

Keys to the market

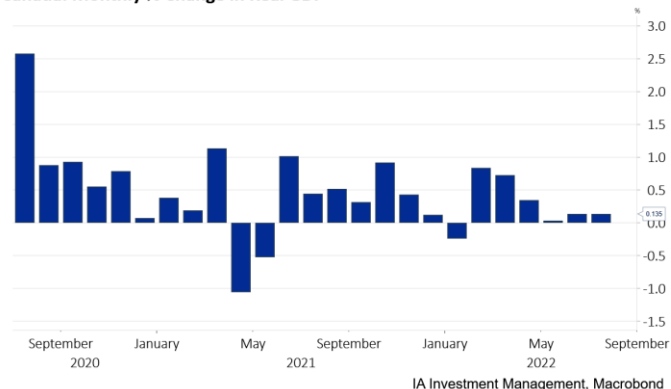
What happened last week

September 30, 2022

As financial markets took in the full inflationary implications of the United Kingdom's new budget, asset prices reacted violently. In response to the size of the funding shortfall in the UK, global government bond yields spiked higher, with 30-year UK gilts rising by 100 basis points (bps). The equity markets followed suit, blazing through their June lows. The US dollar shot up amid the initial shock but retraced when the Bank of England intervened in the markets to stabilize long maturity bonds' yields and take pressure off the financial system. The markets are now very nervous about the tug of war between monetary policymakers' resolve to fight inflation and fiscal policies intended to mitigate the impact of rising consumer prices on households and businesses alike. All eyes are on Italy where the election of a populist, right-wing government is casting doubts on fiscal restraint.

The Canadian economy remains resilient, with July GDP coming in above expectations. The robust labor market, as well as the mining and resources sectors, are providing strong support for economic activity. We've had only one month of negative GDP this year in Canada, whereas the United States has already recorded two quarters of negative economic growth and the economy is expected to shrink in the third quarter as well.

Canada: Monthly % Change in Real GDP



In a world where daily 20-bps yield swings for G7 sovereign debt are now commonplace, the ante was upped last week, as shown by the rise in 30-year gilt yields. That dramatic volatility nonetheless contributed to a dip in 10-year Treasuries and Canadian bonds over the week. Despite PCE data down south that disappointed to the high side, an exhausted bond market held on to its gains. The story in credit was decidedly worse, however, with IG spreads moving above 160 basis points, their highest level

Highlights

- Diverging fiscal and monetary policies in the UK wreaked havoc on global financial markets, which are now nervous about the next government that might go against the monetary policy tide.
- Canada's economy is churning along steadily, with July GDP coming in slightly above expectations.

On our radar

- In Canada: net change in the September employment and unemployment rates.
- In the US: September data for ISM Manufacturing and Services, non-farm payrolls and unemployment.

since the middle of 2020. Meanwhile, HY crumbled further, moving steadily to 600 basis points. We remain cautious on spreads and believe there is more widening to come as credit catches up with the reality of slowing economic conditions.

The stock market continued its decline this week amid the chaos in the UK. Furthermore, reports that Apple is curtailing its efforts to increase production of their new iPhone is yet another sign that things are slowing for all. We think the adage "the general is always the last one to fall" applies here, with Apple's underperformance indicating that equity investors could be capitulating.

In terms of opportunities in the stock market, we're witnessing a big valuation discount skewed towards smaller caps. The 10 largest stocks in the S&P500 trade at close to 23x forward earnings while the remaining 490 stocks trade at about 13x. The valuation discount in small caps is one of the largest in history. Another positive for smaller caps is that they export less; thus, the strong US dollar shouldn't affect them as much as it does the larger capitalizations. This valuation difference is similar in Canada within the S&P/TSX.

Markets

(Total Return, in CAD)

As at September 29, 2022	WTD %	MTD %	YTD %	1Y %	3Y %	5Y %
Equities						
S&P 500	-0.47	-3.47	-16.08	-8.76	10.20	11.61
S&P/TSX	-0.07	-4.27	-11.15	-5.81	6.52	6.54
NASDAQ	-0.36	-4.73	-25.72	-18.57	14.63	15.41
MSCI ACWI	-0.51	-4.11	-18.26	-13.34	6.22	7.46
MSCI EAFE	-0.78	-5.43	-21.14	-19.74	-0.89	0.93
MSCI EM	-2.61	-7.77	-20.85	-22.43	-0.65	0.33
Commodities (USD)						
Gold	1.01	-2.95	-9.22	-3.81	3.52	5.35
CRB	-0.25	-4.46	-3.35	0.46	12.98	5.52
WTI	3.16	-9.29	8.00	8.55	13.26	9.47
Fixed Income						
FTSE TMX Canada Universe	-0.84	-0.53	-11.78	-10.48	-2.50	0.66
FTSE TMX Canada Long	-2.06	-1.49	-20.96	-17.20	-6.05	0.09
FTSE TMX Canada Corporate Overall	-0.96	-0.97	-10.76	-9.80	-1.41	1.27
Currencies						
DXY	-0.83	3.27	17.33	18.99	4.24	3.82
USDCAD	0.65	4.19	8.25	7.24	1.08	1.87
USDEUR	-1.31	2.42	15.86	18.16	3.68	3.78
USDJPY	0.80	3.96	25.53	29.03	10.21	5.13
USDGBP	-2.32	4.54	21.69	20.79	3.40	3.80

	CA	US
Yields		
2Y	3.79	4.19
5Y	3.33	4.02
10Y	3.17	3.79
30Y	3.10	3.72
Spreads		
IG corporate bonds	170	168
HY bonds	373	550

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ROOTED IN HISTORY. INNOVATING FOR THE FUTURE.

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