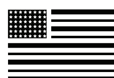
Monthly Market Monitor

November 2020

NEI

HIGHLIGHTS



No clear winner... yet

Election night ended with much uncertainty in the air as millions of ballots remain to be counted. While markets are still pricing in a Biden victory, it will likely come with Republicans holding the Senate, resulting in a divided federal government.

Renewed lockdowns

The appearance of second and third waves of the coronavirus has prompted nations to reinstate temporary lockdowns. These measures will no doubt have a negative impact on Q4 economic activity and are already reflected in equity market weakness.

Fiscal policy will drive the recovery

Renewed lockdowns mean there is even greater need for governments to support the economy. With monetary policy pushed close to its limit in many nations, we look toward fiscal policy to take center stage in supporting the recovery.

ASSET ALLOCATION OUTLOOK SUMMARY

	Negative		Neutral	Positive	
Equity					
Canada Equity			This month		
U.S. Equity				This month	
International Equity			This month	Last month	
EM Equity				This month	
Fixed Income					
Government Bonds		This month			
Corporate Bonds				This month	
High Yield Bonds			This month		
Overall equity				This month	
Overall fixed income		This month			

This month (blue)
Last month (green)

This table illustrates the short-term outlook of NEI's Asset Allocation Team on various equity and fixed income asset classes as of October 31, 2020. If an asset class has a blue box in its row and no green box, it means this month's outlook is the same as the prior month's.

U.S.

Election night had investors on the edge of their seats as the two candidates raced neck and neck to win the presidency. At the time of writing (12pm ET on November 4), no clear outcome had been produced and major media outlets, which are typically are able to project winners due to a sizable majority of ballots being counted and/or extensive exit polling, have held back on making their calls. The reason? Key battleground states including Michigan, Pennsylvania, and Wisconsin still have millions of mail ballots to count, a process that could take days—or longer.

In the meantime, what we do know is the odds of a "blue sweep" have dropped substantially, which can be seen in the initial market reaction. Equity volatility has come down with the VIX dropping below 30. Technology stocks are leading the rally, largely fueled by falling bond yields where we saw the 10-Year U.S. Treasury yield fall more than 13 basis points. The U.S. dollar fluctuated overnight but remains largely unchanged.

The most likely outcome at the time of this writing is for a Biden presidency (albeit with a narrower victory margin than previously expected), and for Republicans to retain control of the Senate. The House of Representatives is expected to remain in Democrat control. This scenario has important macro and market implications.

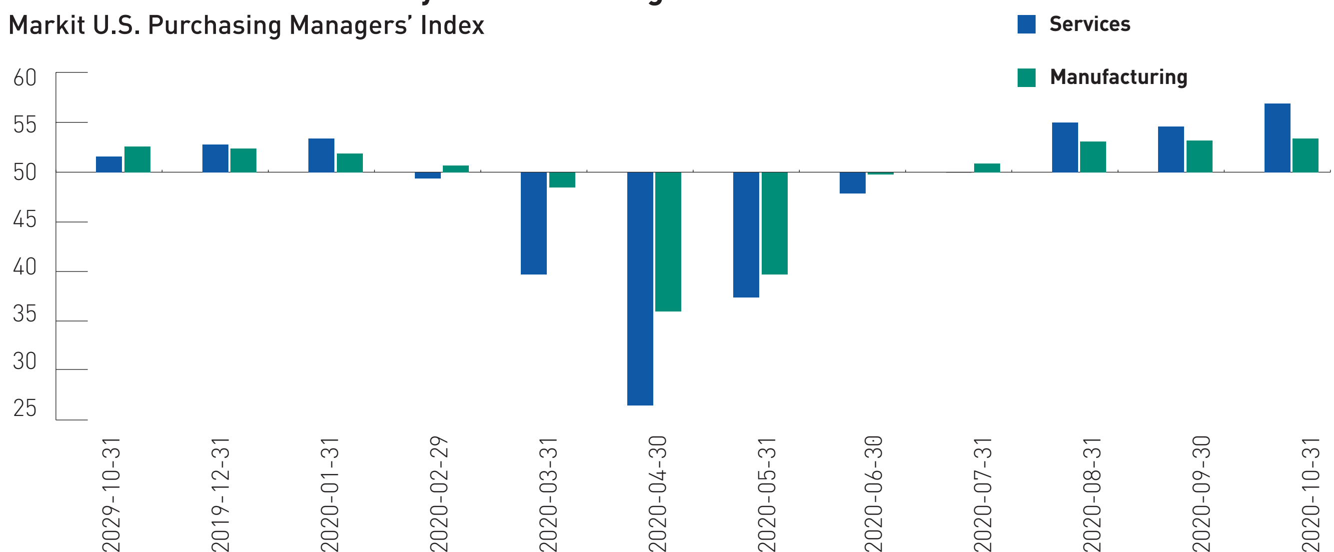
A Biden presidency with a divided Congress will likely lead to further political gridlock. Control of the Senate is just as important as the White House to push fiscal policy. This would imply that any major policy changes that either candidate campaigned for are unlikely to come to fruition. On the one hand, this could mean little to no changes to Trump's 2017 tax cuts. On the other hand, it could mean that subsequent fiscal packages will be smaller than what Democrats have been pushing for prior to the election.

