November 2023 Market Newsletter

October 31, 2023

Prepared by Andrew Kay, MBA, CFA, Senior Portfolio Manager
& Nathan Leveille, CFA, QAFP, Associate Portfolio Manager

Opening Comments

- The rally in global equity markets took a breather in Q3 as investors priced in the probability of higher-for-longer policy rates and struggled with the impact that those rates may have on growth in 2024.
- U.S. investment-grade bonds now offer their highest all-in yield, at 5.5%, since the late 1990's. As third-quarter performance demonstrates, returns may be volatile over the short term but will accrue for those with longer term time horizons.

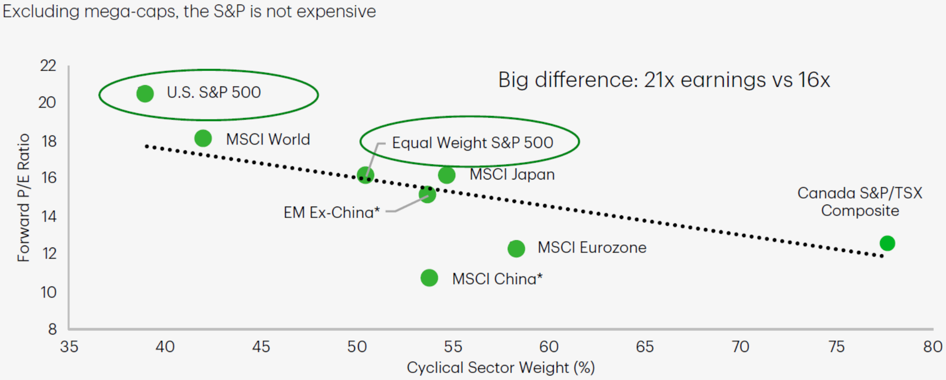
Noteworthy News

- The conflict in the middle east has heightened tensions in markets. We continue to closely monitor the impact of this on portfolios.
- The Bank of Canada held rates steady again at 5% on October 25th. They were notably concerned that progress toward price stability was slow and risks from inflation had increased. They stated they were prepared to raise the policy rate further if needed.

Positive Outlook for US Stocks Outside "The Magnificent Seven" Tech Stocks

- Last year, CPI inflation was at 8.3% and the Fed was barely halfway through its tightening program. Today, inflation has fallen to around 3.7%. The 12-month change now sits at a two year low, while the more recent three-month annualized inflation trend is running at 3.1%, just a notch above the long-term targeted range of 1% to 3%.
- The main reason attributed for the rise in long-term yields is the renewed optimism on economic growth in the U.S., with the consensus now pricing in a low probability of recession over the next 12 months.
- This has the potential to awaken the part of the market that has been a slumber of late, with buyers instead focused on the “Magnificent Seven” megacap tech stocks (Apple, Amazon, Google, Meta, Microsoft, Nvidia, and Tesla).
- Cyclical companies are now beginning to outperform defensives as ISM new orders also begin to pick up. A near record-low unemployment rate, depressed initial jobless claims and strong wage growth all point to a resilient labour market. Fiscal policy, and the U.S. consumer all remain in healthy territory.
- While the market-cap-weighted S&P 500 trades at 21x forward earnings, the equal-weighted version trades at a mere 16x, indicating value outside the “Magnificent Seven” mega-caps .
- Roughly two-thirds of the gain in S&P 500 this year has been driven by these seven names that account for about 30% of the index, while the remaining 70% of the index has delivered mainly mid-single-digit returns.
- We believe that earnings growth is starting to stabilize/show signs of positive momentum and that valuations are more consistent with a slowing growth environment. Valuations for the rest of the U.S. equity market are reasonable, which offers some potential support for the stock market, even in a modest economic slowdown.

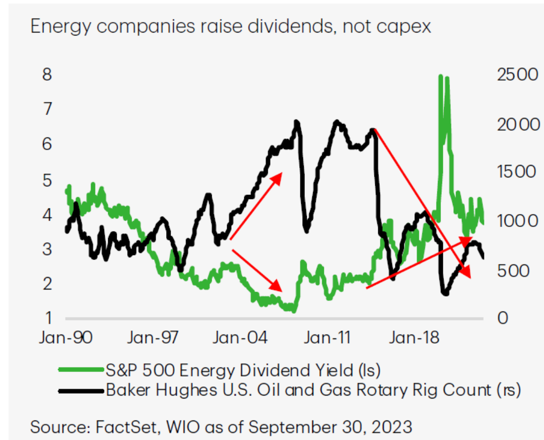
Excluding mega-caps, the S&P is not expensive



Source: FactSet, WIO as of September 30, 2023.

Looking Forward

- In Canada, the full effect of higher rates on the consumer and real estate market remains to be seen. As such, we anticipate that the Canadian economy will slow in 2023. However, strong free cash flows within the energy sector, and relatively inexpensive financials stocks, may present attractive opportunities.
- The energy sector is trading at 12 times forward earnings (at the 33rd percentile of the historical range), a 41% discount to the S&P 500. Meanwhile, North American operators remain disciplined in their capital allocation (see figure below), preferring to focus on returning cash to shareholders (sector dividend yield of 3.1% as of September 2023) rather than capital expenditures for suboptimal returns.
- As resilience in the labour market persists and inflation continues to normalize in line with the expectations of the Bank of Canada, we believe monetary policy pivoting to rate cuts over the next nine to 12 months is less likely than is currently priced by investors. This may translate into a slower decline in interest rates. On the flip-side, this may also imply higher for longer income returns within the fixed income asset class.
- International equity markets have rebounded strongly since the fall of 2022. International stocks continue to face concerns regarding corporate profits, rising rates, and slowing macroeconomic conditions, particularly in Europe. Given this view, we feel that further gains will be more limited.



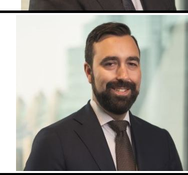
Closing Thoughts

- In uncertain times it is important to remember that we manage investments based on a guiding set of principles designed to work in a world that's constantly changing. We focus on investor's goals and true diversification. We build resilient portfolios that aim to perform regardless of the environment.
- As the weather turns colder we hope you all have a great month of November! - Andrew & Nathan

Market Performance (Source: Bloomberg Finance L.P.)			
	Oct. 31, 2023	Dec. 31, 2022	YTD Change
Equity Index Update			
S&P 500	4193	3840	+9.2%
S&P/TSX Comp.	18874	19385	-2.6%
MSCI EAFE	1948	1944	0.2%
Government Bond Yields			
U.S. 10-yr Treasury	4.90	3.88	+1.02
Canada 10-yr Bond	4.06	3.30	+0.76
Foreign Exchange Cross Rates			
C$ (USD per CAD)	0.72	0.74	-2.7%
Euro (USD per EUR)	1.07	1.06	0.9%
Official Policy Rate Targets Central Banks		Current Target	
Federal Reserve (Fed Funds Rate)		5.25% - 5.50%	
Bank of Canada (Overnight Rate)		5.00%	

Andrew Kay, MBA, CFA
Senior Portfolio Manager
TD Wealth Private Investment Counsel
780-408-6124
andrew.kay@td.com
portfolio-managers.td.com/andrew.kay/

Nathan Leveille, CFA, QAFP
Associate Portfolio Manager
TD Wealth Private Investment Counsel
780-498-3558
nathan.leveille@td.com
portfolio-managers.td.com/nathan.leveille/



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