-0.54	-2.72	-1.59	2.03	13.95	5.87
WTI	-1.95	-4.97	13.15	17.20	15.77	11.27
Fixed Income						
FTSE TMX Canada Universe	0.06	-0.21	-11.50	-11.61	-1.96	0.75
FTSE TMX Canada Long	0.97	-0.40	-20.09	-18.85	-4.81	0.28
FTSE TMX Canada Corporate Overall	-0.01	-0.19	-10.05	-10.26	-0.75	1.48
Currency						
DXY	0.68	0.96	14.71	18.58	3.75	3.62
USDCAD	1.50	0.74	4.67	4.73	-0.15	1.63
USDEUR	0.40	0.52	13.72	18.15	3.46	3.62
USDJPY	0.74	3.28	24.71	31.21	9.91	5.31
USDGBP	1.07	1.36	17.98	20.71	2.92	3.46

	CA	US
Yields		
2Y	3.82	3.86
5Y	3.35	3.67
10Y	3.15	3.45
30Y	3.05	3.47
Spreads		
IG corporate bonds	165	145
HY bonds	358	477

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ROOTED IN HISTORY. INNOVATING FOR THE FUTURE.

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