Equity Rally Turns into a Pumpkin as Market Magic Fades

Quarterly Market Commentary

Third Quarter 2021

- The global equity rally stalled during the third quarter, with challenges accumulating as the clock ticked toward the final hours of September.
- Developed-market equities were generally positive for the period, while their emerging-market counterparts sank on deep losses from China and Brazil.
- We believe that analysts are still underestimating the earnings strength of publicly traded companies, which remains robust around the world. This could allow for upward revisions in earnings estimates—assuming that the renormalization of global economic growth gets back on track, as we suspect it will.

SEI's Domestic View

The outlook for Canada is certainly a mixed bag. First, some good news. Although the country's COVID-19 cases remain elevated during the current wave of infections, daily new confirmed cases are running at only half the rate recorded at the peak of the previous two waves in January and April. Adjusted for population, Canada currently has only one-third the number of daily new cases recorded in the U.S. and one-fifth that of the U.K. Daily new confirmed deaths per million are one-fifth that of the U.S. And Canada's vaccination rate is now one of the highest of any country; after a slow start, over 71%[1] of the population is now fully vaccinated.

In addition to its strong vaccination rate, Canada's relative success in containing the virus is largely owed to its comparatively strict lockdowns. According to the Oxford COVID-19 Government Response Tracker, despite recent moves in Canada to ease restrictions, Australia, New Zealand and Italy are the only developed countries with tougher measures currently in place.

This brings us to some bad news. Canada's strict lockdowns have affected its inflation-adjusted (real) gross domestic product (GDP). After rebounding sharply between April 2020 and July 2020, GDP growth downshifted to a more measured but still-consistent upward trend. By March 2021, the overall economy was almost back to its pre-pandemic peak. Since then, however, the monthly pattern of growth has been increasingly ragged. Goods-producing industries as of July have shown no improvement since the start of the year. Service-producing industries have registered a moderate 3.2% annualized rate of gain over the same period, but their activity remains below the pre-pandemic peak. By comparison, U.S. real GDP has already achieved a new high, with goods production above its pre-pandemic trend line.

The labour market continues to recover rapidly despite the uninspiring growth this year. Through September, the unemployment rate has dropped to 6.9% from a year-end 2020 level of 8.8%. This is a significant improvement from the peak of 13.7% in May of 2020. However, the U.S. recovery has been sharper, falling from an even higher peak of 14.9% in April 2020 to a jobless rate of 5.2% through August this year—almost two percentage points lower than in Canada. This difference in favour of the U.S. is not at all unusual. Except for the five-year period from 2009 to 2013 that followed the global financial crisis and last year's springtime era of widespread economic lockdowns, the U.S. typically has enjoyed notably lower levels of unemployment than Canada. Much of this disparity comes down to the greater generosity and inclusiveness of unemployment insurance benefits in Canada versus its southern neighbour.

At SEI, we expect the labour market to tighten further in both countries given the amount of fiscal and monetary stimulus that has been injected since the start of the pandemic.

As is true elsewhere, Canada is facing inflation pressures that its central bank and most economists deem transitory. However, all but one of the four major consumer-price measures that we track show dramatic gains for the year-over-year in August. The total Consumer Price Index (CPI), the CPI-trim (which excludes the strongest and weakest 20% of contributors by market weight to the monthly change in CPI) and the CPI-median (which corresponds to the price change located at the center of the distribution) all reached or exceeded their year-over-year high readings of the past two decades.

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[1] Source: Our World in Data

The Bank of Canada (BoC), however, has chosen to downplay these three measures of inflation in favour of a series called the CPI-common, which tracks common price changes across categories in the CPI basket. The goal of this statistic is to filter out price movements that may be caused by idiosyncratic factors specific to individual components. And what does this measure of inflation show? A modestly rising but still well-behaved inflation rate that remains just under the BoC’s 2% inflation target.

Granted, the pandemic itself and governmental responses to this black-swan event have played havoc with many measures of economic activity. The global supply-chain crisis, which we address at length later in this report, has certainly exerted a powerful and mostly transitory impact on reported inflation rates in Canada and the rest of the world. However, basing policy on the one measure that essentially ignores an inflationary shock of historic dimensions is something we view as quite odd. In any event, the BoC’s focus on the CPI-common makes it amply clear that monetary policy will likely remain expansionary for the foreseeable future. We suspect the central bank will continue to cautiously taper its purchases of securities, but will probably not increase its policy interest rate anytime soon.

