TD Wealth

Q3 | Quarterly Market Review

Everything you need to know about the quarter that was

October 3, 2023

Wealth Investment Office

QMR - Q3 23 | Highlights

David Dias • Aurav Ghai, CFA • Chadi Richa, MBA, CFA • Christopher Blake, MBA, CFA | TD Wealth

Unless otherwise indicated, performance figures are stated on a total-return basis. This document is for distribution to Canadian clients only. Please refer to Appendix A of this report for important disclosure information.

U.S. Equities

- Risk sentiment ebbed and flowed in the third quarter, as mixed data raised doubts about the direction of the economy and investors swung between “rate-pause optimism” and “higher-for-longer pessimism.”
- The S&P 500 fell by 3.3% in Q3, the Dow fell by 2.1% and the Nasdaq Composite Index fell by 3.9%.
- Nine of the 11 sectors in the S&P 500 produced a negative return. Energy and communication services outperformed, with returns of 12.2% and 3.1% respectively. The utilities sector was again the worst performer, falling 9.2%.
- Large-cap stocks outperformed small-caps; growth stocks outperformed value.

Canadian Equities

- The broad equities index tracked its U.S. counterpart closely in Q3, pushing and pulling on mixed inflation data and interest-rate jitters. Despite a windfall for energy producers, Canadian investors seemed fixated instead on “higher-for-longer” rates and the struggling Chinese economy.
- West Texas Intermediate finished the quarter at US$90.79, up 28.5% from the June quarter close of US$70.64. The large financial sector declined 3.6%. Banks declined 3.4%, as rising rates reignited concerns over the ability of households to service their mortgages.
- The S&P/TSX Composite Index ended the quarter down 2.2%. Nine of 11 S&P/TSX sub-indices posted negative returns.
- Small-cap stocks outperformed large-caps in Q3; value stocks outperformed growth.

Canadian & U.S. Fixed Income

- The FTSE Canada Universe Bond Index posted a return of -3.9%, while the Bloomberg U.S. Aggregate Bond Index posted -3.4%.
- The Canadian government bond index fell 4.4% in Q3; the U.S. government bond index fell 3.2%.
- Canadian and U.S. investment-grade corporate bond indices registered returns of -2.2% and -3.2%, respectively.
- U.S. investment-grade corporate spreads tightened by 2 bps over the quarter, while high-yield spreads widened by 4 bps.

International Equities

- International developed markets traded in a tight range in the third quarter, with commodity-heavy indices getting a lift from surging oil prices.
- Emerging markets were downbeat for the quarter, with Indian and Brazilian markets outperforming.
- Mexican shares fell on currency devaluation after the central bank’s decision to wind down a currency-hedging program.
- China’s SSE Composite Index continued on its downward trajectory this year, falling 2.9% in Q3 due to a raft of mounting concerns.

Market Movers
Equities in Review

Early July

Q3 gets off to a good start as June data comes in cool. Lower inflation and a weakening job market raises hopes that the Fed will soon end its program of rate hikes. Tech and other rate-sensitive growth stocks lead gains. Chipmakers get a boost from exposure to AI.

August 8

China reports bleak trade data for July, dragging down commodity-linked stocks. Hopes that the government will step in with fresh stimulus, however, lifts markets.

August 25

At the Global Economic Symposium, the Fed Chair says another rate hike is still a possibility, while signalling a much longer period of credit restriction. The ECB's Christine Lagarde, however, suggests that the euro zone may soon move to the sidelines.

August 28

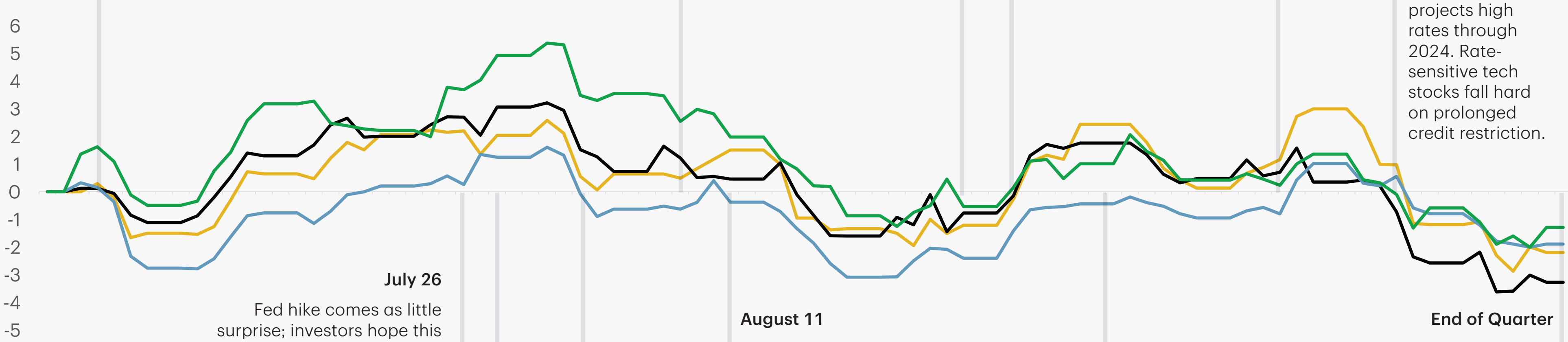
China enacts stimulus measures. The government cuts stock trading duties, loosens margin loan rules and puts the brakes on new listings. The central bank, meanwhile, cuts the amount of foreign exchange that institutions must hold. Commodity-linked stocks get a lift, but strain on the Chinese property market intensifies.

