Monthly Market Commentary

October 2023

Worries on multiple fronts weigh on the markets.

- Global equity markets lost ground in October. Investors were concerned about rising long-term U.S. Treasury yields, stronger-than-expected economic data-which reignited worries that the U.S. Federal Reserve would resume its rate-hiking cycle-as well as growing geopolitical tensions in the Middle East.
- Most global fixed-income assets recorded negative returns for the month, although Canadian bonds bucked this trend. U.S. Treasury yields moved higher for all maturities greater than one year, particularly in the intermediate and long segments of the curve (bond prices move inversely to yields).
- We expect bond yields to remain at the higher end of the recent range as inflation proves perhaps a bit more stubborn than markets anticipate and the supply of new debt remains extremely high.

Economic Backdrop

Global equity markets lost ground in October. Investors were concerned about rising long-term U.S. Treasury yields, stronger-than-expected economic data—which reignited worries that the U.S. Federal Reserve (Fed) would resume its rate-hiking cycle—as well as growing geopolitical tensions in the Middle East. Developed markets outperformed their emerging-market counterparts for the month.

North America experienced comparatively smaller losses and was the strongest performer among developed markets in October, led by the U.S. The Pacific region was the most notable market laggard due mainly to weakness in New Zealand and Japan. Eastern Europe posted a double-digit gain and was the top-performing region within the emerging markets during the month due primarily to strength in Poland. In contrast, the Gulf Cooperation Council (GCC) countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates—and Latin America recorded the largest losses among the emerging markets during the month.

Most global fixed-income asset classes lost ground in October, although Canadian bonds bucked this trend. U.S. Treasury securities saw relatively smaller losses and were the top performers within the U.S. market for the month. U.S. mortgage-backed securities (MBS) and corporate bonds were the most notable market laggards. Treasury yields moved higher for all maturities greater than one year, particularly in the intermediate and long segments of the curve. Yields on 2-, 3-, 5- and 10-year Treasury notes rose 0.04%, 0.10%, and 0.29%, respectively, over the month. The spread between 10- and 2-year notes moved from -0.44% to -0.19% during the month, and the yield curve remained inverted.

As widely expected, the Fed maintained the federal-funds rate in a range of 5.25% to 5.50% following its meeting on October 31-November 1. However, the central bank did not rule out future interest-rate increases if needed in its ongoing effort to combat inflation. In a statement announcing the continuation of the pause in its rate-hiking cycle, for a second consecutive policy meeting, the Federal Open Market Committee (FOMC) stated that it "would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals. The Committee's assessments will take into account a wide range of information, including readings on labour market conditions, inflation pressures and inflation expectations, and financial and international developments." Since the Fed's last rate increase in late July through the end of October, the yield on the 10-year U.S. Treasury note rose more than 100 basis points (1.00%). This has prompted speculation that higher long-term yields could slow U.S. economic growth, thereby reducing the need for the Fed to raise the federal-funds rate further.

Long-simmering tensions in the Middle East escalated to war following a surprise attack on Israel by Hamas in early October. In addition to the casualties resulting from Hamas' initial incursion into Israel, the militant group and some of its allies abducted more than 200 soldiers and civilians, including several Americans; the Israeli government subsequently entered into negotiations to secure their release. President Joe Biden traveled to Israel on October 18 to meet with Prime Minister Benjamin Netanyahu to discuss the conflict. The meeting occurred amid increasing tensions following the bombing of a hospital in Gaza, a Palestinian territory controlled by Hamas. The Israeli government and Gazan militants each blamed the other for the attack. Biden stated that, based on information provided by the U.S. Department of Defense, the explosion was caused by an errant rocket launched by Palestinian Islamic Jihad, a Sunni Islamic militant group. In protest of the U.S. government's conclusion about the attack, the leaders of several Arab nations canceled a previously scheduled meeting with Biden in Jordan. Soon thereafter, Biden announced that the U.S. had reached an agreement with Israel and Egypt to send humanitarian aid into Gaza by truck. Later in the month, Israeli troops entered Gaza to begin a ground offensive in an effort to defeat Hamas.