In the meantime, look for those other inflation measures to stay elevated. There has been an extraordinary rebound in the price of West Texas Intermediate (WTI) oil since hitting bottom in April 2020. At a recent price of nearly $76 per barrel, WTI is above the peak recorded in 2018 and at its highest level since November 2014. Oil drillers in the U.S. and Canada, however, are not responding to this price incentive as they have in the past. Although the rig count is rising, the actual number of rigs in operation remains well below the levels reached in 2018. Capital discipline has become the new mantra of the oil patch. OPEC+ (Organization of the Petroleum Exporting Countries led by Saudi Arabia, plus Russia) is also showing an unusual cohesion—resisting temptation to hike output more dramatically than the gradual rise in production to which its member countries agreed. Given the fact that oil demand is still well below pre-pandemic levels despite recovering sharply as economies normalize, it is very possible that the oil price will continue to climb in the months ahead. WTI traded above $100 per barrel as recently as 2014; it may approach that level again in 2022 as consuming nations scramble for supplies.

Luckily for Canada, it is a producing nation—not just a consuming one. The energy shortage (and the commodity squeeze generally) should be good news for the country’s equity market. The MSCI Canada Index is heavily weighted toward commodity producers and other cyclical companies. The energy sector makes up about 14% of the Index, while materials and industrials account for approximately 11% and 10%, respectively. The information technology sector, which adds up to nearly 13% of the total Index capitalization, is dominated by one highly volatile stock—Shopify, whose Index weight reached a hefty 8.2% at the end of September.

Meanwhile, the financials sector—which contains six of the top-10 companies by capitalization that make up the MSCI Canada Index—accounts for a massive 37% of the MSCI Canada Index. Financials has performed quite well in the year to date, up 24.8% versus 17.5% for the overall index, with only energy and real estate outperforming the sector.

Last year, all companies within the financials sector were hit pretty hard in the first quarter; this included the big banks that dominate the Index as well as asset managers, mortgage lenders and life insurance companies. Once governments announced stimulus measures, the stocks started bouncing back. Banks had previously provisioned for increased loan losses, but ended up not having to realize as much as initially feared. House prices continued to trend higher, and consumers’ debt-service amount appears to be in fairly good shape despite still being higher than in many countries.

As is the case with other country-specific stock markets with heavy weightings in financials, commodities and industrial companies, Canada’s equity market has the characteristics of a value stock, and the MSCI Canada Index (total return) lagged the MSCI USA Index (total return) over the past decade. But relative performance has held steady in the past year, with the Canadian market managing to keep up with its U.S. counterpart.

Security analysts expect a strong earnings gain for companies in Canada’s market, totalling almost 70% in 2021 versus 46% for the companies that make up the U.S. equity market. In terms of earnings expected over the next 12 months, the MSCI Canada Index (total return) is trading at an abnormally large 32% discount to the MSCI USA Index (total return). Prior to 2018, the valuation discount had not surpassed 20% going back to 2004. Even something as ugly as that can start to look good. (source: Yardeni Research Inc.)

SEI's Global View

In a natural reaction to the prospect of more lockdowns and delayed returns to normal life given the surge in COVID-19 infections that began this past May, investors revisited stocks that benefited the most during 2020—namely the work-at-home, big technology companies and other large-cap stocks that do well when interest rates fall (lower interest rates make future cash flows of these types of stocks more attractive). However, the subsequent bounce-back in growth- and momentum-oriented large-cap stocks at the expense of value and cyclical stocks has already shown signs of deteriorating as rates spiked at the end of the third quarter.

We expect economic growth—in the U.S. and globally—to continue over the next year or two at a pace that meaningfully exceeds the sluggishness of the years that followed the 2007-to-2009 global financial crisis; the recent gloom about flagging economic growth is likely a bit overdone.

Household wealth is at an all-time high, owing to booming stock and home prices. A big decline in the saving rate has helped cushion the blow to consumer spending; still, saving as a percentage of disposable income remains elevated compared to pre-pandemic levels. We think households generally can adjust to a decline in pandemic relief payments without necessitating a sharp contraction in their expenditures.

The impact of COVID-19 on global supply chains has been a more significant impediment. Vendor deliveries have seldom been as slow in the 74-year history of the Institute for Supply Management's (ISM) survey as they are now, even with the situation having eased slightly since May. Inventories remain exceedingly low relative to demand.

Input costs have been rising rapidly, but companies have been able to compensate by passing along their increased costs to customers. After-tax corporate margins on an economy-wide basis hit a new all-time high in the second quarter, rising to 14.9% of sales (source: BEA, ECRI, Philosophical Economics).