September 13

European Commission President Ursula von der Leyen accuses China of dumping subsidized electric vehicles into the European market, announcing a formal probe. China warns that the probe will hurt ties.

Septermber 20

The Fed leaves rates unchanged, but hawkish commentary projects high rates through 2024. Rate-sensitive tech stocks fall hard on prolonged credit restriction.



July 26

Fed hike comes as little surprise; investors hope this may be the last. Investors coalesce around the increasing likelihood of a soft landing.

July 28

Bank of Japan shocks markets with a tweak to its "yield curve control" policy. Ten-year yields will now be allowed to rise to 1% before the BoJ intervenes.

August 2

Markets plummet after Fitch downgrades U.S. government debt from AAA to AA+, alluding to Congressional brinksmanship that nearly led to a catastrophic debt default in Q2.

August 11

U.S. inflation data for July comes in hotter than expected (3.2%) after a mild June reading (3%). The market's hopes for rate cuts this year come into doubt. In Canada, meanwhile, CPI data on August 15 show headline and core inflation both rising.

Early Septermber

Risk sentiment dampens as investors brace for a showdown on government funding between the U.S. House of Representatives and the White House. The right flank of the Republican party threatens a government shutdown unless spending is cut dramatically.

End of Quarter

Markets end the quarter on a pessimistic note, as the U.S. government barrels toward a shutdown due to Congressional brinksmanship. (It was narrowly averted after market close on September 30.) In China, meanwhile, it remains to be seen whether government measures will be enough to counter a slew of growing concerns including weak economic data; increasing tensions with the U.S. and Europe; and a crisis in its property-development sector.

S&P 500
MSCI EAFE
S&P/TSX Composite
MSCI Emerging Markets

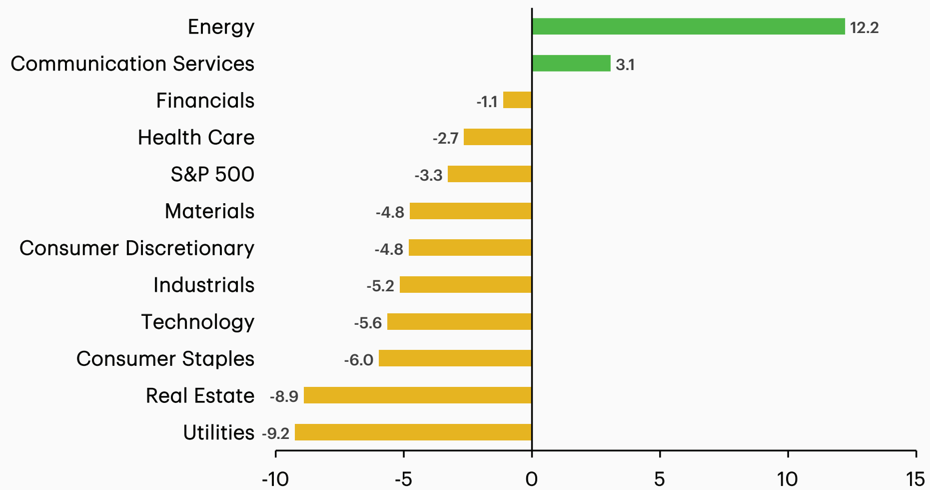
Source: TD Wealth, Reuters, FactSet as of September 30, 2023. **Note:** Indices are tracked in local currencies.

U.S. Equities

Indices	Q3 Return (%)	Q3 Return (%, C$)	Annual Return (%)	Annual Return (%, C$)
Dow Jones Industrial Average	-2.10	0.24	2.73	2.85
S&P 500	-3.27	-0.96	13.07	13.19
S&P 400	-4.20	-1.91	4.27	4.39
Nasdaq Composite	-3.94	-1.64	27.11	27.25
Russell 2000	-5.13	-2.86	2.54	2.66

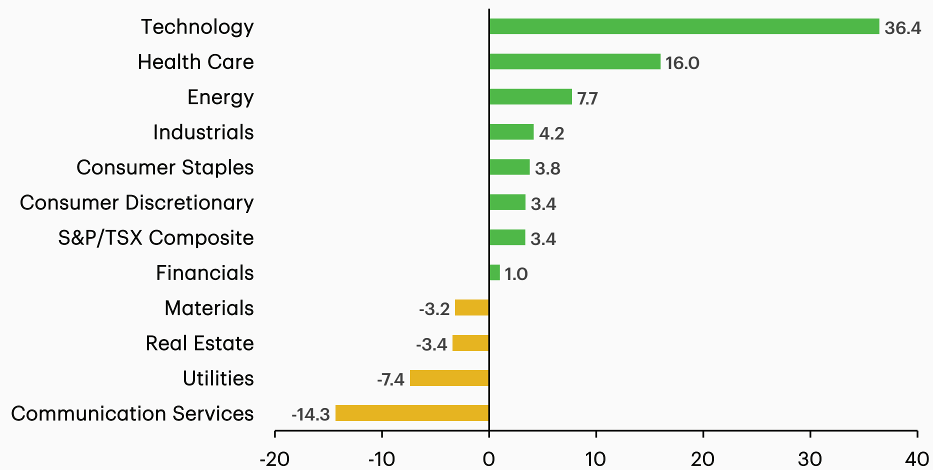
Source: FactSet as of September 30, 2023. Total returns including dividends and distributions. Index returns calculated in U.S. and Canadian dollars.