All in all, the macro implications of this scenario would be relatively neutral to slightly deflationary (hence the fall in bond yields). In the short term, between now and January 20 when the president is inaugurated, we would still expect a relatively high level of uncertainty as ballots are tallied up. If it turns out to be a close outcome, we can expect contention, perhaps followed by litigation.

Regardless of the outcome, the expected first order of business for the new administration will be to focus on the next fiscal package to combat the economic fallout from COVID-19. As the virus rages on, without wage support we would expect personal incomes to fall, which would drag down consumer spending, which makes up 68% of U.S. GDP. While the latest Purchasing Managers' Index readings show continued expansion, lack of further fiscal support risks derailing the strong economic recovery.

October U.S. business activity remains strong

Markit U.S. Purchasing Managers' Index



Source: Bloomberg. Data as of November 4, 2020.

CANADA

The Canadian economy has rebounded from the pandemic more strongly than expected. GDP expanded 1.2% in August and a preliminary estimate shows a further 0.7% growth in September. These numbers would imply that Q3 GDP expanded approximately 10% (or a whopping 47% annualized). Employment also continues to recover, with the September reading outpacing expectations.

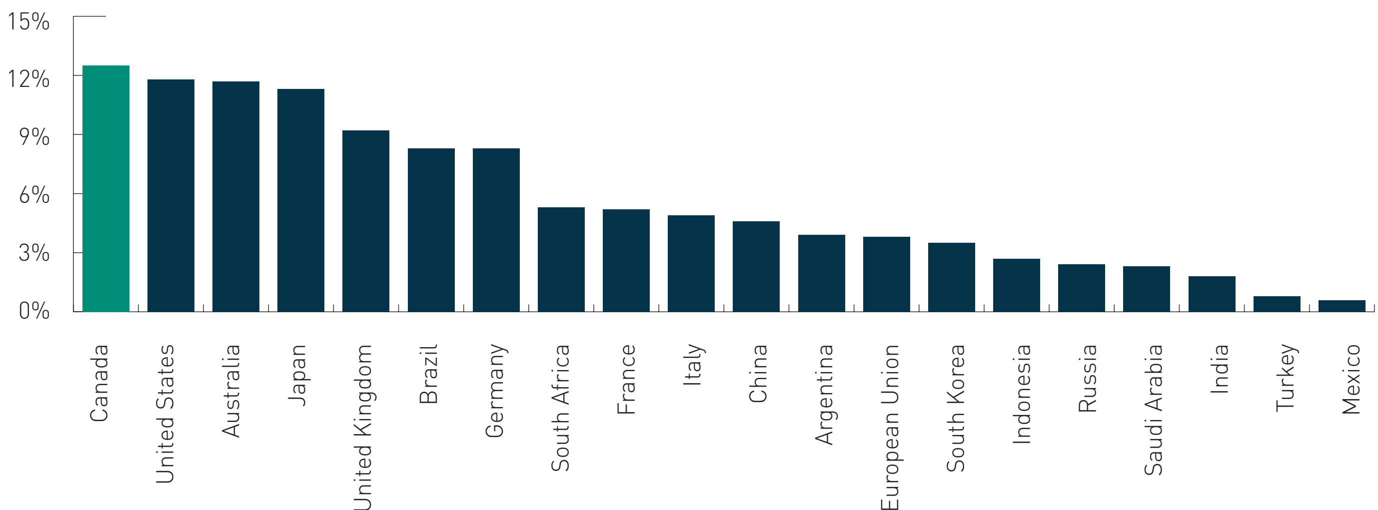
The most recent GDP estimate from the Bank of Canada is for a contraction of 5.7% for all of 2020, a significant upward revision from the central bank's earlier forecast of a decline of 7.8%. Growth expectations for 2021 are 4.2%. Compared to the latest IMF World Economic Outlook projections, this places Canada on a slightly lower recovery trajectory compared to the broader global economy.