Corporate pricing power is the good news. The bad news is that inflation keeps exceeding consensus expectations. We still expect inflation to run at a higher rate for a longer period than has been commonly assumed, not just over the next one or two years, but well into the decade.

Growth in unit labour costs typically plummets when the economy emerges from recession. Now, however, unit labour costs are running near a 2.7% rate—the fastest pace since the peak of the 2002-to-2007 expansion (source: Bureau of Labour Statistics).

While commodity inflation and parts shortages may indeed prove transitory, it isn't clear whether the labour shortage and resultant pressure on compensation growth will be as quick to revert to lower levels. The tax and regulatory initiatives of the Biden administration will likely add to the cost pressures facing businesses in the years immediately ahead.

Since U.S. demand is expected to remain robust as economic growth normalizes, it would not be surprising to see companies continue passing along their increased costs. Inflation over the long haul could thus be closer to 3% than the 2% or so currently expected by the Fed and most investors.

If that turns out to be the case, the Fed may be forced to raise interest rates higher and faster over the next three years than anticipated.

A concern that is much nearer in timeframe is the fight in Washington over infrastructure spending and the debt limit. We assume President Biden will get about half of what he is seeking, but the devil will be in the details. Investors are probably right not to react too dramatically to every development. The debt-limit drama, however, could elicit a more significant disruption as the deadline for must-pass legislation nears. Although the debt ceiling will be raised, the wrangling over it will almost certainly come down to the wire.

We suggest focusing on longer-term considerations: The latest COVID-19 wave will eventually pass. Economic growth should stay relatively strong in 2022. Households are in solid financial shape and will benefit as employment and wages continue to move higher. Companies are still able to pass along increased costs and maintain high profit margins. Fed policy is still biased toward easing, allowing the economy to run hot at the risk of higher inflation. This should all create a favourable backdrop for risk assets and support a resumption in the coming months of the cyclical/financial/value trend versus growth/technology.

Other developed countries are broadly on the same path as the U.S., and are reacting to the same catalysts.

Purchasing managers' surveys from recent months show that U.S. economic growth is cooling, yet still strong versus pre-pandemic levels. Activity in Europe, led by Germany, appears to be on the upswing—boosted by a decline in Delta (which has allowed for more travel and tourism in Europe) and an increase in EU fiscal support.

The major outlier is Japan, which has been rather weak so far this year versus its industrial-country peers. Inflation-adjusted GDP fell in the first quarter and posted only a tepid gain in the second quarter. Economists blame COVID-19-related restrictions. The global shortage in the supply of semiconductor chips, meanwhile, has impeded auto production. Citizens nonetheless blamed Prime Minister Yoshihide Suga. In response, he pledged to cede leadership of the Liberal Democratic Party to former foreign minister Fumio Kishida, who is expected to also succeed Suga as prime minister following the November elections.

U.S. inflation may be near a peak, but a further acceleration appears in store for Europe. The immediate concern for households in the region is the cost of energy. Even without energy-production shortages, electricity prices across Europe tend to be much higher than in North America—especially for households, particularly in Germany. The U.K. is in the midst of a petrol crisis due to an inability to make deliveries to gas stations amid a severe truck-driver shortage.

Europe's energy woes probably won't cause the region's governments to deviate from the climate-change agenda they have put in place. The German election underscores this point. Although it will take a couple of months to cobble together a coalition, all political parties are committed to reducing carbon admissions.

Beyond energy, Europe's reopening should cause the price of services to rise as they have in the U.S., albeit to far less of an extent. The overwhelming assumption is that any pickup in inflation will be short-lived.

China is dominating investor perceptions of emerging markets. The Xi government's push to enforce "common prosperity" has had far-reaching effects on corporate China. The country's 20-year boom has exacerbated social inequality. Crackdowns on for-profit tutoring companies, major gig employers, and individuals (notably, Jack Ma) is a brutal but effective way of addressing disparities in wealth and income.

Although some of these moves have hurt foreign equity investors, it's unclear whether the economy itself will be severely constrained. China is a huge country with tremendous internal capital upon which to draw. Foreign companies probably won't cut and run, but they will certainly be forced to play by Beijing's rules if they stay.

We expect diversification of supply chains away from China at the margin, but this has been happening anyway. It is in advanced countries' interests to be more self-sufficient in producing critical products. But China is too big, too efficient and too important a manufacturer for the world to turn its back on.