In response to news of the attack in Israel, both the West Texas Intermediate (WTI) and Brent crude oil prices rose sharply amid concerns that any expansion of the conflict into the major oil-producing nations in the Middle East could reduce supply. However, prices subsequently pulled back as fears regarding the Middle East conflict eased and inventories rose. The WTI crude oil price ended the month down 10.8%, while Brent crude fell 7.8% in U.S. dollar terms. Other global commodity prices were mixed in October. The New York Mercantile Exchange (NYMEX) natural gas price climbed 22% over the month amid higher demand. The gold spot price increased 6.9% over the month as investors sought "safe-haven" assets amid geopolitical tensions in the Middle East. Wheat prices were up 2.7% in October, benefiting from hopes of increased demand from China, as well as speculation that the Israel-Hamas and Russia-Ukraine conflicts could hamper supply.

Central Banks

- As was widely expected, the Bank of Canada (BoC) held its overnight interest rate steady at 5.00% and continued its policy of quantitative tightening following its October 25 meeting. BoC Governor Tiff Macklem noted that higher interest rates have slowed the Canadian economy and that data suggest that demand and supply are approaching a balance. Furthermore, Macklem also noted that in addition to the incalculable level of human suffering, the wars in Ukraine and Israel/Gaza have increased uncertainty and hurt the global economy. The next BoC meeting is scheduled for December 6.

- During a speech at the Economic Club of New York nearly two weeks before the FOMC's most recent policy meeting, Fed Chair Jerome Powell noted that he is encouraged by the decline in inflation and that the Fed could keep its interest rate-hiking cycle on hold if no signs emerge that strong economic activity might reignite inflation. Powell stated, "Given the uncertainties and risks, and how far we have come, the Committee is proceeding carefully. We will make decisions about the extent of additional [monetary] policy firming and how long policy will remain restrictive based on the totality of the incoming data, the evolving outlook, and the balance of risks." However, Powell sounded a cautious note: "Given the fast pace of the [policy] tightening, there may still be meaningful tightening in the pipeline." As previously noted, the Fed left its benchmark interest rate unchanged at its meeting on October 31-November 1.

- In a split 6-3 vote at its meeting in early November, the Bank of England (BOE) left the Bank Rate unchanged at a 15-year high of 5.25%. Three BOE Monetary Policy Committee members supported a 25-basis point increase (0.25%). In its announcement of the rate decision, the BOE commented, "The Committee continues to judge that the risks to its modal inflation projection are skewed to the upside. Second-round effects in domestic prices and wages are expected to take longer to unwind than they did to emerge. There are also upside risks to inflation from energy prices given events in the Middle East." The central bank also stated, that, based on its projections, "inflation returns to target [an annual rate of 2%] in two years' time and falls to 1.6% at the three-year horizon."

- The European Central Bank (ECB) left its benchmark interest rate unchanged at 4.50% following its meeting on October 26. In a statement announcing the rate decision, the ECB's Governing Council noted that "inflation dropped markedly in September…and most measures of underlying inflation have continued to ease. The Governing Council's past interest rate increases continue to be transmitted forcefully into financing conditions." The central bank also expressed its optimism that "the key ECB interest rates are at levels that, maintained for a sufficiently long duration, will make a substantial contribution to this goal. The Governing Council's future decisions will ensure that its policy rates will be set at sufficiently restrictive levels for as long as necessary."

- The Bank of Japan (BOJ) left its benchmark interest rate unchanged at -0.1% following its meeting on October 30-31, but announced an adjustment to its yield curve control policy. The central bank redefined the upper yield limit of 1.0% for the 10-year Japanese Government Bond (JGB) that it had established in July of this year as an "upper bound" rather than a stringent cap. The BOJ's decision sent the Japanese yen tumbling to a 15-year low against the euro, and falling to a one-year trough versus the U.S. dollar. In a statement announcing the monetary policy actions, the central bank commented that it will "control the yields mainly through large-scale JGB purchases and nimble market operations. In this manner, the Bank will patiently continue with monetary [policy] easing." The 10-year JGB yield rose 18 basis points (0.18%) to 0.95% over the month.

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

- According to Statistics Canada, consumer prices (as measured by the change in the Consumer Price Index (CPI)) fell 0.1% for September, while the year-over-year increase slowed to 3.8%. The deceleration in the 12-month CPI was broad-based as price increases for travel-related services, durable goods and groceries eased. Meanwhile, gasoline costs were up 7.5% from a year ago. Producer prices rose by varying amounts. The Industrial Product Price Index (IPPI) and Raw Materials Price Index (RMPI) climbed 0.4% and 3.5%, respectively, in September. Year-over-year prices were up a modest 0.6% for the IPPI and 2.4% for the RMPI. The Canadian economy added just 18,000 jobs in October, as the unemployment rate climbed 0.2% to 5.7%.

