Foreign Equities Rise on Warming Trade Talks
Monthly Market Commentary
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- Global equity markets' early-autumn rebound accelerated in October with a boost from emerging markets, however Candian equities failed to participate.
- The U.S. cancelled a planned increase in tariffs on Chinese products, while China announced $20 billion in purchases of U.S. agricultural goods and declared willingness to soften policies on forced technology transfers and barriers to foreign investment.
- In view of uncertainties facing investors today, we believe it is especially important for those with long time horizons to avoid trying to time the market or making outsized sector or regional bets.

Economic Backdrop

Even though domestic equities were down, foreign equity markets climbed at an accelerating pace in October with a boost from emerging markets. U.S. and Japanese stocks followed a relatively steady upward path, while U.K. and European stocks advanced sharply after a mediocre start to the month. Mainland Chinese equity markets ended higher for the full month despite multiple rallies and selloffs; Hong Kong stocks fared well after a soft start.

Short-term U.S. Treasury rates declined and long-term rates increased marginally. The opposing changes in U.S. rates—driven largely by the Federal Reserve's most recent 0.25% cut to the federal-funds rate—resulted in the yield curve partially reverting to its "normal" upward slope, as longer-term Treasurys began to yield more than shorter-term Treasurys. Government bond rates increased fairly evenly across all maturities in the U.K. and Europe during October, with long-term yields rising slightly more than short-term yields.

Trade relations appeared to thaw between the U.S. and China—the two countries with the world's largest economies, which together account for 40% of global gross domestic product (GDP) as of 2018. The U.S. cancelled a planned October 15 increase in tariffs on Chinese products; later in the month, China announced $20 billion in purchases of U.S. agricultural goods and declared willingness to soften policies on forced technology transfers and barriers to foreign investment.

Already-divisive U.S. domestic politics turned sharply contentious as Democrats in the House of Representatives continued their impeachment inquiry into President Donald Trump—punctuating the month with a full House vote to formalize the investigation. Democrats began the probe in response to allegations that the president urged Ukrainian President Volodymyr Zelensky to pursue investigations into Trump's political opponents in exchange for $400 million of congressionally-approved military aid meant to counter a five-year Russian-backed insurgence in Eastern Ukraine. (The aid was eventually released in September once the allegations came into public view.) Toward the end of October, Zelensky—armed with the belatedly-released U.S. military aid—succeeded in negotiating an artillery pullback from the front lines between Kremlin-backed separatist forces and the Ukrainian military.

Elsewhere in Eastern Europe, Polish and Hungarian voters continued to back the governing right-populist parties, but with less enthusiasm than in recent years: Poland's Law and Justice party lost its majority in the Senate, while Hungary's dominant Fidesz party lost mayoral races in a lengthy slate of major cities that included its capital city of Budapest.

The U.K.'s unclear path out of the EU came into focus during October. Prime Minister Boris Johnson's re-negotiated Brexit deal was deemed acceptable in principle by a majority of the House of Commons on October 22—marking the furthest progress toward resolution up until that point—but was ultimately defeated in Parliament on concerns about executing the solution within its proposed three-day timetable. EU leaders agreed to extend the departure date again, this time from October 31 to the end of the calendar year. Jeremy Corbyn, the main opposition leader, consented to Johnson's call for a snap election on December 12, increasing the likelihood that a solid road to Brexit will be paved before the next departure date.

Tensions rose in the Middle East after the U.S. announced and then partially reversed a military withdrawal from Syria: Turkey and Russia exerted greater control in the country's north, which put the U.S.-allied Kurdish population at risk. The prime ministers of Iraq and Lebanon each announced their resignations in late October after weeks of growing antigovernment protests rooted in economic dissatisfaction and concerns about corruption.

In South America, Chileans protesting higher subway fares remained in the streets despite producing concessions that included a pause on planned increases in electricity rates and a new slate of cabinet members. Brazil suffered one of the largest environmental disasters in its history during October when an oil spill off of its north-eastern shore (with no clear cause) spread to contaminate 1,400 miles of the country's coastline.

Alberto Fernandez unseated Argentinian President Mauricio Macri after only one term in the country's late-October election. While remarkable in that an Argentine incumbent lost for the first time, the result was unsurprising: Fernandez was expected to benefit from the popularity of his running mate, former President Cristina Fernandez de Kirchner. The prospect of a handover from conservatives to the center-left Peronist movement during a period of crippling pressure on Argentina's finances raised anxiety among investors, particularly given the movement's antagonistic relationship with foreign creditors. The International Monetary Fund (IMF) recently withheld $5 billion of loan aid in anticipation of the election results to determine whether Argentina's leadership would maintain a commitment to austerity, which appeared unlikely given the Peronist platform.