China's economic growth rate should nevertheless slow as a result of the government's actions. Property development has been the driving force behind its rapid expansion over the past 15 years. Critics of China's economic model have wondered for years if the bill would ever come due. It might be coming due now.

We are watching the trend in commodity prices for hints that pressure on China's construction activity is beginning to reverberate beyond its borders. So far, there has been little sign of that occurring. Iron ore prices have plunged, but that appears to have been caused primarily by government-mandated closures of steel plants in an effort to curb pollution.

Even within China itself, investors seem to be taking the Evergrande debacle in stride. The effective yield on the country's high-yield bonds has been rising sharply since May, but it is nowhere near the 40% yield reached in 2008. It also remains some six percentage points below the high reached in 2011, when the government clamped down on excessive credit growth and rampant speculation in the property and stock markets.

In contrast to high yield, the yield on Chinese investment-grade bonds is currently at its lowest level in the past 20 years—indicating no sign of contagion.

One explanation for the resiliency of the MSCI Emerging Markets Index is the strength of the global economy outside China. The U.S. has been leading the way, but other advanced countries—notably Europe—continue to post improved economic activity.

If history is any guide, however, upside inflation surprises in the G-10 countries suggest that emerging economies will follow suit over the next few months. Unlike advanced countries, where inflation expectations tend to better anchored, central banks in vulnerable emerging economies are forced to raise interest rates sooner than they would prefer in order to dampen inflation pressures and defend their currencies.

Given these concerns, investors might be tempted to avoid emerging-market equities. We believe that would be a mistake. Valuations, particularly relative to the developed world, look especially cheap.

Globally, the earnings of publicly traded companies generally remain robust; we believe that analysts are still underestimating that strength. With the exception of Japan, earnings estimates for 2021 have been raised dramatically versus just six months ago. Forecasts for 2022 earnings have been cut in half from where they were six months ago, but they still are expected to show mid-to-high single-digit gains.

This lowering of the bar for next year could allow for upward revisions in analysts' earnings estimates—assuming, as we do, that the renormalization of global economic growth gets back on track with wider vaccine distribution and a declining COVID-19 wave.

Economic Backdrop

The global equity rally stalled during the third quarter, with challenges accumulating as the clock ticked toward the final hours of September. Developed-market equities were mostly positive and generally remained quite strong in the year to date; Japan was a bright spot among major markets during the quarter. Meanwhile, China and Brazil registered deep losses for the three-month period that sank emerging-market equity returns for the quarter, which tipped returns negative for the year to date.

Across the U.S., U.K. and eurozone, government bond rates generally increased for the full three-month period. After declining across the yield curve in July, rates rose in August and accelerated their climb in September. Inflation-protected securities were the top-performing segment of fixed-income markets during the quarter; high yield followed, while emerging-market debt and global sovereigns had the steepest losses.

Crude-oil prices moved lower during the first half of the quarter but then reversed to end the period higher. OPEC+ (the Organization of the Petroleum Exporting Countries led by Saudi Arabia, plus Russia) decided at the beginning of October to maintain (rather than accelerate) the monthly increase in production of 400,000 barrels per day, which sent the price of West Texas Intermediate crude oil to its highest level since 2014.

The Delta wave of new COVID-19 cases drove U.S. infection and hospitalization counts to a peak at the beginning of September, just two weeks ahead of the country's mid-September top in daily deaths. U.K. cases peaked during mid-July, and had a smaller resurgence in early September. Both episodes roughly coincided with high points in the hospitalization rate, while the number of daily deaths crested along with the early September infections surge.

Regions that were at or near all-time high infection rates included Northern South America and the Lesser Antilles of the Caribbean; Eastern Europe; Australia; and pockets within Sub-Saharan Africa and Asia-Pacific.

Countries with the highest percent of their populations having received at least one dose of the COVID-19 vaccine through the end of the third quarter were the United Arab Emirates (95%), Portugal (86%), Cuba (83%) and Singapore (82%), while Canada (78%), the U.K. (73%) and U.S. (65%) lagged. Cuba's vaccination pace led the world as of September 30, administering more than 2,000 daily doses per 100,000 people. (source: Our World in Data)

The People's Republic of China (PROC) had an outsized sway over capital markets during the third quarter. President Xi Jinping's "Common Prosperity" campaign accelerated in July with a number of regulatory steps to rein in e-commerce companies and for-profit schools. Evergrande, one of China's largest real estate developers, also faced a pivotal turning point in July when several banks began denying mortgages on its backlog of unfinished projects. The late-September selloff in stocks around the globe exacerbated concerns about the extent of potential fallout effects if the company defaulted on its roughly $300 billion in debt.

