Developed Markets Drive Equity Advance

Monthly Market Commentary

October 2021

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- Equities charged ahead around most of the world in October, erasing September's dip. Developed-market stocks surged, while emerging-market stocks mounted a subdued advance.
- Government-bond yield curves flattened during the month; inflation-indexed sovereign debt was the top performer within fixed income, retaining its lead from the third quarter.
- While U.S. inflation may be near a peak, Europe appears poised for further acceleration given immediate concerns about the cost of energy.

Economic Backdrop

Equities charged ahead around most of the world in October, erasing September's dip. Developed-market stocks surged, with Canada and the U.S. at the helm, while emerging-market stocks mounted a subdued advance. European and U.K. stocks delivered strong performance in October, while Japan continued its countertrend pattern with a plunge that offset its sizeable September gain.

Outside of developed markets, Argentina and Indonesia sustained remarkable multi-month runs, and China offset recent drops with a healthy showing in October. Peru outpaced nearly all other markets (second only to Egypt), but Latin America's overall equity-market performance sank as Brazil and Chile clocked the worst emerging-market country-level performance.

Government-bond yield curves flattened in the U.S., U.K. and eurozone during October as short-to-medium-term rates climbed and longer-term rates declined. Inflation-indexed sovereign debt retained its third-quarter rank as the top-performing segment of fixed-income markets in October, while local-currency emerging-market debt continued to sustain the deepest losses.

The price of West Texas Intermediate crude oil increased by 11.4% to end October at $83.57 per barrel, its highest level since October 2014.

The number of new COVID-19 cases reported globally appeared to bottom in mid-October after hitting a recent peak in mid-August (as measured by the seven-day average, according to Reuters' global tracker). By the month's end, Eastern Europe (and, to a lesser degree, the Caribbean and Southeast Asia) had the highest concentrations of countries contending with all-time peak or near-peak outbreaks.

On a country-level, the U.S. continued to report the highest average number of new infections and COVID-19-related deaths per day at the end of October; yet its infection rate declined to 29% of its all-time high. The U.K. averaged the second-largest number of daily infections and recorded a rising infection trajectory for most of October, but it registered a much lower death rate compared to other countries. Russia had the third-highest average number of new infections per day in late October (hitting its all-time peak at the end of the month) and averaged the second-highest daily number of COVD-19-related deaths. By the end of the month, large majorities of the U.K. (74%) and U.S. (67%) populations had received at least one COVID-19 vaccine dose, while 38% of Russia's residents had received the same (source Reuters' global tracker).

The Congress voted to increase the federal debt ceiling by $480 billion in mid-October, effectively allowing federal borrowing until early December in order to temporarily prevent a government shutdown. Competing priorities—centered on funding for a large multi-year infrastructure plan and a wide-ranging healthcare, education and child care program—have fragmented the Democrats' razor-thin majority; although there appears to be enough votes to enact the infrastructure priorities.

In early October, U.S. Trade Representative Katherine Tai formally articulated the U.S.-China trade policy of President Joe Biden's administration, which includes retaining existing tariffs, avoiding new ones, and committing to the Phase One trade deal. She also announced the reinstatement of an exclusion process for U.S. companies that apply for relief from tariff-induced damages.

Beleaguered Chinese property developer Evergrande made two interest payments in October as 30-day grace periods were set to expire, narrowly averting defaults. Fantasia Holdings Group, a much smaller developer, failed to repay a $206 million bond payment early in the month.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) increased by 0.2% and 4.4%, respectively, for the month and year ending September. Gasoline prices have risen by nearly a third in the past 12 months—excluding gasoline, the CPI was up 3.5% over the year. Producer price increases remained robust. The Industrial Product Price Index (IPPI) was up 1.0% in September, while the Raw Materials Price Index (RMPI) was up 2.5%. Over the past 12 months, the IPPI jumped 14.9% and the RMPI rose 31.9%. The unemployment rate again ticked lower, dropping 0.2% to 6.7% at the end of October. Employment rose by 31,000 and has now risen slightly above the pre-pandemic level.

- The growth of U.S. manufacturing activity remained strong in October, cooling only slightly. Services-sector growth accelerated from solid levels in September to remarkably strong levels in October. New weekly U.S. jobless claims broke below 300,000 during October for the first time since March 2020—beginning the month at 326,000 filings per week and trending steadily lower to finish at 281,000. The U.S. economy expanded at a 2.0% annual rate in the third quarter, down steeply from 6.7% during the second quarter. Meanwhile, U.S. wages increased by 1.5% during the third quarter, the highest rate in the Department of Labor's 20-year measurement period.