Central Banks

- The Bank of Canada (BoC) left the overnight rate unchanged at 1.75% following its meeting on October 30. Bank Governor Stephen Poloz noted the Governing Council considered the worsening global economic situation and the increasing impacts of trade conflicts, but ultimately decided the downside risks to Canada's economy did not warrant a rate cut at this time. The BoC will hold its eighth and final meeting of 2019 on December 4.

- The Federal Open Market Committee announced an expected 0.25% decrease in the federal-funds rate toward the end of October, representing its third cut in as many meetings. In mid-October, the U.S. central bank made its first monthly purchase of $60 billion in Treasury bills as part of a program to increase liquidity in the financial system.

- The European Central Bank (ECB) made no changes following October's final monetary-policy meeting with Mario Draghi at its helm. The outgoing ECB president offered a defense of the central bank's recent policy shift toward further accommodation, as Christine Lagarde, former managing director of the IMF, prepared to take the reins in November.

- The Bank of Japan announced no change in its monetary policy program following its late-October meeting.

- The Bank of England's Monetary Policy Committee had no meeting in October.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) slipped by 0.1% in September, while prices increased at a 1.9% ratefor the past 12 months—slower than the prior period. The sluggishness in consumer prices can be attributed to dramatically lower gasoline prices. Producer prices were weak—the Industrial Product Price Index (IPPI) declined 0.1% in July while the Raw Materials Price Index (RMPI) was unchanged. Over the past 12 months, the IPPI and RMPI fell by 1.3% and 5.3%, respectively. Similar to consumer prices and in line with recent year-over-year trends, the weak data can be attributed to sliding energy prices; however, energy prices at the producer level were a bit higher in September. The unemployment rate was unchanged in October at 5.5% despite a small loss of 1,800 new jobs, as more people participated in the labour market.

- U.S. manufacturing activity improved in October, contracting at a less significant pace, as export orders returned to growth territory. Services sector conditions continued to expand slowly. The U.S. unemployment rate increased to 3.6% during the month despite a higher-than-expected gain in payrolls, an improved labour-force participation rate, and greater average hourly earnings.

- Eurozone manufacturing continued to contract sharply in October, while modest services-sector growth eased slightly. Labour conditions in the eurozone were fair during September: The eurozone unemployment rate was unchanged at 7.5%—the lowest since July 2008—while the number of unemployed increased by 33,000 during the month. The eurozone economy continued to grow by 0.2% during the third quarter, while year-over-year growth slowed to 1.1% (from 1.2% in the second quarter).

- The contraction in U.K. manufacturing activity mostly levelled off during October, although new orders continued to slide as falling domestic demand overtook rising exports. Inventory stocking ahead of the October 31 Brexit deadline also contributed to the relative improvement in activity. The U.K. claimant count unemployment rate held firm at 3.3% during September, while the blended June-to-August U.K. unemployment rate edged up to 3.9%; average year-over-year earnings growth fell from 4.0% to 3.8% in the June-to-August period.

Market Impact (in Canadian dollar terms)

Domestic equities drifted lower, while foreign equities produced gains. A number of domestic sectors, including healthcare, consumer staples, consumer discretionary and energy, declined over 4%. Foreign equities benefited from positive trade war and Brexit developments along with accommodative central bank policies. Emerging markets outperformed developed markets, while Japan, Europe and the U.K. all performed better than U.S. equities. This broke the trend of U.S. equity outperformance at least for one month.

Domestic fixed-income markets fell slightly in October. Corporate debt outperformed government debt. Real-return bonds lagged as recent inflation reports were weak; meanwhile, short-term bonds produced modest gains. U.S. high-yield bonds were negative in CAD terms as the loonie appreciated, but were slightly positive in currency-hedged terms.

Index Data (October 2019)

- The S&P/TSX Composite Index was down 0.86%.
- The FTSE Canada Universe Bond Index returned -0.17%.
- The S&P 500 Index, which measures U.S. equities, rose 1.42%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, climbed 1.99%.
- The ICE BofAML U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.18% (currency hedged) and -0.50% (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"—briefly spiked above 20 on two occasions but significantly declined from 16.24 to 12.33 during the full month.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, were little changed—rising from US$54.07 on the last day of September to US$54.18 at the end of October.
- The loonie strengthened versus the U.S. dollar; it ended the month at C$1.31 per U.S. dollar. The U.S. dollar also weakened against sterling and the euro, but was essentially unchanged versus yen. It ended the month at US$1.29 against sterling, US$1.12 versus the euro and 108.11 yen.

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