Q3/23 S&P 500 Sector Returns



Source: FactSet as of September 30, 2023

Annual S&P 500 Sector Returns



Source: FactSet as of September 30, 2023

Risk sentiment ebbed and flowed in the third quarter, as mixed data raised doubts about the direction of the economy. For instance, oil prices — usually a good indicator of global demand — continued to rise, but this was almost certainly a result of supply management by OPEC and its allies, given that the Chinese economy continues to struggle. While U.S. core inflation has gradually cooled, overall inflation has stayed above target due to rising energy prices, leading the Fed to suggest that rates could remain elevated right through 2024.

Uncertainty prevailed for much of the quarter, with investors swinging between “rate-pause optimism” and “higher-for-longer pessimism.” If there was a turning point, however, it came in early August when Fitch downgraded U.S. debt from AAA to AA+, citing political difficulties — those “difficulties” alluding to the Congressional brinksmanship that in Q2 nearly led to a debt default. Markets plunged on the news before paring back losses later in the month. The quarter then ended on a pessimistic note, as dysfunctional politics once again threatened a government shutdown.

For the three months ended September 30, 2023, the S&P 500 fell by 3.3%, the Dow Jones Industrial Average fell by 2.1% and the Nasdaq Composite Index fell by 3.9%. Nine of the 11 sectors in the S&P 500 produced a negative return. Energy and communication services outperformed, with returns of 12.2% and 3.1% respectively. The utilities sector was again the worst performer, falling 9.2%. Large-cap growth stocks outperformed in Q3. Large-cap stocks (S&P 500) returned -3.3%, outperforming small-cap stocks (Russell 2000), which returned -5.1% in the third quarter. Growth stocks (S&P 500 Growth Index) registered a total return of -2.6%, outperforming value stocks (S&P 500 Value Index), which returned -4.1%.

Despite market struggles, the economy continues to chug along at a solid pace. In late August, the Bureau of Economic Analysis released its second estimate for Q2, reporting real GDP growth of 2.1% (q/q annualized, 2.0% in Q1) — well above the 1.4% forecast by TD Economics (TDE). However, there's some indication that the impact of higher rates is beginning to filter down to the consumer level. Spending decelerated significantly in Q2, to just 1.7% (4.2% in Q1). Higher rates are also taking a toll on the housing market, with residential investment contracting 3.6% (-5.4% in Q1). In stark contrast, the business sector exceeded expectations for the quarter, with non-residential investment advancing 6.6% (1.4% in Q1), its strongest showing since the start of 2022.

Moving into Q3, manager surveys suggested that the elusive "soft landing" scenario — wherein the U.S. economy avoids a cyclical recession — has become a real possibility. While the Institute of Supply Management's purchasing managers index (PMI) for manufacturers remains in contractionary territory, it rose in July and again in August to 47.6, up from 46.9 in May. The much larger services side of the economy, meanwhile, has avoided contraction altogether. After teetering on the edge in May, with a reading of 50.3, the ISM Services PMI bounced back to 54.5 in August. TDE expects the economy to accelerate briefly in Q3, with real GDP forecasted to rise 3.7%. The bank has also lifted its projection for the year, from 1.5% to 2.3%.

The labour market, meanwhile, seems to have finally come off the boil in recent months. The economy generated 105,000 jobs in June, 157,000 jobs in July and 187,000 jobs in August. That represents a three-month average of around 150,000 jobs, which is less half the figure reported in January. Job openings have fallen to a 28-month low, and the unemployment rate — while still near historical lows, at 3.8% — has ticked up to its highest level since February 2022. This is all welcome news for Fed officials, who've been trying to cool the labour market for the past year. But with real wages still rising 4.3% year-over-year (as of August) and gasoline becoming more expensive by the day, the Fed is likely to remain guarded in its optimism.

Indeed, while the survey of Fed board members in September left its policy-rate projection for 2023 unchanged — with one more hike estimated by year's end — the committee signalled a much longer period of restrictive lending, raising its policy-rate projection for the end of 2024 by 50 bps, to 5.25%. While the long-term hawkish projection has unsettled the markets, it may ultimately be intended to lock in tighter financial conditions by "talking yields up." TDE, for its part, thinks the Fed will have to step in sooner than that to shore up weakness in the economy, with rate cuts beginning in the second quarter of 2024. It projects a much lower policy rate of 4.25% by the end of 2024.

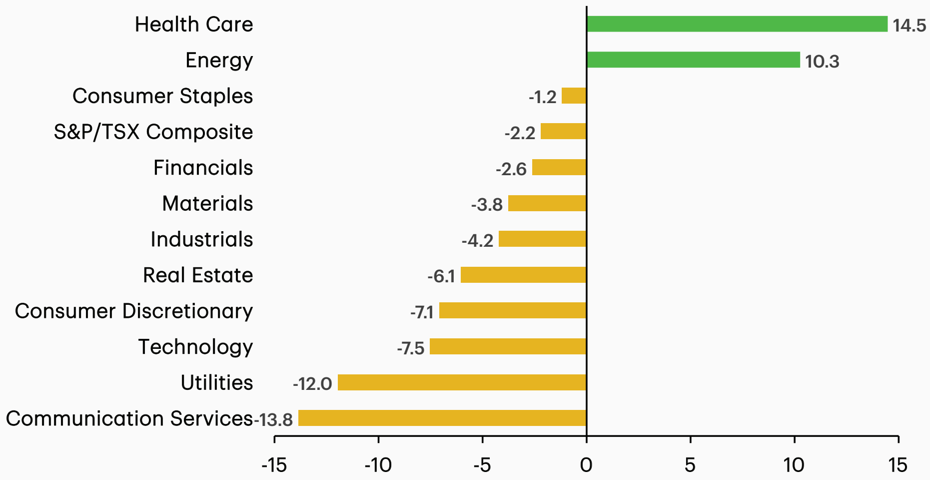
Ultimately, a lot will be riding on the trajectory of inflation over the coming months. While headline CPI has remained stubbornly above target, ticking upward in recent months (3% in June, 3.2% in July, 3.7% in August), core inflation, which excludes food and energy prices, has continued to fall, from 5.4% in May to 4.4% in August. With core inflation moving in the right direction and the labour market slowly coming back into balance, the Fed can afford to "monitor the data." However, it's still too soon to know whether the recent easing in inflationary pressure will be fleeting or longer-lasting. This should keep the possibility of another rate hike in play, in the event that progress on inflation or the labour market stalls in the months ahead.

