Market Matters

OCTOBER HIGHLIGHTS

- Good news from the global economy – early fourth quarter data supports "soft landing" in China. South Korea reported a rise in factory output last month, while Germany's retail sales in September rose more than expected. The United Kingdom's economy emerged from recession after a nine-month downturn.
- The S&P/TSX composite index rose in October, led by rising mining stocks as commodity prices gained ground.
- The S&P 500 index posted a down month, unable to sustain its gains following a string of earnings disappointments from big multinationals.
- Canada's bond market weakened modestly as investors found favour with most sectors of the equity markets.

OCTOBER SURGES

Canada's benchmark index surged in the last five trading days of October with commodities among the strongest performers. Critical to some of Canada's energy-related and commodity companies, China's economy, the second-largest in the world, is showing signs of bottoming.

China is finally catching the wave of recovery, although it's a slow-moving current. China's official manufacturing Purchasing Managers' Index (PMI) rose in October to 50.2 from 49.8 in September, the first reading since July that is above 50, the important dividing line between a pickup in activity and a slowdown.

Economic growth fell to a 3 1/2 year low of 7.6 per cent in the third quarter but other indicators, including retail sales and investment, improved. These indicators, including the October PMI, reinforce expectations that China's growth will improve this quarter, ending a seven-quarter slowdown in growth.

China's economic data is further expected to list to the upside as the government maintains its monetary easing policy through the period of leadership transition in November.

Table 1
Summary of major market developments

Market returns*	October	YTD
S&P/TSX Composite	0.9%	3.9%
S&P 500	-2.0%	12.3%
- in Canadian dollars	*-0.4%*	*10.4%*
MSCI EAFE	1.1%	7.2%
- in Canadian dollars	*2.4%*	*6.0%*
MSCI Emerging Markets	-0.4%	8.1%
DEX Universe Bond Index**	-0.2%	3.1%
BBB Corporate Index**	0.1%	6.7%

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

Table 2
Other price levels/change

	Level	October	YTD
U.S. dollar per Canadian dollar	$1.000	-1.6%	1.7%
Oil (West Texas)*	$86.14	-6.4%	-13.0%
Gold*	$1,724	-2.8%	9.5%
Reuters/Jefferies CRB Index*	$295.85	-4.3%	-3.1%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	October	YTD
S&P/TSX Composite	0.9%	3.9%
Energy	0.1%	-2.0%
Materials	0.5%	0.6%
Industrials	2.1%	8.0%
Consumer discretionary	1.3%	14.6%
Consumer staples	2.3%	13.2%
Health care	0.5%	20.7%
Financials	0.8%	8.1%
Information technology	1.8%	-8.1%
Telecommunication services	3.6%	6.9%
Utilities	0.3%	-0.6%

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

Superstorm Sandy, one of the costliest natural disasters in U.S. history, caused a storm surge that devastated the eastern seaboard and shut down U.S. stock and bond markets for two days. When markets reopened on October 31st, investors seemed to have adopted a "wait and see" attitude – looking toward economic data and earnings reports due for release in early November – causing U.S. stock markets to drift downward at month-end.

Investors were rewarded by data that showed U.S. companies added jobs in October at the fastest pace in eight months. Manufacturing expanded for the second straight month, boosted by growth in new orders and production. And Americans' confidence in the economy surged in October to the highest level in nearly five years, as many were encouraged by an improving job market.

The latest U.S. employment numbers might possibly save one more job – the President's. Investors will be paying close attention to November's U.S. election and the approaching U.S. government "fiscal cliff", which could mean significant tax increases and spending cuts as early as January 2013.

CORPORATE EARNINGS CAUSE CLOUDY DISTURBANCE

After meeting or beating analysts' expectations for eleven quarters in a row, third quarter corporate earnings results have caused a cloudy disturbance for equity markets. While analysts were expecting a downtrend, American multinationals McDonald's, DuPont chemical and conglomerates General Electric and 3M Inc., along with other giants like Google and Apple, have disappointed, reminding investors about how fragile economic conditions are, particularly in Europe. On the good news side of the ledger, expectations for next year's earnings are improving.

Corporate earnings results for Canadian companies have been a mixed bag – some solid results along with disappointments.

The global economic slowdown is translating into slower revenues and earnings growth rates, particularly for Canadian resource companies. While consensus expectations for further earnings growth have been revised downwards significantly, they remain positive going into next year.

Manufacturing appears to be picking up in different areas of the world and if factories keep boosting their output, corporate earnings are more likely to bounce back.

BONDS CLOSE WITH A MODERATE SLIP

Canada's bond market weakened moderately in October, with the higher-yielding corporate bonds sector the only sector to post a positive return. Canada 91-day treasury bills finished slightly higher.

Modest income generated from low bond yields has not been sufficient to offset bond price drops due to investors' shift from safe-haven fixed income assets to riskier equity assets. In order for yields to rise significantly, investors need to see more evidence that the economy is improving, or that the Bank of Canada's easing is fueling inflation, but either of those factors would take time to develop.

Even when income generation is low, and the outlook for returns is modest at best, fixed income investments continue to serve investors as excellent volatility and risk management vehicles, when they are included as part of a diversified investment portfolio.

WEATHER THE STORM UNDER AN UMBRELLA OF PORTFOLIO HOLDINGS

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