- The Department of Labor reported that the U.S. consumer-price index (CPI) rose 0.4% in September, following a monthly increase of 0.6% in August. The CPI advanced 3.7% year-over-year—unchanged from the 12-month rise in August. Core inflation, as measured by the CPI for all items less food and energy, posted an annual increase of 4.1%–in line with market's expectations and down slightly from the 4.3% year-over-year upturn in August. Core inflation rose 0.3% in September, matching the month-over-month increase in August. Housing costs comprised the bulk of the rise in the CPI in September, while higher gasoline prices also contributed to the upturn. Food prices rose 0.2% for the third consecutive month, and recorded a 3.7% gain versus the same period in 2022. According to the initial estimate from the Department of Commerce, U.S. gross domestic product (GDP) grew at an annualized rate of 4.9% in the third quarter of 2023, sharply higher than the 2.1% rise in the second quarter of the year. U.S. GDP has increased for five consecutive quarters following declines in the first two quarters of 2022. The largest increases for the third quarter were in consumer spending, private inventory investment (a measure of the changes in values of inventories from one time period to the next), and exports. These gains offset a reduction in nonresidential fixed investment (purchases of both nonresidential structures and equipment and software), and an increase in imports, which are a subtraction in the calculation of GDP. The government attributed the significantly higher GDP growth rate relative to the previous quarter primarily to accelerations in consumer spending and private inventory investment, as well as upturns in exports and residential fixed investment (purchases of private residential structures and residential equipment that property owners use for rentals). Conversely there were quarter-over-quarter decreases in nonresidential fixed investment, a slowdown in state and local government spending, as well as an increase in imports.

- According to the Office for National Statistics (ONS), consumer prices in the U.K. rose 0.5% month-over-month in September—up slightly from the 0.4% increase in August. Inflation advanced 6.3% year-over-year, matching the 12-month upturn in August. The largest contributors to the annual rise in inflation included food and non-alcoholic beverages, as well as alcoholic beverages and tobacco. These more than offset a decline in prices for household appliances, fitting and repairs. Core inflation, which excludes volatile food prices, rose at an annual rate of 5.9% in September, unchanged from the year-over-year increase in August. The ONS also reported that U.K. GDP grew 0.5% in August (the most recent reporting period), after falling 0.6% in July, and increased 0.3% over the previous three-month period. Production output decreased 0.7% month-over-month in August, compared to the 1.1% decline in July. The services sector saw an upturn of 0.4% in August, versus a 0.5% decrease during the previous month. The construction sector contracted 0.5% in August, compared to the 0.4% downturn in July.

- Eurostat pegged the inflation rate for the eurozone at 2.9% for the 12-month period ending in October, down sharply from the 4.3% annual increase in September. Prices for food, alcohol and tobacco rose 7.5% in October, but the pace of acceleration slowed from the 8.8% annual rate for the previous month. Additionally, costs for services and non-energy industrial goods rose 4.6% and 3.5%, respectively, over the previous 12 months. Conversely, energy prices fell 11.1% year-over-year, following a 4.7% decline in September. Core inflation, which excludes volatile energy and food prices, rose at an annual rate of 4.2% in October, down 0.3 percentage point from September. According to Eurostat's final estimate, eurozone GDP grew 0.2% in the second quarter of 2023, slight improvement from the flat growth rate in the first quarter, and increased 0.5% year-over-year. The economies of Lithuania and Iceland were the strongest performers for the second quarter, expanding 2.4% and 2.2%, respectively, while Poland's economy contracted 2.2% during the period.

Index Data (October 2023)

- The S&P/TSX Composite Index fell 3.21%.
- The FTSE Canada Universe Bond Index returned 0.37%.
- The S&P 500 Index, which measures U.S. equities, rose 0.52%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, was down 0.41%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -1.32% (currency hedged) and 1.40% (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"—was moderately higher, as it moved from 17.52 to 18.14.
- The WTI Cushing crude oil price—a key indicator of movements in the oil market—was somewhat volatile, but moved lower from US$90.79 to US$81.02 a barrel to end October.
- The Canadian dollar weakened to C$1.39 per U.S. dollar. The U.S. dollar was little changed versus the world's other major currencies, ending October at US$1.06 versus the euro, US$1.21 against sterling, and at 151.45 yen.

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