Canadian Equities

Indices	Q3 Return (%)	Annual Return (%)
S&P/TSX Composite	-2.20	3.38
S&P/TSX 60	-2.55	3.03
S&P/TSX Completion	-0.70	4.85
S&P/TSX SmallCap	-0.79	-1.11
S&P/TSX Preferred Share	-1.43	-1.28

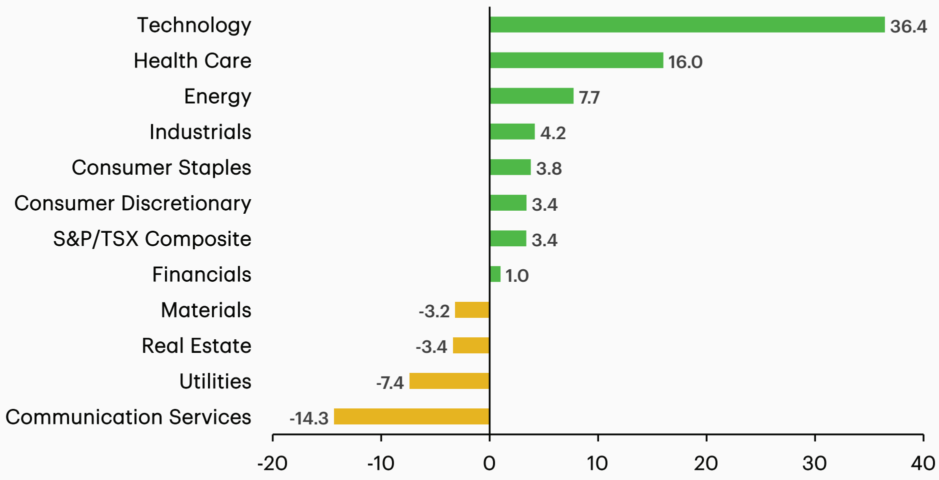
Source: FactSet as of September 30, 2023. Total returns including dividends and distributions.

Q3/23 S&P/TSX Sector Returns



Source: FactSet as of September 30, 2023. Index total returns.

Annual S&P/TSX Sector Returns



Source: FactSet as of September 30, 2023. Index total returns.

The broad equities index tracked its U.S. counterpart closely in the third quarter, pushing and pulling on mixed inflation data and interest-rate jitters. Indeed, despite a veritable windfall for energy producers — with CAD-denominated oil prices up 31% for the quarter — Canadian equity investors seemed fixated instead on "higher-for-longer" interest rates and the struggling Chinese economy. An uptick in July inflation, after a solid June report, also created some consternation in the markets, with wage growth proving stickier than expected.

Overall, however, political dysfunction south of the border seemed to be the dominant narrative this quarter. In early August, global markets plunged in the wake of Fitch's downgrade of U.S. debt. The ratings agency cited "political difficulties" in the U.S., alluding to the brinksmanship that nearly led to a debt default in Q2. Then, after the markets rallied to pare back losses in August, political gridlock in September once again threatened the economy, with fringe politicians threatening another government shutdown as the quarter came to a close.

The S&P/TSX Composite Index ended Q3 down 2.2%, with nine of 11 sub-indices posting negative returns. Small-cap value stocks outperformed in the third quarter. Small-cap stocks (S&P/TSX Canadian Small Cap Index) fell by 0.8%, outperforming large-caps (S&P/TSX 60 Index), which fell by 2.5%. Growth stocks (MSCI Canada Growth Index) fell by 2.7%, underperforming value stocks (MSCI Canada Value Index), which ended the quarter down 0.7%.

West Texas Intermediate finished the quarter at US$90.79, climbing 28.5% from the June 30 close of US$70.64. The market for oil tightened during the quarter as energy producers continue to hold back on investing in capacity, while OPEC and its allies have cut production. Oil hit an intraday high of US$95.03 on September 28 and an intraday low of US$69.69 on July 3, book-ending the quarter with low and high. Gold ended the quarter at US$1,866.10, down 3.3% from the June 30 close. The drop in gold was a reflection of the market's perception that interest rates in the United States will stay higher for longer, as the Fed projects.

Financials declined 3.6%, reflecting weakness in all sub-sectors except insurance, which was relatively flat. Banks declined 3.4%, as rising rates reignited concerns over the ability of households to service their mortgages. EPS for the six largest banks declined 5.2% y/y in the quarter. On average, the banks missed consensus estimates by 4%, with only Royal Bank of Canada beating, on a lower-than-expected tax rate.

The Canadian economy seems to have entered a prolonged period of sluggishness. In early September, Statistics Canada reported that real GDP in Q2 had contracted a marginal 0.2% (q/q annualized, +2.6% in Q1) — well under the tepid 1.1% growth forecasted by TD Economics (TDE). The contraction came amid a steep drop-off in consumption growth and a host of extreme events. While consumer spending was essentially flat, rising 0.2% (4.8% in Q1), striking workers and a horrific fire season acted as a drag on activity, bringing the economy to a standstill.