Germany's center-left Social Democrats (SPD)—led by current vice chancellor and finance minister Olaf Scholz—earned the greatest share of votes in the country's September election, edging out its coalition partner the Christian Democratic Union of Germany (CDU)/Christian Social Union of Bavaria (CSU). A coalition with SPD at its head will likely form this fall, leaving Chancellor Angel Merkel to remain at the top of a caretaker government in the interim.

In the U.S., a razor-thin majority that President Joe Biden's Democrats have enjoyed in the Congress has created an evolving array of challenges during the quarter. The progressive and moderate wings of his party debated through the end of September over the size and scope of legislation necessary to fund an infrastructure plan, the overall federal budget, and an increase in the U.S. government's debt ceiling (that is, the total borrowing limit). Secretary of the Treasury Janet Yellen had warned that the debt ceiling would need to be increased by mid-October in order to avoid a government shutdown.

Central Banks

- As expected, the BoC held its policy rate at a historically low 0.25% throughout the quarter. Following the most recent meeting on September 8, the BoC reiterated that it expects to hold rates low until inflation consistently exceeds 2% (the lower end of its target inflation band), which is not currently expected to occur until the second half of 2022. The next scheduled meeting is October 27.

- The Bank of England's (BOE) Monetary Policy Committee (MPC) voted twice during the second quarter to maintain its policy path; the bank rate remained 0.1% and the maximum allowance for asset purchases was unchanged at £895 billion. Elevated inflation pressures provoked the BOE to acknowledge in its September Monetary Policy Summary that modest policy tightening may eventually be warranted.

- The European Central Bank (ECB) began the third quarter adopting a symmetric inflation target of 2% over the medium-term (meaning that it views deviations above or below its target as undesirable) and acknowledging that it anticipates greater fluctuations over shorter time frames. After reaffirming in July that purchases under the pandemic emergency purchase programme (PEPP) would be conducted at a significantly higher pace than during the first months of the year (approximately €80 billion per month compared to €60 billion), ECB President Christine Lagarde stated in September that the eurozone's economic rebound and higher inflation would enable "a moderately lower pace of net asset purchases."

- The Bank of Japan (BOJ) maintained its monetary-policy path throughout the third quarter, with its short-term interest rate at -0.1% and 10-year government bond yield target near 0%; it also continued open-ended asset purchases. The central bank's green lending programme came into focus: starting in December, 0% interest-rate loans will be made available to banks for lending that supports efforts to counteract climate change. Banks will be able to roll these loans forward until 2030.

Economic Data (unless otherwise noted, data sourced to Bloomberg)

- According to Statistics Canada, the rate of inflation accelerated (as measured by the change in the Consumer Price Index (CPI)) to 0.2% for the month and 4.1% for the year ending August. Higher costs for durable goods and services continued to drive consumer prices higher, while clothing and footwear was the only major component to see softening prices. Producer prices fell in August, but were still up sharply on a year-over-year basis. The Industrial Product Price Index (IPPI) was 0.3% lower in August and the Raw Materials Price Index (RMPI) slid 2.4%. On a year-over-year basis, the IPPI rose 14.3% and the RMPI jumped 27.7% with petroleum products as the largest contributor to higher prices. Canada's labour market added 157,000 jobs in September, reaching the pre-pandemic level of employment from February 2020. However, due to 1.4% population growth, the employment rate was just 60.9%, or 0.9% lower than the pre-pandemic rate. The unemployment rate improved by 0.2%, falling to 6.9%.

- Growth in the U.S. manufacturing sector moderated during most of the third quarter, yet strengthened somewhat in September. The services sector remained healthy but unremarkable for the third quarter as growth continued to slow from the record-fast pace registered in May. New weekly U.S. jobless claims essentially finished the third quarter where they started—between 360,000 and 375,000 filings per week—after ranging widely throughout the period from 310,000 to 420,000 claims per week. The U.S. economy expanded at a 6.7% annual rate during the second quarter, up from 6.3% during the first quarter.

- The fever pitch of U.K. manufacturing activity that defined conditions heading into July steadily declined over the course of the third quarter, leaving manufacturing growth at strong, perhaps more sustainable-levels in September. Services-sector growth also slowed from multi-decade highs, but at an even faster pace, settling at moderately healthy levels toward the end of the quarter. The U.K. claimant count (which calculates the number of people claiming Jobseeker's Allowance) continued to decline during the third quarter, by roughly 107,000 between June and August, with claimants representing 5.4% of the population as of August's reading. The U.K. economy expanded by 5.5% during the second quarter and 23.6% year over year after contracting by 1.4% during the first quarter.

