

Highlights



Global equities rebound on dovish cues from the Bank of Canada (BoC) and European Central Bank (ECB)



US Q3 corporate earnings are faring better than expected, but signs of weakness grow



Rishi Sunak replaces Liz Truss as Prime Minister, bringing a sense of calmness to UK markets for now



President Xi secures unprecedented third term in office, consolidating his power in China

Stocks bounce on dovish cues

Global equities bounced back in October, recovering some of the hefty losses in the prior two months. US stocks led the way, with the Dow Jones Industrial Average recording its best month since 1976, while the S&P 500 saw broad gains across all sectors. Canadian and international equities also fared well, enjoying mid-single-digit advances. Deeply oversold conditions leading to a technical bounce likely supported equities in the month. Bank of America's latest Global Fund Manager Survey showed cash levels rising to the highest since 2001, while the Financial Times reported that retail investors shifted meaningfully into cash in recent months. In addition, potential FOMO likely supported the rally, given the strong historical performance of equities in the final two months of the year. The case for a year-end rally may be even stronger this time around, given the strong historical returns seen after US midterm elections. Outside of technical and seasonality factors, a resolution to the Truss saga in UK politics, better than expected US Q3 earnings and, most importantly, a the BoC and ECB's slightly more dovish tone powered stocks higher. Regarding the latter, ECB President Christine Lagarde cited the risk of an economic slowdown, while the BoC raised their overnight rate less than expected (50 bps versus 75 bps expected). The same could not be said for the bond market, where they are now pricing in a terminal (peak) Fed Funds Rate of ~5% and see rates holding at the 4.5% level into 2024. The rally excluded emerging market stocks, as the effects of rolling lockdowns in China, rising interest rates, and elevated US dollar continue to temper the growth outlook.

WTI crude oil spiked to as high as ~US\$94/bbl after OPEC+ unleashed a massive 2 million barrels a day cut to its collective output limit. The move prompted the White House to release another 15 million barrels from the US Strategic Petroleum Reserve (SPR) in December, completing the historic 180-million-barrel drawdown authorized in March. Meanwhile, European natural gas prices were chopped in half as gas storage sites are nearly full during an unusually mild October.

President Xi consolidates power

Chinese equities sold off following the conclusion of China's 20th Party Congress, where President Xi consolidated his power by winning an unprecedented third term in office and filling the seven-member Politburo Standing Committee, China's highest

Canadian Fixed Income	Level	Month	YTD
FTSE Canada Universe Bond	1,040	-1.0%	-12.7%
FTSE Canada All Corporate Bond	1,219	-0.9%	-11.5%
Bloomberg Canada High Yield	155	-0.4%	-6.8%
Global Equities	Level	Month	YTD
S&P/TSX Composite	19,426	5.3%	-8.5%
S&P/TSX Small Cap	661	3.6%	-14.6%
S&P 500	3,872	8.0%	-18.8%
NASDAQ	10,988	3.9%	-29.8%
Russell 2000	1,847	10.9%	-17.7%
UK FTSE 100	7,095	2.9%	-3.9%
Euro Stoxx 50	3,618	9.0%	-15.8%
Nikkei 225	27,587	6.4%	-4.2%
MSCI China (USD)	47	-16.8%	-43.9%
MSCI EM Index (USD)	848	-3.2%	-31.2%
Currencies and Commodities	Level	Month	YTD
CDN \$	\$0.734	1.5%	-7.2%
US Dollar Index	111.53	-0.5%	16.6%
Oil (West Texas)	\$86.53	8.9%	12.4%
US Natural Gas	\$6.36	-10.0%	59.6%
Gold	\$1,634	-1.6%	-10.7%
Copper	\$3.38	-1.1%	-23.5%
Canadian Interest Rates	Level	Month	YTD
3-month T-bill	3.93	35	377
GOC bonds 2-yr	3.89	11	295
GOC bonds 10-yr	3.25	8	183
GOC bonds 30-yr	3.28	19	161
Canadian Sector Performance	Month	YTD	
Energy	13.8%	31.6%	
Materials	-0.7%	-8.0%	
Industrials	7.0%	0.2%	
Cons. Disc.	8.0%	-8.3%	
Info Tech	10.8%	-52.9%	
Health Care	7.1%	-54.3%	
Financials	2.5%	-12.6%	
Cons. Staples	5.4%	5.8%	
Comm. Services	4.9%	-7.0%	
Utilities	-2.6%	-8.5%	
Real Estate	2.6%	-26.7%	

decision-making body, with his allies. The NASDAQ Golden Dragon Index, which tracks a basket of US-listed Chinese companies, dropped >14% -- the worst daily loss on record. Meanwhile, Hong Kong's Hang Seng Index, the preferred vehicle for foreign investors in Chinese equities, fell >6% – the worst daily loss since 2008. According to the Financial Times, investors withdrew a record US\$2.5 trillion from Chinese equity markets on the day of the news. With fewer voices to oppose him, the capital flight out of China highlights investors' fears of further deglobalization and a higher probability of conflict with the West. During his speeches, President Xi warned of 'dangerous storms' ahead and defended his zero-covid policy strategy, raising concerns about further lockdown measures. On that note, after China reported 1,321 new Covid cases, dozens of cities were placed under lockdown.