The labour market is still churning out jobs, although monthly data is keeping the markets guessing. In June, the economy generated an impressive 60,000 jobs. Then, in July, with wildfires raging, the economy shed 6,400 jobs. Then, finally, the August numbers bounced back, with job generation rising to 39,900, for a total three-month gain of 93,500 — about the same as the previous period. While the unemployment rate has continued to tick up, from 5.2% in May to 5.5% in August, year-over-year wage growth has remained stubbornly high, falling a mere 20 bps over three months, from 5.1% to 4.9%.

This reflects a labour market that still has a healthy appetite to hire, even if it's facing increasing headwinds. Elevated immigration levels, for instance, are creating a population boom — with an astonishing 232,000 new residents in the first half of the year, up 20% — and that is helping to bring the market back into balance. Job vacancies are still roughly 250,000 positions higher than before the pandemic, but the number of unemployed workers has grown by 137,600 over 2023, as the immigration boom causes labour-force growth to outpace hiring.

Fewer job opportunities will in time pull wage growth down, but there's good evidence that Canadians are already starting to feel the pinch. For instance, the recent rise in debt-servicing costs, at a time of still rampant inflation, has resulted in credit deterioration. According to Equifax Canada's Q2 2023 consumer credit report, delinquency rates have either reached, or are near, pre-pandemic levels for most consumer credit products. Rising investments (+1.3%) and home prices (+2.0%) actually led to a 1.6% bump in household wealth in the second quarter (q/q), but this figure will undoubtedly come under pressure given that investments and residential markets have since weakened.

For now, rising income levels continue to outpace rising debt levels, leading to a decline in the debt-to-income ratio (at 180.5%). Similarly, the debt-service ratio (debt payments relative to disposable income) declined to 14.8% in Q2 from 14.9% in Q1. However, these improvements mask the pain felt by some Canadian households. The Bank of Canada will need to maintain a close watch on household credit performance as higher interest rates continue to weigh on households this year.

The Bank will have to balance, on the one hand, the shrinking Canadian economy (-0.2%) and the precarious situation of recent homebuyers against, on the other, wage growth and inflation figures that remain stubbornly high. CPI inflation, after falling within the target range in June (2.8%), has been rising steadily alongside the price of oil, to 3.3% in July and 4% in August. Surprisingly, core inflation (CPI-Median), which excludes energy and food prices, has also risen slightly. From May to August, core inflation rose from 3.9% to 4.1%. That's still well below the policy rate (5.00%), but much higher than the target range of 1% to 3%.

TD Economics expects the Bank of Canada to hold the policy rate at current levels for the remainder of the year, given weak economic performance as of late. If the labour market or inflation continue to heat up, we may see some turbulence, but on balance, a rising savings rate (+1.4% in Q2) shows that, while wages are growing at a healthy clip, consumers are no longer spending those wage gains as freely. As a result, with consumers beginning to tighten their belts, the BoC's rationale for another rate hike has weakened.

Preferred Shares

The S&P/TSX Preferred Share Index weakened in Q3/23, ending the quarter 1.4% lower on a total-return basis. The weakness was caused by a spike in interest rates, driven by a higher-than-expected July CPI inflation print in Canada. While it's counterintuitive that preferred shares underperform when interest rates rise, as a reminder, only around 20% of the fixed rate-reset universe resets in any given year, and lower prices were required to make preferred shares more competitive with other income-generating instruments. If interest rates remain near current levels for a long period of time, pushing dividends higher for the majority of the universe, the resulting significant increase in yield should make preferred shares more attractive. On a year-to-date basis, preferred shares are down 5.9%. The five-year government of Canada yield closed at 4.25%, 57 bps higher q/q.

Toronto-Dominion Bank (TD) surprised the market by redeeming TD.PF.K, a $400-million issue with a reset spread of 259 bps. As of Q3/23, TD had a common equity tier 1 (CET1) ratio of 15.2%, the highest among the six largest Canadian banks and significantly above the 11.5% requirement that will be effective in November 2023. With a CET1 ratio of 13.5%, National Bank of Canada also has a significant amount of excess capital, while the remaining four banks are very close to their regulatory requirements. While Royal Bank of Canada has a CET1 ratio of 14.1%, the acquisition of HSBC Canada will bring it closer to 12.0%, as guided by management.

Flows into the five largest exchange-traded funds turned positive for the first time since the fourth quarter of 2021. We attribute this reversal to attractive yields in the preferred-share market, lower volatility in risk assets and perhaps lower uncertainty over the macroeconomic outlook, compared to the first half of the year. Fixed-floaters and perpetuals were the worst performers, declining 7% and 4% during the quarter (price return). Fixed rate-resets and floating rate-resets declined 2%.

The average yield on investment-grade fixed rate-resets was 6.3%, with all issues except TD.PF.K closing below par. The yield on investment-grade perpetuals was 6.9%, which is equivalent to a bond yield of 8.9% after accounting for the tax advantage of Canadian dividends.

Canadian & U.S. Fixed Income

Government Bond Yield	Canada			United States		
	Current (%)	Q/Q Change (pp)	Annual Change (pp)	Current (%)	Q/Q Change (pp)	YTD Change (pp)
91-Day Treasury Bill	5.11	0.21	0.87	5.45	0.16	1.10
2-Year Government Bonds	4.87	0.29	0.82	5.04	0.15	0.62
5-Year Government Bonds	4.25	0.56	0.84	4.61	0.45	0.61
10-Year Government Bonds	4.02	0.76	0.72	4.57	0.73	0.70
30-Year Government Bonds	3.81	0.72	0.53	4.70	0.84	0.74

Source: FactSet as of September 30, 2023. Index returns are reported on a total-return basis; pp (percentage point).

