Market Matters

OCTOBER 2013 HIGHLIGHTS

- American politics took centre stage in October. Fiscal issues were hotly debated resulting in stand-offs, hold-outs, shut-downs and the eventual do-over of budget and debt ceiling discussions as deadlines were kicked down the road to early next year.
- The 16-day U.S. government shut-down and debt ceiling debate may have captured the headlines, but it was equity markets that stole the show in October.
  - Year-to-date the S&P500 has had the best year since 1997.
  - The S&P/TSX had its best month since October 2011.
  - Global equity markets followed suit with both developed and developing markets posting strong returns for the month.
- Resilient corporate earnings buoyed investor confidence and helped move equity markets higher.
- Fixed-income investors benefited from expectations that the U.S. Federal Reserve would further delay tapering of their asset-purchasing plan. Yields dropped slightly, boosting bond prices.
- Commodity prices weakened, in particular oil. An improving geopolitical situation in the middle-east emerged and diminished the price premium associated with supply disruption risks in that region.

RESILIENT EQUITY MARKETS

Investors no sooner dealt with the prospect of the U.S. Federal Reserve (Fed) tapering its asset purchasing plan and their confusing "On your mark. Get set. Psych!" communication strategy, when they were faced with the government shutdown in October and narrowly averted a US Treasury default. In spite of these significant events threatening to derail investor confidence and shake the U.S. economic recovery, October proved to be an exceptionally strong month for equities.

Table 1
Summary of major market developments

Market returns*	October	YTD
S&P/TSX Composite	4.5%	7.5%
S&P 500	4.5%	23.2%
- in Canadian dollars	*5.8%*	*29.1%*
MSCI EAFE	3.3%	20.3%
- in Canadian dollars	*4.6%*	*22.8%*
MSCI Emerging Markets	3.9%	2.1%
DEX Universe Bond Index**	1.1%	-0.5%
BBB Corporate Index**	1.5%	1.6%

*local currency (unless specified); price only
**total return, Canadian bonds

Table 2
Other price levels/change

	Level	October	YTD
CAD per USD exchange rate	$0.959	-1.2%	-4.9%
Oil (West Texas)*	$96.38	-5.8%	5.0%
Gold*	$1,324	-0.6%	-21.0%
Reuters/Jefferies CRB Index*	$277.86	-2.7%	-5.8%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	October	YTD
S&P/TSX Composite	4.5%	7.5%
Energy	3.1%	8.0%
Materials	1.5%	-27.7%
Industrials	9.2%	27.2%
Consumer discretionary	5.1%	36.6%
Consumer staples	5.1%	23.2%
Health care	2.7%	55.1%
Financials	5.9%	15.5%
Information technology	-0.8%	26.3%
Telecommunication services	4.5%	6.9%
Utilities	5.3%	-5.5%

*price only
Source: Bloomberg, MSCI Barra, NB Financial, PC Bond

INVESTORS' GOLDILOCKS SCENARIO

It would seem that the 16-day U.S. government shut-down was not long enough to derail the overall path of the economic recovery (important for investor confidence). However, it was just long enough to dampen nearer-term economic growth expectations, thereby decreasing the chances of the Fed pulling back on its asset purchasing program by year-end (i.e. more accommodative monetary policy for longer). Effectively this created a 'not too hot and not too cold' Goldilocks effect for markets. Clearly this sat 'just right' with investors and allowed them to focus on corporate fundamentals where, for the most part, companies continue to meet or beat conservative earnings forecasts.

The pushed-back timeframes for the Fed to begin tapering its asset purchasing program also gave comfort to bond holders. Yields came down and bond prices rose, resulting in some relatively attractive bond returns for the month of October.

Contrary to the U.S. equity market rally, the Canadian market rally has not been as broad-based. This month's strong gains on the S&P/TSX Composite by and large came from the Industrial, Consumer Discretionary and Financial sectors. These sectors have also been key positive contributors on a year-to-date basis.

- Good operating results from railway leaders CN Rail and CP Rail helped to drive stock gains in the Industrial sector (7.5% weight in the S&PTSX Composite).
- Strong auto sales helped auto parts manufacturers like Magna experience significant stock gains in the Consumer Discretionary sector (5.5% weight in the S&PTSX Composite).
- It has been a strong year overall for Canadian banks and insurance companies in the financial sector (35.1% weight in the S&PTSX Composite). Canadian banks benefited from a better-than-feared housing market environment and improved margins on mortgages, while sentiment towards insurance companies improved as they tend to benefit from a rising yield environment and strong equity markets in general.
- To the downside, Canadian investors have been particularly hard-hit by an annus horribilus for Canadian mining companies. A drop in gold bullion and metal prices, cost overruns, environmental concerns and poor earnings results have all contributed to the decline. Gratefully, while the Canadian Materials sector (currently a 12.6% weight in the S&PTSX Composite) has by no means recovered, the sharp drops appear to have subsided and the sector managed a very modest gain in October.

WHEN BAD NEWS IS GOOD NEWS

These are unique times for market watchers as currently investors are reading bad news as good news, and prizing weaker economic data over strong results because it supports the continuation of extraordinary monetary measures. That's not a sustainable long-term scenario and we expect heightened attention and market volatility surrounding economic data releases and expectations for the timing, direction and magnitude of the Fed's next move.

WINTERIZING YOUR PLAN

Around this time of year we put on winter tires, pack a windshield scraper in the car, pull out warm boots and gloves. We get ready for inclement conditions – whether it arrives sooner or later, knowing that when it does arrive we will be grateful we planned ahead. Having a conversation with a trusted advisor about your investment plan can offer similar comfort when it comes to planning ahead. Ensuring your long-term investment plan is well diversified and aligned with your risk tolerances and time horizons can help you weather inclement market conditions…whether they arrive sooner or later.