The Bank of Canada continues to reiterate it is likely to hold rates at their effective lower bound until inflation sustainably reaches 2%. This is not expected until 2023, when the economic slack is expected to be fully absorbed. Perhaps more importantly, changes to the quantitative easing program were announced. The amount of purchases will start being scaled back from $5B to $4B per week, and the central bank will focus instead on longer-term debt. Much like the U.S. Fed's "Operation Twist" back in 2012, this recalibration indirectly targets the yield curve, which should help suppress the steepening of the curve and reduce borrowing rates for households and businesses.

It should come as no surprise that small business sentiment weakened in October as COVID-19 cases in the Greater Vancouver and Toronto areas continued to climb and the cities had to reinstate stricter lockdown restrictions. The government has committed to spending measures of over 10% of GDP to limit the damage, and as a percentage of GDP Canada is among the highest spenders of the G20 countries. In fact, Canada continues to signal that more support is on the way, with Finance Minister Chrystia Freeland saying that "doing too little is more dangerous and potentially more costly than doing too much." Freeland continues to advocate for more fiscal support to speed up and ensure a robust recovery. Of course, the future will ultimately be shaped by what happens with the coronavirus, but appropriate fiscal support can help the recovery stay on course.

Canada, U.S., and Australia are spending the most on pandemic response

Fiscal Response to COVID-19 (Additional spending or foregone revenues as % of GDP)



Source: IMF. Data as of September 11, 2020.

Our position on Canadian equities relative to global equities remains neutral. We would need to see signs of a broader global recovery before increasing our bullishness on Canadian equities.