Global fixed income markets suffered a sharp decline in the third quarter. The upward repricing of government yields was the usual culprit, with a sharp rise in medium- to longer-maturity yields across developed markets. Stronger-than-expected macroeconomic data, slowing progress on efforts to curb inflation and a still robust labour market led central banks to maintain their hawkish stance, and subsequently, led the market to price in higher-for-longer policy rates through higher government yields.

Due to these higher government yields, both Canadian and U.S. markets lagged in Q3. The Canadian fixed income universe, which despite having higher rate sensitivity, saw a relatively modest rise in government yields in the longest-maturity bucket, underperformed the U.S. universe. The FTSE Canada Universe Bond Index posted a return of -3.9%, while the Bloomberg U.S. Aggregate Bond Index (CAD-hedged) posted -3.4%.

In the U.S., the Federal Reserve raised its policy rate by 25 bps in July to 5.5% and decided to keep it unchanged in September. As broadly expected, the main takeaway from September's meeting was that rates were expected to remain "higher for longer," given that the job of bringing inflation back to target was far from over. September's economic projections suggested that the Fed will keep policy at a historically restrictive stance through the end of 2024, if the committee's forecasts are correct. The projections for the policy rate in 2024 were shifted notably higher, with next year's median projection of only two rate cuts to 5.125%, compared to four cuts projected in June, while the 2023 median projection was kept at 5.625%.

Fixed Income Indices	Q3 Return (%)	YTD Return (%)
FTSE Canada Universe Bond Index	-3.9	-1.5
FTSE Canada Universe All Government Bond Index	-4.4	-2.2
FTSE Canada All Corporate Bond Index	-2.2	0.7
FTSE Canada Real Return Bond Index	-7.4	-7.7
FTSE Canada Provincial Bond Index	-5.9	-2.8

Source: FactSet as of September 30, 2023. Total index returns.

The Bank of Canada also tightened, with another 25-bp rate hike in July, lifting the overnight rate to 5.0% while keeping the policy rate on hold in September. The policy statement was slightly more hawkish than expected, with the Bank citing the risk of higher inflation in Q3 due to higher oil prices, but it also acknowledged that the economy has entered a period of weaker growth. The Bank's guidance noted that it is ready to hike further if needed, as it continues to assess whether incoming data is consistent with a return to the inflation target.

The broad global fixed income universe, represented by the Bloomberg Global Aggregate Index (CAD-hedged), posted a -2.0% return over the third quarter. Canadian government bonds underperformed both U.S. Treasuries and the global universe, with the Canadian government bond index returning -4.4%, while the U.S. Treasury Index (CAD-hedged) returned -3.2% and the global government bond index returned -2.0%. The U.S. 10-year Treasury yield started the quarter at 3.84% and ended at 4.57%

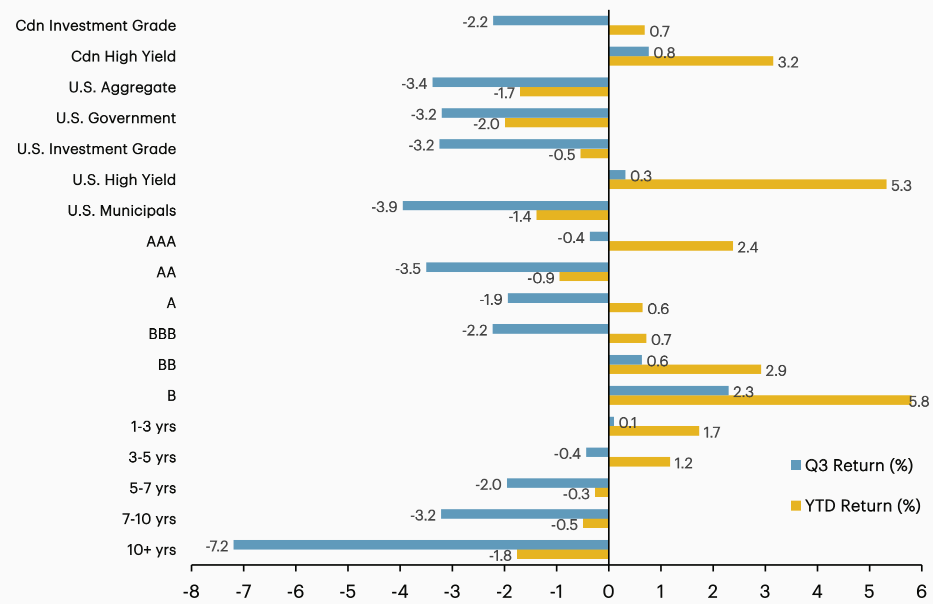
(a 73-bp increase), while the equivalent Canadian government bond yield started at 3.27% and ended at 4.02% (also 75 bps).

Surprisingly resilient economic data in the U.S. was supportive of spreads. On the Canadian side, the investment-grade (IG) spread remained stable, widening by 1 bp and ending at an option-adjusted spread of 150 bps, while U.S. IG spreads tightened by 2 bps to end at 121 bps. Negative performance from Canadian government bonds was the major performance detractor, and higher overall yields were unable to offset the losses. The corporate sector posted a return of -2.2%, outperforming the aggregate Canadian fixed income index return of -3.9%. Diving deeper, higher-quality credit outperformed the other cohorts, with AAA-rated credit posting returns of -0.4%. Lower-rated credit underperformed, with AA-rated and A-rated credit posting -3.5% and -1.9%, and BBB-rated credit at -2.2%.

