Market Matters

OCTOBER 2014 HIGHLIGHTS

- Capital markets went for a wild ride in October. Concerns over European, Japanese and Chinese economic growth, along with accelerating geopolitical concerns (including the Ebola and ISIS crises) converged mid-month, but markets were quickly calmed by positive economic and corporate earnings results.
    - The S&P 500 was down 9.8% from its previous high on Sept 19, 2014 to its low on October 15, 2014, but ended the month up 2.3% and hitting another (its 35th) new closing high on the last day of the month.
    - The S&P/TSX Composite was down 11.4% from its previous high on September 3, 2014 to its low on October 15, 2014. From there the index recovered 5.4% before the end of October, though still ending down 2.3% for the month on weakening commodity prices.
    - 10-year US Treasury bond yields dropped as low as 1.86% intra-day on October 15th, 2014, closed that day at 2.14%, and ended the month at 2.34%.
- The US dollar continues to strengthen. A safe-haven bet backed by a strengthening economic picture - its global peers are no match to the greenback's relative attractiveness at the moment.
- Oil prices continued their slide down as ample supply couples with decreasing demand forecasts from countries like China.

LIKE IT NEVER HAPPENED...

This October capital markets reminded us of how quickly things can change. In fact, had you somehow managed to avoid market news and headlines for the last half of the month, you could be forgiven for thinking the markets had simply chugged along at a steady pace.

But 'boring and steady' October was not! The ides of October saw global markets plunge to 'correction' territory (as defined by a 10% drop from market highs) and 10-year Treasury bond yields made a beeline for lows not seen since July 2012. While equity markets had been susceptible to a correction, as valuations had pushed above historical averages and the market's breadth had narrowed, the speed and harshness of the move was unnerving.

Table 1
Summary of major market developments

Market returns*	October	YTD
S&P/TSX Composite	-2.3%	7.3%
S&P 500	2.3%	9.2%
- in Canadian dollars	***3.0%***	***15.9%***
MSCI EAFE	-0.3%	1.4%
- in Canadian dollars	***-0.9%***	***0.7%***
MSCI Emerging Markets	1.3%	4.3%
FTSE TMX Canada Universe Bond Index**	0.6%	6.5%
FTSE TMX Canada Corporate BBB Bond Index**	0.4%	7.3%

*Local currency (unless specified); price only
**Total return, Canadian bonds

Table 2
Other price levels/change

	Level	October	YTD
CAD per USD exchange rate	$0.888	-0.6%	-5.7%
Oil (West Texas)*	$80.54	-11.6%	-18.2%
Gold*	$1,172	-3.0%	-2.7%
Reuters/Jefferies CRB Index*	$271.96	-2.4%	-2.9%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	October	YTD
S&P/TSX Composite	-2.3%	7.3%
Energy	-8.0%	1.6%
Materials	-11.6%	-8.6%
Industrials	-0.1%	20.9%
Consumer discretionary	4.3%	16.2%
Consumer staples	4.6%	28.2%
Health care	4.0%	17.5%
Financials	0.7%	9.4%
Information technology	4.5%	21.5%
Telecommunication services	4.1%	5.0%
Utilities	1.6%	8.7%

*Price only
Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

Bonds have traditionally served as the barometer for the health of the economy. While bond yields had been moving downward since the end of September, this trend was accentuated by a dramatic intra-day drop to levels as low as 1.86% in 10-year US Treasury yields on October 15th, 2014. The magnitude of that intra-day move for 10-year Treasury yields had not been experienced in decades.

In the end, the S&P 500 rose an impressive 2.3% in October, the Canadian bond market finished with a solid gain of 0.6%, and the S&P/TSX Composite was down 2.3% (with all of that decline attributed to the resource space with the other sectors doing much better), as though that mid-month turmoil never happened.

SO WHAT HAPPENED?

The market's fear factor hit the roof as concerns rapidly grew that slowing economic growth in Europe and China would derail the burgeoning recovery in the United States. This sparked deflation concerns that caught traction with dropping oil prices. At the same time geopolitical risks were percolating as western military strikes against ISIS were ramping up, a Russia/Ukraine cease fire looked tenuous, and Ebola cases began emerging in US.

Then came the turn around. The market recovery came within days as strong corporate earnings in the US re-focused investors on the fundamentals behind the stock market strength of the last few years. In other words, companies really are doing better and they are experiencing an economic recovery. This is particularly true in the U.S., though Canadian companies reported strong earnings as well. It's not a perfectly linear recovery, but one that continues to be intact thus far. Investors gained reassurance that the US economy is still leading the pack and, with two-thirds of their economy being domestic consumer driven, has thus far been more insulated from global growth concerns. While some global markets finished the month in negative territory (including the S&P/TSX Composite and some European markets), the recovery from mid-month lows was substantial across the board.

THIS HAPPENED TOO

Additional help for the October market recovery came from two very different government monetary policy announcements.

As expected, the US Federal Reserve (Fed) announced an end to their asset buying program, indicating that enough economic recovery had been experienced to no longer need quantitative easing. They also stated that they would continue with their low-rate policy for a 'considerable time', confirming that they intend to stay very accommodative for further economic growth.

Unexpectedly, on October 31st, the Bank of Japan increased their economic stimulus package. In an effort to finally break the back of decades of deflation, they increased their already sizeable asset purchase program from 70 trillion yen/year to 80 trillion yen/year. This amounts to US$60 billion/month, nearly as big as the Fed's asset purchase program at its peak US$85 billion/month. While that alone may seem impressive, consider that the Japanese economy is only a third of the size of the US economy. No two ways about it, that's an enormous injection of funds into an economy! Japan's announcement pushed global markets up, with Japan's Nikkei 225 up an impressive 4.8% on the day.

STILL HAPPENING

Ongoing themes this fall include the strengthening US dollar and the commodity price slide, the latter aided in part by the former.

The US dollar continues to strengthen as the US economy shows resilience. Economic guidance supports modest but steady growth, in contrast to the more concerning growth forecasts out of Europe, Japan and China. Oil prices continued their slide down in October. Increasingly the US is able to augment their production (dampening their demand from other regions of the world – some of which are in current conflicts with the US). This, coupled with slower growth outlooks from emerging markets such as China, and oil prices are experiencing the basic economic effects of less demand and ample supply.

REMEMBING WHAT HAPPENED

October gave us many reminders of lessons long learned. Don't panic on short-term volatility. Think long-term. Stay diversified. But October also gave us tragic reminders that conflicts, often fought far away from Canadian shores, can strike on our soil as well. Lest we forget the lessons history has taught us, the value of the freedoms we enjoy, and the honour of the men and women who've helped us keep them.

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