- U.K. manufacturing growth picked up during October from already-strong levels. Services-sector growth re-accelerated in the month after slowing from multi-decade highs during the third quarter. The U.K. claimant count (which calculates the number of people claiming Jobseeker's Allowance) declined further in September by roughly 50,000 claimants, lowering the claimant share of the population from 5.4% to 5.2%. The U.K. economy expanded by 0.4% in September, remaining below the monthly readings that surpassed 2% during the springtime peak in economic activity but above August's near-flat showing.

- The eurozone sustained its spirited manufacturing growth in October. Services growth continued to soften in the month, albeit to still-healthy levels. The eurozone unemployment rate slipped from 7.5% in August to 7.4% in September. The overall eurozone economy grew by 2.2% during the third quarter, matching the second-quarter pace, and by 3.7% year over year in September. France's economy expanded by 3.0% during the third quarter, beating forecasts for 2.1% and improving on the country's second-quarter pace of 1.2%; the German economy grew by 1.8%, in line with the second quarter but below estimates.

Central Banks

- As expected, the Bank of Canada (BoC) held its policy rate at a historically low 0.25% following its October 27 meeting. The BoC reiterated that it expects to hold rates low until economic slack is absorbed and inflation consistently exceeds 2% (the lower end of its target inflation band), which is not currently expected to occur until the middle of 2022. The Bank is ending its quantitative easing program as it shifts from purchasing new Government of Canada bonds to buying bonds only to replace maturing bonds. This year's final meeting is scheduled for December 8.

- The Federal Open Market Committee (FOMC) did not hold an October meeting, but announced in early November a long-anticipated timetable to reduce its asset purchase programme, which is currently running at purchases of $80 billion in Treasurys and $40 billion in agency mortgage-backed securities (MBS) per month. The central bank will shrink its monthly asset purchases by $15 billion—split between a $10 billion reduction in Treasury purchases and $5 billion in MBS—in November and again in December, with the expectation that the reductions will continue until asset purchases conclude altogether in June 2022, although the pace can be adjusted "if warranted by changes in the economic outlook."

- The Bank of England (BOE) did not convene its Monetary Policy Committee (MPC) during October. The bank rate remained 0.1% at its last meeting. The maximum allowance for asset purchases was unchanged at £895 billion, but 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) kept its monetary-policy orientation on hold at its late-October meeting, enabling a moderately lower pace of net asset purchases under the pandemic emergency purchase programme (PEPP) than the target of approximately €80 billion per month that prevailed prior to its September meeting. ECB President Christine Lagarde stated that market expectations for an ECB rate hike in 2022 seemed a bit premature based on the central bank's analysis.

- The Bank of Japan (BOJ) maintained its monetary-policy course at its late-October meeting—holding its short-term interest rate at -0.1% and its 10-year government bond yield target near 0%, while continuing open-ended asset purchases. The central bank downgraded its near-term consumer inflation forecast in its latest quarterly economic outlook.

Market Impact (in Canadian dollar terms)

Equities generally posted strong gains as some markets reached new highs. Canadian equities were among the top performers, led by energy, industrials, materials and smaller companies. Meanwhile, healthcare and consumer staples were notable laggards. Foreign developed markets were mixed as Japan slid while Europe and the U.K. were up. Emerging markets were weak—China notched modest gains while Brazil plunged by double digits.

Fixed-income markets mostly struggled, with residential mortgages as the lone stand out due to a hot housing market. Corporate bonds moderately outperformed government debt, while real-return bonds fell the most domestically. U.S. high-yield was nearly flat on a currency-hedged basis.

Index Data (October 2021)

- The S&P/TSX Composite Index was up 5.02%.
- The FTSE Canada Universe Bond Index returned -1.05%.
- The S&P 500 Index, which measures U.S. equities, gained 4.70%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, was up 2.84%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -0.18% (currency hedged) and -2.34% (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"—moved lower from 23.14 at the end of September to 16.26 at the end of October.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, moved sharply higher from US$75.03 on the last day of September to US$83.57 at the end of the month.
- The loonie strengthened versus the U.S. dollar; it ended the month at C$1.24 per U.S. dollar. The U.S. dollar was generally weaker versus the world's other major currencies. It ended the month at US$1.37 against sterling, US$1.16 versus the euro and 114.03 yen.

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