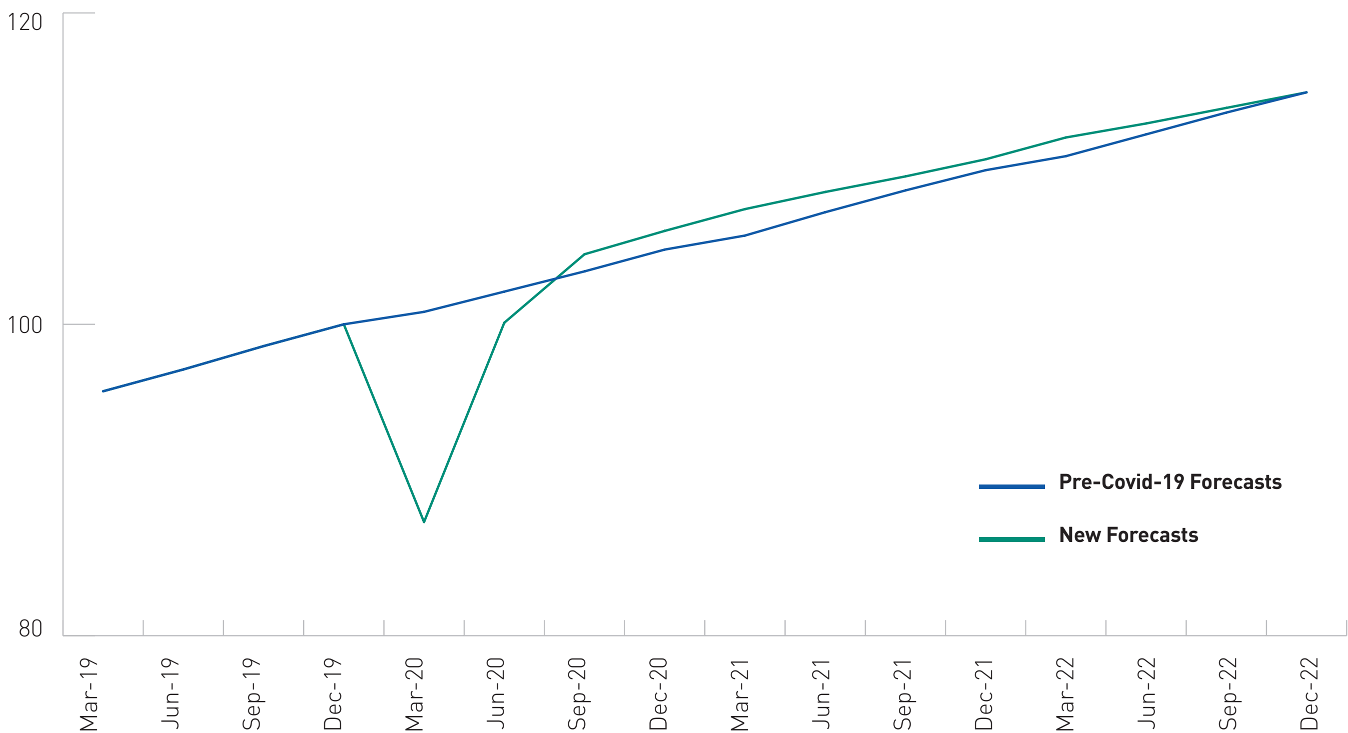
INTERNATIONAL AND EMERGING MARKETS

The big story in October was the new lockdowns across European economic powerhouses Germany, the U.K., and France. British Prime Minister Boris Johnson, German Chancellor Angela Merkel, and French President Emmanuel Macron all announced new month-long lockdowns as hospitals are beginning to show signs of stress in coping with the rising case count.

Even prior to the lockdown, confidence in Europe was beginning to wane. Brexit trade talks with the European Union fell apart, with major disagreements adding to the uncertainty of a potential "no-deal" Brexit. The IHS Markit Eurozone Composite PMI reading for October fell back into contractionary territory as the service sector experienced a steep drop, and the ZEW Indicator of Economic Sentiment for Germany also saw a sharp decline.

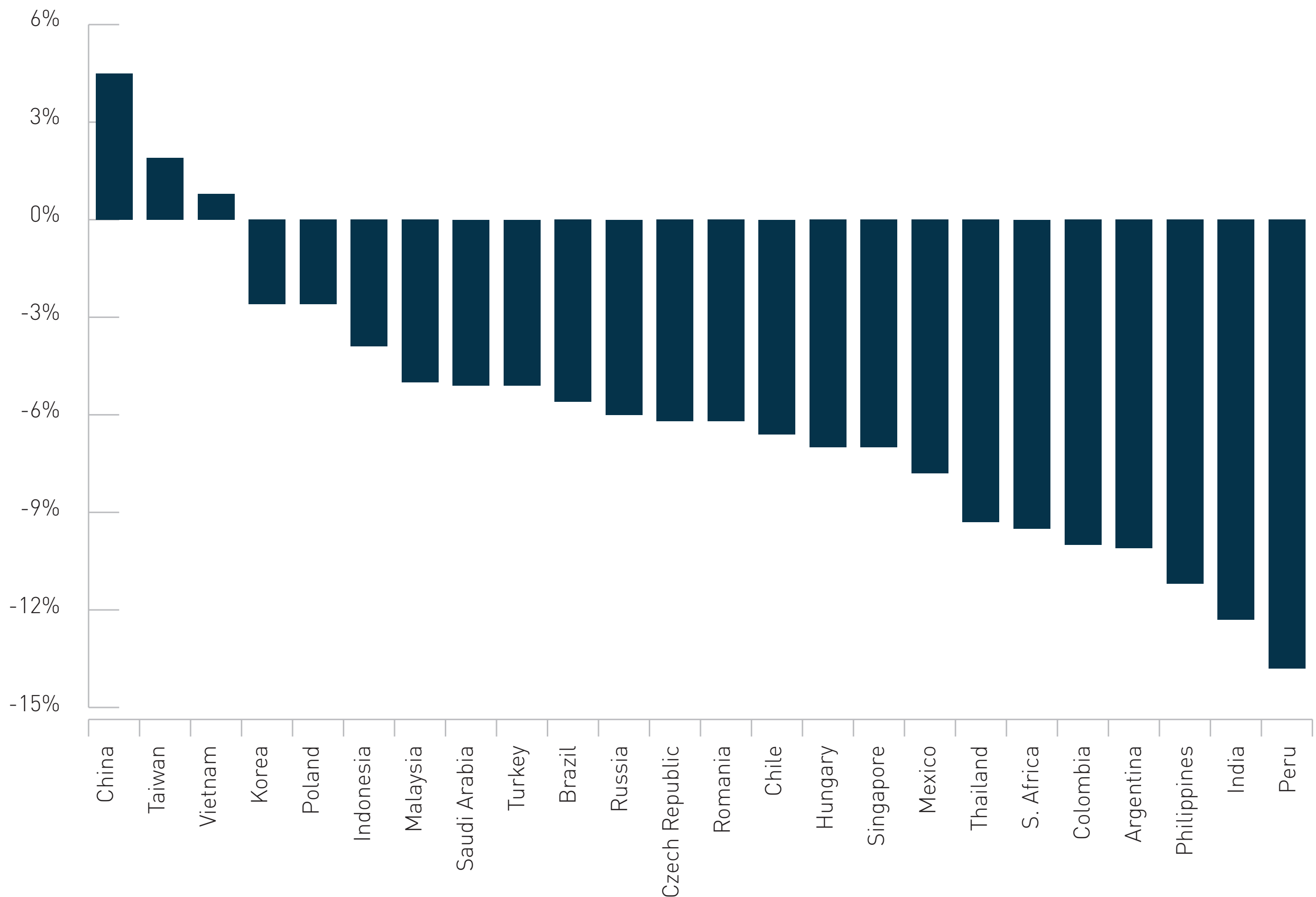
The European Central Bank hinted at more stimulus in December as the region re-enters lockdowns. ECB President Christine Lagarde said the euro area economic recovery is "losing momentum more rapidly than expected," with risks clearly tilted to the downside. She says the ECB will be reviewing all the tools at its disposal to recalibrate its monetary policy.