UK PM Truss resigns

Liz Truss announced that she was stepping down as UK Prime Minister after a short but tumultuous six weeks on the job. Replacing her is Rishi Sunak, former UK Chancellor and Chief Secretary to the Treasury, who has brought some much-needed sense of calmness to UK markets for the time being. The 30-year gilts government bond yield fell to 3.6% from as high as 5.0% just a month ago. Meanwhile, the British Pound (GBP) recovered to ~1.15 against the dollar, completing the round trip from levels prior to the controversial September 23 mini-budget announcement. However, more work is required to restore credibility. The unpredictable policymaking in the face of the ongoing energy crisis and double-digit inflation has forced credit rating agency Moody's to downgrade their outlook on the UK economy.

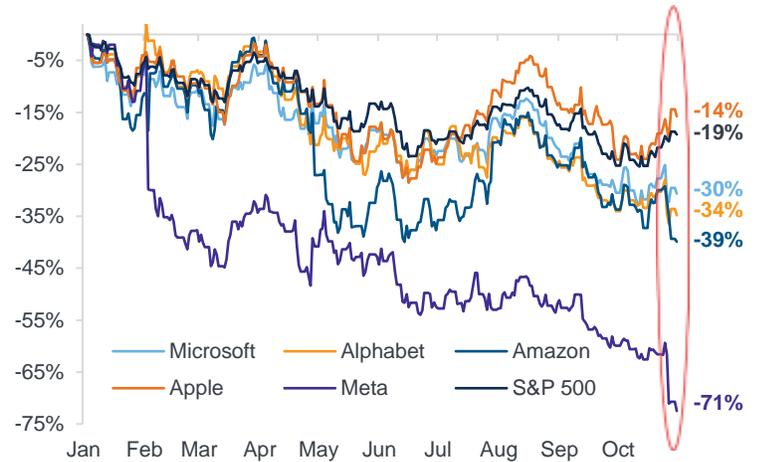
A significant takeaway from the volatility seen in UK markets during Truss' tenure serves as a blunt reminder to other governments that times are different – policymakers can no longer print their way out of challenging situations in today's hyperinflationary environment. Prime Minister Sunak, a former hedge fund veteran, has certainly taken notice of the bond vigilantes' return, a group that will ensure a level of political discipline severely lacking in Truss' tenure.

Cracks forming in Corporate America?

At the halfway point of Q3 earnings season, S&P 500 companies are faring better than expected. Of the 52% of companies that have reported, 71% have 'beat' their earnings estimates by a 2.2% margin. Meanwhile, 68% of companies have reported higher-than-expected revenues by a combined magnitude of 1.7%. However, the many headwinds facing corporations are starting to weigh. Although revenue growth remains strong at 9.3%, earnings growth has stalled to a paltry 2.2%, below the 2.8% expected at the end of September. This is perhaps an indication that corporations are starting to face difficulties in passing on their increased costs to consumers, a tailwind that swelled profit margins to record levels during the pandemic. If this trend continues, and an economic slowdown ensues, the S&P 500 2023 consensus earnings estimate of ~\$234 (implying a 5.7% y/y growth rate) will likely need to be revised lower.

Chart in focus: The only game in town...for now

YTD Performance: S&P 500 vs. US Big Tech



The theme that continues to dominate price action is the “bad news is good news” phenomenon, where weakness in the economy is interpreted as good news for markets, as it raises the odds for a dovish pivot from central banks. The moves in the final week of the month exemplified this dynamic perfectly. Although lacklustre earnings results from US Big tech companies dominated headlines, investors instead focused on the dovish cues coming from the BoC and ECB, resulting in the S&P 500 rallying 4% on the week. Although this narrative will likely endure until we receive more clarity on the US Federal Reserve's (Fed) path of rate hikes, perhaps the more interesting takeaway from this earnings season is evidence of the market's price discovery function working again, a mechanism that has been largely dysfunctional during the decade long period of near-zero interest rates. In other words, investors are back to focusing on the fundamentals: cash flow and balance sheet analysis. This was illustrated in how US Big Tech names traded following the release of their earnings results last week. Meta (-24%)* continues to be punished by the questionable choices made for the company's direction, now having lost US\$800 billion in market cap this year – the stock closed above US\$1 trillion in June 2021! Meanwhile, Amazon (-13%) missed its sales estimate and guided lower due to a weaker consumer, Microsoft (-3%) recorded its slowest quarterly sales growth in five years due to the surging US dollar, and Alphabet (-5%) lowered its guidance due to waning advertising growth from its Google subsidiary. Conversely, markets reacted positively to Apple (+6%) after it beat its earnings and revenue estimates, further solidifying its safe haven status in this challenging environment. Although we see monetary policy being the key driver for where markets move next, the era of one-way market action, in which stocks have traded in unison, may soon be over.

*(Performance week ending October 28, 2022).

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