TD Wealth

Investor Newsletter

Fall 2021

After a strong summer that added to 2021's first half gains, traditional seasonality kicked in with a weak September. At every occurrence previous to September, corrections to the S&P/TSX Composite and S&P 500 were met with buying support around the 50-day moving average before a rally that set a new historical high. That changed shortly after Labour Day and continued into early October. Heightened inflation expectations and the accompanying increase in interest rates appear to be the general catalyst, though flagging movement within the U.S. government towards an infrastructure bill is likely contributing negatively to investor sentiment. That said, the year-to-date performance for North American equities remains ahead of historical averages: S&P/TSX Composite Index 17.48%, S&P 500 16.00%, U.K. London FTSE 11.89%, German DAX 5.47%, MSCI Japan 6.29%, China Shanghai Comp 3.74%, MSCI EAFE 8.86%, MSCI Emerging Markets -0.93%, and MSCI World Index ex-USA 6.36% (Q1 2021 returns adjusted to Canadian dollar).[1] Weakening commodity prices over the summer resulted in the Loonie giving back its first half gains relative to the U.S. dollar, meaning currency has had a limited impact on these YTD returns. While the September declines had a negative impact on market breadth, most sectors remain in positive territory, with 8 of 12 Canadian and seven of 12 U.S. sectors maintaining double digit returns. Leading the way on both sides of the border has been energy, though off a very low base after years of weak performance. The only sectors reaching the three-quarter mark for 2021 with negative returns were materials and health care, on both sides of the border.

Following the September U.S. Federal Reserve's Federal Open Market Committee (FOMC) meeting, Chairman Powell confirmed expectations that they would be looking to taper their quantitative easing (QE) program later this year with plans to wind it down by mid-2022. With just the two meetings remaining on the calendar, we expect them to choose the closer November meeting to start reducing QE. While this is a step towards rate hikes, rate "liftoff" doesn't appear likely for some time yet. The survey of Fed officials showed that though a few expect hikes to start in late 2022, the group is broadly looking towards 2023. With our expectation that the FOMC board composition will likely become more accommodative/dovish in the coming year, as several seats will require new governors to be nominated by President Biden, we expect that they will prefer to hold off to the longer end of that range.

Recent commentary from the Bank of Canada (BoC) has been limited to a steady as it goes approach. The BoC continues to slowly reduce their QE program and reiterates their economic view that the slower than expected second quarter isn't indicative of a change in trend. While it remains yet a long way off, we see their choice to move before the FOMC on tapering as indicative that they'll likely do so again when it comes to rate hikes. Along those lines, TD Securities recently pulled forward their expectation of a first hike occurring in the summer of 2022.

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The aforementioned announcement by Powell that the FOMC would be looking to start tapering later this year led to a late quarter move in interest rates after a quiet summer. The impact was more meaningful on the front end of the yield curve as the 2-year Canadian and U.S. Treasury bond yield moved to their highest level since March 2020; 0.76% and 0.39% respectively.[2] A more muted move of the 10-year Treasury bonds saw them regaining the 0.25% they lost over the summer. This rebound in rates, though relatively modest in absolute terms, looks to be setting the FTSE Canada Universe Bond Index up for its first negative return year since 2013. This move serves as a reminder that duration, a measurement of a bond or group of bonds' price sensitivity to changes in interest rates, is a double-edged sword. Much of the tailwind experienced in 2020 when rates moved lower has been given back.

The acknowledgement of tapering plans had a meaningful impact on the currency market as well, with the U.S. dollar index gaining just over 2% in the weeks since the FOMC's late September meeting. Those relative gains were experienced outside of North America as strong energy prices and employment gains have pushed the Loonie back towards CAD/USD level of $1.231 that it was trading at in early July.[3] From here we expect the Canadian dollar to keep pace with the U.S. dollar, with gains relative to the rest of the U.S. Dollar Index's constituents (Euro, Japanese yen, Pound sterling, Swedish krona, and Swiss franc) as details around U.S. tapering are laid out.

While concerns about the Delta variant, inflation, and the supply chain haven't abated, early Q3 financial results have provided support to North American equities. We expect the results announced in the next few weeks to provide the market's direction as we head towards the end of 2021. Though we expect results to again be strong, the year-over-year earnings growth rate becomes more difficult to maintain due to late 2020's second half earnings recovery. We believe this will lead to slower, but still positive, gains over the balance of the year with additional internal volatility.

Sources:
1. Bloomberg Finance L.P. as at September 30, 2021. Total Index returns. Index returns calculated in C$.
2. Refinitiv 2021. October 20, 2021
3. Refinitiv 2021. October 20, 2021

Interest Rates as of Oct 20, 2021

Fixed Income Securities	1 year	2 years	3 years	5 years	10 years	20 Years	30 Years
GICs**	0.80%	1.25%	1.45%	1.65%			
Canadian Treasury Bonds*	0.49%	0.81%	0.88%	1.29%	1.64%	1.93%	2.03%
U.S. Treasury Bonds*	0.10%	0.39%	0.70%	1.16%	1.65%	1.84%	2.12%

* Rates provided by Refinitiv 2021
** Rates provided by TD Wealth

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