Light Lockdowns Return at a Pivotal Political Moment
Monthly Market Commentary
October 2020

- A broad-based advance of global equity markets in the first few weeks of October gave way to a steep selloff driven by a new wave of rising COVID-19 cases.
- Early votes in the U.S. general election pointed to a high turnout, with a significant likelihood of reaching the largest participation rate in more than 50 years.
- We sense that the next few months of what has already been an eventful year could prove critical to the future course of the global economy and financial markets.

Economic Backdrop

Global equity markets declined in October for the second month in a row. A broad-based advance for the first few weeks of October gave way to a sharp late-month spike in volatility and a steep selloff driven by a new wave of rising COVID-19 cases. Developed markets were down for the period. European and U.K. equities declined most dramatically, followed by the US; Japan's loss was comparably mild. Emerging markets, on the other hand, rallied following their September slide. China's gains helped propel the rebound, while Brazilian shares were modestly negative.

The West-Texas Intermediate crude-oil price declined by approximately 11% from its October peak through the end of the month as prospects for global economic activity cooled alongside rising cases. U.S. and U.K. government-bond rates generally increased across the yield curve, while rates declined in the eurozone. U.S. dollar weakness returned in October after being temporary interrupted by a large rebound in late September, resuming its slide against a trade-weighted basket of foreign currencies that began in March after the passage of a massive U.S. fiscal stimulus.

Governments re-imposed lockdown measures as COVID-19 cases climbed through October. England announced four weeks of closures affecting pubs, restaurants, gyms and other non-essential retail businesses. The restrictions were coupled with plans for greater government payments for affected self-employed workers as well as an extended deadline (until January) to apply for business loans underwritten by the government. France and Germany announced similar plans in late October centered on closing bars and restaurants for a month.

In the U.S., another major round of fiscal stimulus remained elusive. President Donald Trump expressed willingness to meet the high price tag proposed by Democrats in control of the House of Representatives, while Republicans with power in the Senate did not appear willing to go along. The 2020 U.S. general election featured the highest U.S. voter-participation rate in 120 years. Historic turnout, combined with an unprecedented surge in mail-in ballots, slowed the vote-counting process compared to past elections. Former Vice President Joe Biden appeared set to win the race, although he's expected to face vote re-counts and other election-related lawsuits before the results can be certified.

U.K. and EU negotiations over a potential post-Brexit trade agreement continued through the end of October but remained stuck on fishing rights and state aid to businesses. Specifically, the EU wants a long-term guarantee regarding the allocation of fishery rights and access to British waters, while the U.K. wants to renegotiate these rights every year. With regard to business subsidies, the EU seeks to ensure a level playing field that would unlikely give either side unfair advantages.

These talks accelerated to a daily pace as of late October; negotiators now estimate that final terms must be settled by mid-November for any deal to be enforced by the end-of-year expiration of the Brexit transition period. An agreement would need to be passed through U.K. and EU Parliaments before becoming law. At the same time, an EU-U.K. joint committee had begun hashing out the real-world implications of the Withdrawal Agreement's Northern Ireland Protocol for customs and border cooperation under a no-deal Brexit scenario.

The World Trade Organization handed down a ruling in mid-October that allows the EU to impose retaliatory tariffs on $4 billion of U.S. exports in response to favourable tax treatment for major U.S. aerospace companies. Elsewhere, China demanded that the U.S. stop a planned sale of surface-to-surface missiles to Taiwan (which China considers part of its territory). China responded in part by announcing in late October that it intends to sanction major U.S. defense companies for arms sales to Taiwan.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) increased 0.1% and 0.5%, respectively, for the month and year ending September. Producer prices were considerably weaker: the Industrial Product Price Index (IPPI) slipped 0.1% in September, while the Raw Materials Price Index (RMPI) fell 2.2% due to lower costs for energy and petroleum products. Over the past 12 months, producer prices remained weak; the IPPI slid by 2.2% while the RMPI plunged 9.4%. The unemployment rate ticked down 0.1%, to 8.9%, as employment rose by 84,000 in October, with most of the gains in full-time employment.