Understandably short-maturity corporate bonds with less interest-rate sensitivity outperformed both medium- and long-maturity bonds. Over the quarter, the shorter-maturity cohorts of one- to three-year bonds and three- to five-year returned 1.0% and -0.4%. The medium-maturity cohort of five- to seven-year and seven- to 10-year returned –2.0% and -3.2%. The longest-maturity cohort of 10-year-plus posted returns of -7.2%. Lower inflation expectations added to the overall detraction from wider real yields, leading to significant negative performance for Canadian real return bonds. They underperformed the government bond universe, at -7.4%. Canadian provincial bonds, with relatively longer maturity profiles, also detracted and underperformed corporate bonds over the third quarter, posting a return of -5.9%.

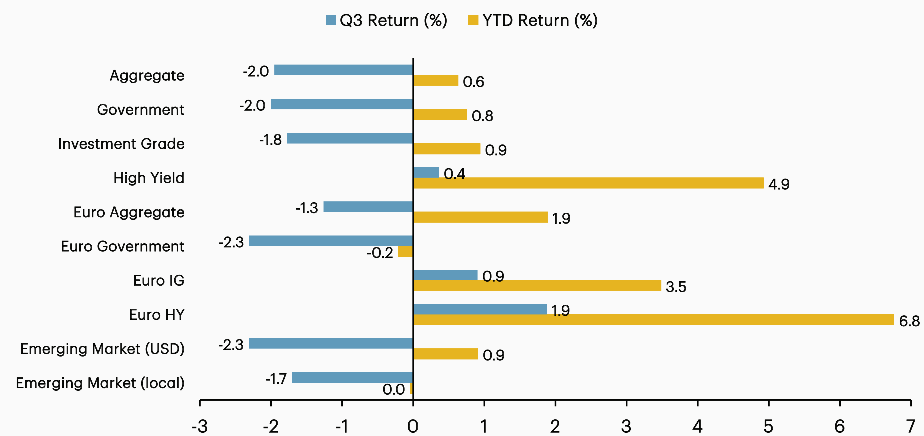
For global corporate bonds, higher government yields across geographies led to performance detraction. U.S. IG corporate spreads tightened by 2 bps over the quarter, while U.S. high-yield (HY) corporate spreads widened by 4 bps. The U.S. IG corporate bond universe (CAD-hedged) returned -3.2%, underperforming the global IG corporate universe (CAD-hedged), which returned -1.8%. U.S. HY corporate bonds (CAD-hedged) remained resilient, posting a 0.3% return, but marginally underperformed the global HY corporate universe (CAD-hedged) at 0.4%. USD-denominated emerging-market debt also detracted, posting performance of -2.3% over the quarter, while local currency debt returned -1.7%.

Canadian & U.S. Fixed Income



Source: FactSet as of September 30, 2023.

Global Fixed Income



Source: FactSet as of September 30, 2023.

International Equities

Indices	Q3 Return (%)	Q3 Return (%, C$)	Annual Return (%)	Annual Return (%, C$)
FTSE 100	2.19	0.44	5.50	6.56
DAX	-4.71	-5.48	10.51	9.26
CAC 40	-3.40	-4.17	13.42	12.13
MSCI European Monetary Union (local currency)	-4.61	-4.94	7.86	10.21
Nikkei 225 Stock Average	-3.27	-4.32	24.45	9.24
MSCI Emerging Markets Free (local currency)	-1.29	-0.47	4.40	2.27

Source: FactSet as of September 30, 2023. Total returns including dividends and distributions. Index returns calculated in local currencies and Canadian dollars.

International developed markets traded in a tight range in the third quarter, with commodity-heavy indices getting a lift from surging oil prices. The United Kingdom's blue-chip FTSE 100, with exposure to energy giants like BP and Shell, led the pack this quarter, rising 2.2%. In early August, the index fell alongside global peers due to Fitch's downgrade of U.S. debt, although weak Chinese data and earnings misses from the likes of Glencore and the London Stock Exchange were as much to blame. Midway through the quarter, however, the FTSE began to find its footing, with the softening pound (-3.2% vs USD in Q3), which helped exporters, and a signal from the ECB that the central bank may have issued its final rate hike of the cycle.

The Bank of England, on the other hand, still has work to do. GDP growth of 0.8% in Q2 (q/q annualized, 0.4% in Q1), while modest, represented the UK's fastest growth since Q1 2021. Improved consumer sentiment, lower price pressures, good weather in June and the solid labour market all supported spending. The UK consumer confidence index remains weak, hovering around -25 (as of August). Business confidence, meanwhile, has fallen into contractionary territory in recent months, landing at 48.6 in August from 52.8 in June. Inflation, finally, is starting to come down, from 8.7% in May to 6.7% in August, but remains among the highest in the developed world. Against this backdrop, the Bank of England hiked rates for the 14th consecutive time in August, by 25 bps. It then paused in September, leaving the policy rate at 5.25%.

Euro zone markets, similar to their UK and American peers, traded in a tight range in Q3, with the MSCI European Monetary Union Index falling 4.6% (in euro terms) in the third quarter. Risk sentiment was reined in by worries over the Chinese economy — a top market for European luxury goods — and general rate-hike jitters as developed markets around the world enter a "higher-for-longer" period of credit restriction. Early in the quarter, cooling labour and inflation data provided some hope. But a surprise U.S. credit downgrade by Fitch in August and a series of underwhelming economc reports from China seem to have dampened the market's appetite for risk. The ECB's so-called "dovish hike" in September, which signalled an end to rate hikes for the time being, as well as a protectionist probe into Chinese EV subsidies, weren't enough to lift the dour mood.

