# October 2023 Market Newsletter

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## Opening Comments

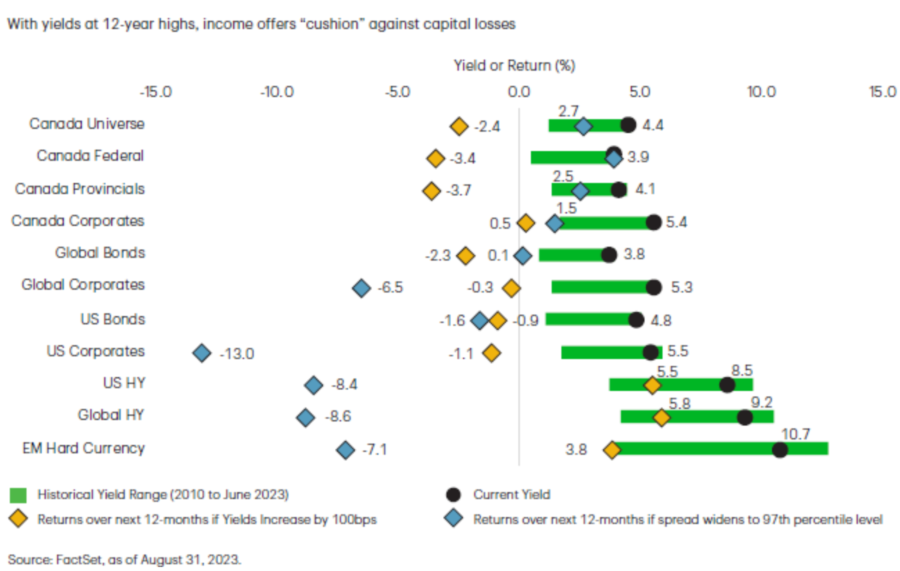
- The strength of incoming macroeconomic data has increased the probability of a soft landing. Most leading indicators, however, still point to a possible recession.
- The Conference Board's Leading Economic Indicators Index, which leads turning points in the business cycle by around six to eight months, has declined for 15 consecutive months, the longest streak since 2008, and is deeply negative year-over-year.

## Noteworthy News

- The US Federal Reserve held interest rates steady on September 20th, but indicated they expect one more hike by the end of the year and fewer cuts than previously indicated for 2024.
- The Bank of Canada also held rates steady at 5% on September 6th. They noted that the economy had entered a period of weaker growth, but left room to possibly raise rates again should inflationary pressures persist.

## The Bond Bull Market May Resume in the Quarters Ahead

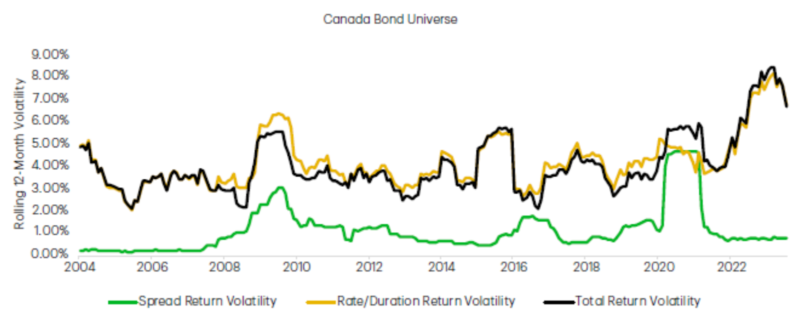
- After more than a decade on the sidelines, bonds are finally coming in to their own. Yields that had shrunk to near irrelevance since the global financial crisis, and were deeply embedded in investor expectations, have risen to heights unseen in decades.
- Investors can now tap into attractive yields in almost all segments of the fixed income market. Indeed, we may now be witnessing a bond bull market fueled by yields that, while unexceptional in historic terms, seem extravagant relative to the depths plumbed in recent years.
- With economic uncertainty a risk for equity markets, the income and diversification on offer from bonds now is far more enticing. Today's starting yields provide attractive entry points across fixed income sectors. As the mixed second quarter performance demonstrates, those returns may be volatile over the short term: however, they will accrue for those with longer-term time horizons. On the other hand, even in the event of adverse scenarios (e.g., higher government rates, wider credit spreads), income levels today provide a healthy cushion (see figure below) that will likely be able to offset losses.
- Only time will tell whether we have a full-blown recession in the coming quarters or not, but the risk of an economic slowdown is elevated. Therefore, maintaining a balanced and diversified portfolio is important.
- With yields finally reaching attractive levels, the income component of fixed income is back. Short term volatility in yields will likely persist as markets guess when central banks will begin to cut policy rates and whether the economic slowdown will accelerate.
- An attractive income cushion should provide a buffer against these bouts of volatility.



## Looking Forward

- Regarding equities, we are cautious over the short term. Market leadership has broadened slightly but remains narrow and continued strength in global equity prices, combined with rising long term bond yields, have compressed equity risk premiums further. Historically, valuations around current levels have suggested decreased potential returns in the near term unless earnings growth re-accelerates.
- The risk of widespread defaults in a deep-recession scenario may seem more significant, but over the past 20 years, it's actually interest-rate risk that has been the main source of volatility for a core Canadian bond index.
- Over that period, the interest-rate component had been significantly more volatile than the credit-risk portion, except during a handful of short-lived periods. While this phenomenon is slightly counterintuitive, it can be especially true during an elevated and uncertain period of inflation, (see figure below).

Policy moves contribute more to volatility than bankruptcies




Source: FactSet, as of August 31, 2023.

## Closing Thoughts

- Good buying opportunities can arise quickly during periods of heightened uncertainty, such as the one we find ourselves in today, and so it's important to maintain an active management approach that can balance both duration and credit exposure tactically and opportunistically.
- Wishing you all and your families a happy Thanksgiving! - Andrew & Nathan

| Market Performance (Source: Bloomberg Finance L.P.) | | | |
|---|---|---|---|
| | Sep. 29, 2023 | Dec. 31, 2022 | YTD Change |
| Equity Index Update | | | |
| S&P 500 | 4288 | 3840 | +11.7% |
| S&P/TSX Comp. | 19547 | 19385 | +0.8% |
| MSCI EAFE | 2031 | 1944 | +4.5% |
| Government Bond Yields | | | |
| U.S. 10-yr Treasury | 4.58 | 3.88 | +0.70 |
| Canada 10-yr Bond | 4.03 | 3.30 | +0.73 |
| Foreign Exchange Cross Rates | | | |
| C$ (USD per CAD) | 0.74 | 0.74 | 0.0% |
| Euro (USD per EUR) | 1.06 | 1.06 | 0.0% |

| Official Policy Rate Targets<br>Central Banks | Current Target |
|---|---|
| Federal Reserve (Fed Funds Rate) | 5.25% - 5.50% |
| Bank of Canada (Overnight Rate) | 5.00% |

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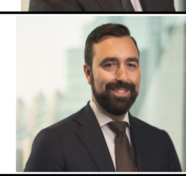

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