- U.S. manufacturing growth has persisted at a moderate pace since August—yet reports were mixed for October, with some showing acceleration and others indicating a continuation of modest expansion. While new orders drove the sector's growth in prior months, manufacturing employment played a key role in October as it began to expand for the first time since July 2019. Initial U.S. jobless claims oscillated between 800,000 and 900,000 during most of October before dipping to 787,000 later in the month. The overall U.S. economy grew at a 33.1% annualized rate in the third quarter, the largest quarterly gain on record following a record-breaking decline in the prior quarter.

- The rebound in U.K. manufacturing growth slowed through October after peaking in August. Growth in the U.K. services sector followed a similar path, although with a higher August peak and a sharper deceleration in October. U.K. mortgage lending jumped dramatically in September, beating forecasts for the first time since June. Meanwhile, consumer credit contracted by £622 million in September on expectations for an expansion, indicating a potential return to contraction after growing through July and August.

- The eurozone's recovery in manufacturing activity continued to solidify in October after a promising improvement during September. Services sector activity contracted for the second consecutive month in October, retreating further from its peak growth recorded in July. Eurozone unemployment hit 8.1% in September, the fourth straight monthly increase. The overall eurozone economy grew by 12.7% during the third quarter and contracted by 4.3% year over year.

Central Banks

- As was widely expected, the Bank of Canada (BoC) held its policy rate firm at a historically low 0.25% following its October meeting. In its Monetary Policy Report, the BoC noted that it expects Canada's economy to contract by 5.5% in 2020 before growing by an average of 4% in 2021 and 2022. The BoC's next and final meeting of 2020 is scheduled for December 9.

- The European Central Bank (ECB) made no new changes to monetary policy following its late-October meeting. However, the Governing Council announced plans to use periodic economic projections at its December meeting to conduct a thorough reassessment and take new actions as appropriate. ECB President Christine Lagarde noted that the eurozone economy appeared to be "losing momentum more rapidly than expected" and that the "rise in COVID-19 cases and the associated intensification of containment measures is weighing on activity, constituting a clear deterioration in the near-term outlook."

- The Bank of Japan (BOJ) also took no new actions following its late-October monetary policy meeting. It will continue to implement all tools associated with its Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control policy; separately, its crisis-response programme will proceed until at least March 2021.

- Neither the Federal Open Market Committee (FOMC) nor the Bank of England's Monetary Policy Committee held meetings in October.

Market Impact (in Canadian dollar terms)

Global equities struggled in October as COVID-19 cases increased around the world. Emerging markets generally fared better than developed markets. Domestic equites slightly trailed most other developed markets, including the U.S. In Canada and other markets there was a bit of a rotation in stocks as technology and consumer staples underperformed; healthcare was a notable outperformer and the only sector to post gains in October. Small caps also performed better than large companies despite modest losses.

Fixed-income markets were generally weak as well. Investors shed government bonds, while real-return bonds dealt with continued poor inflation reports. Residential mortgages and short-term bonds posted modest gains, as did U.S. high-yield bonds.

Index Data (October 2020)

- The S&P/TSX Composite Index was down 3.11%.
- The FTSE Canada Universe Bond Index returned -0.76%.
- The S&P 500 Index, which measures U.S. equities, fell 2.83%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, slipped 2.61%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.44% (currency hedged) and 0.27% (unhedged).
- The Chicago Board Options Exchange Volatility Index—a measure of implied volatility in the S&P 500 Index also known as the “fear index”—increased from 26.37 to 38.02 at month end.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, fell from US$42.61 on the last day of September to US$35.79 at the end of the month as rising COVID-19 cases caused fears of increased lockdowns.
- The loonie strengthened slightly versus the U.S. dollar; it ended the month at C$1.33 per U.S. dollar. The U.S. dollar was little changed versus the world’s other major currencies. It ended the month at US$1.29 against sterling, US$1.16 versus the euro and 104.54 yen.

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