Part of the reasoning for the ECB's early signal may have to do with the weak economic figures coming out of Europe. After dipping into a technical recession, with contractions in Q4 and Q1, real GDP managed to climb back into positive territory in the third quarter, rising 1.2% (-0.4% in Q1). The quarterly expansion came on the back of declining — albeit still high — inflation, easing supply-chain pressures and lower energy prices. Consumer and business confidence have both been declining steadily for at least six months. The economic sentiment index fell to 93.6 in August from 96.4 in May, and the euro zone composite PMI fell to 47.0 in August from 53.3 in May. Inflation varies across the economic bloc, with bright spots in places like Spain (2.6%) and troubled regions like Hungary (16.4%).

Overall, however, inflation has been coming down gradually, from 6.1% in May to 5.2% in August. The ECB has been hiking rates consistently and incrementally. In the third quarter, it raised its key rates by 25 bps apiece in July and September but signalled that it is now moving to the sidelines. Its main refinancing rate stands at 4.5%.

In Japan, the Nikkei 225 Stock Average, after an astounding 18.5% leap in Q2, came back down to earth with a 3.3% loss in Q3. The rate-sensitive index was highly volatile given uncertainty over how high, and for how long, the Fed would maintain its restrictive policy. The Nikkei's performance would actually have been worse if not for steadfast dovishness from the Bank of Japan, a declining yen (-2.9% in Q3) and continued, albeit choppy, momentum for chipmakers in the AI realm. Tourism-related stocks were hit, however, after China in late August banned all Japanese seafood following the controversial release of filtered wastewater from the site of the Fukushima nuclear disaster.

The Japanese economy is gaining a head of steam as the export-dependent region enjoys the effects of operating under a severely weakened yen (down 12% year-to-date). Real GDP soared 6.0% in Q2 (3.7% in Q1), its strongest performance since Q4 2020. Tourists helped drive growth in the quarter, with exports of goods and services rebounding 13.6%. Inflation in Japan has remained relatively low and steady (3.1% in August, 3.2% in May), although consumer confidence has fallen slightly to 35.2 from 36 in May. Business confidence, meanwhile, has been hovering at neutral for years, with the composite PMI ticking upward to 52.6 in August from 52.3 in May. The Bank of Japan pivoted hawkish in late July, raising the upper threshold of long-term bond yields to 1% from 0.5% (Japan controls long-term yields via market intervention). A momentary spike in the yen, however, was pared back as the BoJ reaffirmed its ultra-dovish stance.

Emerging markets were also downbeat for the quarter. Among the four largest emerging-market economies, only India managed to post a positive return, although there were no standout performances. Overall, the MSCI Emerging Markets Index, in local currency terms, fell 1.3% in Q3, led by a 4.9% decline in the Mexican IPC Index. The peso fell hard in early September due to economic weakness and the Mexican central bank's decision to wind down a currency-hedging program. China's SSE Composite Index, meanwhile, continued its downward trajectory this year, falling 2.9% due to a raft of mounting concerns. These included: weak Chinese trade and manufacturing data; insufficient monetary stimulus; increasing tensions with the U.S. and Europe, which recently launched a probe into China's EV export industry; and a growing crisis in its property-development sector.

Brazil's Bovespa Index fell 1.3% but still managed to outperform most Latin American markets as investors held out hope for new fiscal rules that aimed to boost government revenue by taxing offshore developments and the wealthiest individuals while maintaining social programs and eliminating the deficit. The new framework has drawn support from the IMF and investor groups. India's Nifty 50 Index, finally, posted the only positive return among top emerging markets, rising 2.3% in Q3. Investors in the large IT sector, whose clients are mainly based in the U.S., have grown optimistic about the prospect of a soft landing in America, although domestic inflation remains troublingly high at 6.8%. TD Economics forecasts 2023 growth of 2.9%, 5.0%, 3.3% and 6.7% (fiscal year), respectively, for these nations.

Wealth Investment Office, TD Wealth

Head of Wealth Investment Office
Brad Simpson | Chief Wealth Strategist

North American Equities:
Chris Blake | Senior Portfolio Manager
David Beasley | Senior Portfolio Manager, Global Equities
Chadi Richa | Manager, North American Equities
Kevin Yulianto | Quant Equity Portfolio Manager, Global Equities
Neelarjo Rakshit | Senior Equity Analyst
Andrej Krneta | Senior Equity Analyst

Managed Investments:
Christopher Lo | Senior Portfolio Manager, Head of Managed Investments
Fred Wang I Senior Portfolio Manager, Asset Allocation
Aurav Ghai | Senior Fixed Income Analyst
Kenneth Sue | Senior Alternative Investments Analyst
Mansi Desai | Senior Equity Analyst
Nadeem Kassam | Senior Equity Analyst

Investment Consulting:
Brian Galley | Head of Investment Consulting
Shanu Kapoor | Senior Portfolio Consultant
Richard Nguyen | Senior Portfolio Consultant
Shaun Arnold | Senior Portfolio Consultant
Greg McQueen | Senior Portfolio Consultant
Duncan Morton | Senior Portfolio Consultant
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Shaiara Hossain | Senior Portfolio Consultant
Joseph Abinaked | Senior Portfolio Consultant
Jack Zhang | Analyst
Dan Iosipchuck | Analyst
Leroy Li | Analyst