- Eurozone manufacturing conditions followed a path similar to the UK's during the third quarter, but growth remained slightly stronger than the U.K. throughout the period after setting an all-time high in June. Services growth continued to strengthen through July, but softened notably during September. The eurozone unemployment rate's decline persisted throughout the third quarter, sliding from 7.7% in June to 7.6% in July, and to 7.5% in August. The overall eurozone economy grew by 2.2% during the second quarter and 14.3% year over year after contracting by 0.3% during the first quarter.

Market Impact (Referenced Index Returns are in CAD)

Despite a challenging September to close out the quarter, global equities were modestly higher. Canadian equities were essentially flat. Domestically, consumer staples and industrials notched solid gains; notable laggards included healthcare, consumer discretionary and materials. Smaller companies fared poorly. Japan and the U.S. led foreign developed markets higher. Meanwhile, emerging markets generally struggled as Brazil and China plunged, while India soared.

Fixed-income markets mostly struggled as rates moved higher late in the quarter. Government debt, real-returns bonds and corporate issues were all down. Meanwhile, residential mortgages and short-term bonds posted modest gains. U.S. high-yield bonds were positive, aided by higher oil prices and their riskier profile.

Index Data (Q3 2021)

- The S&P/TSX Composite Index gained 0.17%.
- The FTSE Canada Universe Bond Index returned -0.51%.
- The S&P 500 Index, which measures U.S. equities, rose 2.90%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, gained 1.23%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.97% (currency hedged) and 3.27% (unhedged).
- The Chicago Board Options Exchange Volatility Index, a measure of implied volatility in the S&P 500 Index that is also known as the "fear index," rose sharply from 15.83 to 23.14 by the end of the quarter.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, rose from US$73.47 to US$75.03 a barrel to end the quarter.
- The Canadian dollar weakened to C$1.27 per U.S. dollar. The U.S. dollar was also modestly stronger versus the world's other major currencies. It ended September at US$1.16 versus the euro, US$1.35 against sterling and at 111.58 yen.

Index definitions

The **Consumer Price Index** measures changes in the price level of a weighted average market basket of consumer goods and services purchased by households. A consumer price index is a statistical estimate constructed using the prices of a sample of representative items whose prices are collected periodically.

The **ICE BofA U.S. High Yield Constrained Index** is a market-value weighted index of all domestic and Yankee high-yield bonds, including deferred interest bonds and payment-in-kind securities. Its securities have maturities of one year or more and a credit rating lower than BBB-/Baa3 but are not in default.

The **ISM Manufacturing Index** is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms. It is considered to be a key indicator of the state of the U.S. economy.

The **FTSE Canada Universe Bond Index** is the broadest and most widely used measure of performance of marketable government and corporate bonds outstanding in the Canadian market. FTSE Canada has been in the business of providing the benchmark performance standards for Canadian fixed income investments since 1947.

The **MSCI ACWI Index** is a market-capitalization-weighted index composed of over 2,000 companies, and is representative of the market structure of 48 developed and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The index is calculated with net dividends reinvested in U.S. dollars.

The **MSCI Canada Index** is designed to measure the performance of the large- and mid-cap segments of the Canada market. With 91 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in Canada.

The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities.

The **MSCI USA Index** measures the performance of the large- and mid-cap segments of the U.S. market.

The **S&P 500 Index** is an unmanaged, market-weighted index that consists of 500 of the largest publicly traded U.S. companies and is considered representative of the broad U.S. stock market.

The **S&P/TSX Composite** is the headline index for the Canadian equity market. It is the broadest in the S&P/TSX family and is the basis for multiple sub-indices including but not limited to equity indices, Income Trust Indices, Capped Indices, GICS Indices and market cap based indices.

Glossary

Cyclical stocks or sectors are those whose performance is closely tied to the economic environment and business cycle. Managers with a pro-cyclical market view tend to favour stocks that are more sensitive to movements in the broad market and therefore tend to have more volatile performance.

Growth stocks exhibit steady earnings growth above that of the broader market.

Investment-grade bonds are Bonds that are believed to have a lower risk of default and receive higher ratings by the credit rating agencies.

Momentum refers to a trend-following investment strategy that is based on acquiring assets with recent improvement in their price, earnings, or other relevant fundamentals.

Value stocks are those that are considered to be cheap and are trading for less than they are worth.