China is the first major economy to return to its pre-COVID growth path
Level of GDP in China (Q4 2019 = 100, seasonally adjusted)



Source: Capital Economics. Data as of October 23, 2020.

Most EM nations are expected to remain below their pre-COVID growth path for some time
Q3 2020 GDP vs Q4 2019 (% change seasonally adjusted)



Source: Capital Economics. Estimates as of October 23, 2020.

In Asia, China continues to lead the recovery and is the first country to return to its pre-COVID growth path thanks to speedy containment efforts and policy response. Still, the Q3 GDP reading of 4.9% on a year-over-year basis came out weaker than the consensus estimate. Manufacturing in the country has returned to pre-pandemic levels, while the service sector continues to feel the effect of the virus. Other measures including the accelerating industrial production and retail sales in September paint a more positive picture. However, the final stretches of recovery will be the most difficult for China, as it will be dependent on the improvement of foreign countries before a full recovery can be met.

With the increase in coronavirus cases and renewed lockdowns across several major cities in Europe, we have revised our outlook for international equites to neutral from overweight.

MARKET PERFORMANCE

Percent return in Canadian dollars

	1 Mo	3 Mo	6 Mo	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
Bonds								
Bloomberg Barclays Canada Aggregate	-0.75	-1.59	1.53	7.05	6.31	5.18	4.05	4.19
Bloomberg Barclays Global Aggregate (CAD Hdg)	0.00	-0.35	1.48	4.48	4.10	4.39	3.79	4.12
Bloomberg Barclays US High Yield 2% Issuer Cap (CAD Hdg)	0.48	0.34	10.53	-0.11	2.14	3.13	5.43	6.05
Equities								
MSCI World (Developed Markets)	-3.24	-0.62	8.07	1.37	5.87	7.16	8.54	11.61
MSCI World Growth	-3.45	0.64	15.46	18.27	24.33	15.38	13.58	14.80
MSCI World Value	-3.00	-2.03	0.29	-14.67	-11.49	-1.17	3.27	8.25
MSCI Canada	-3.50	-3.61	5.38	-8.10	-4.70	0.65	4.83	4.18
MSCI USA	-2.81	0.23	10.02	6.95	12.57	11.63	11.77	15.55
MSCI EAFE	-4.17	-2.13	4.22	-8.28	-5.52	-0.12	3.24	6.67
MSCI Europe	-5.81	-5.47	3.01	-11.56	-7.98	-1.57	2.00	6.04
MSCI Japan	-1.78	6.44	6.99	0.50	1.79	2.99	5.53	8.72
MSCI Pacific Ex Japan	-0.74	-1.58	4.72	-9.27	-8.08	0.75	5.55	6.24
MSCI EM (Emerging Markets)	1.88	2.17	16.12	3.72	9.82	3.09	8.33	5.23
World currencies (relative to CAD)								
US Dollar	-0.18	-0.46	-4.00	2.82	1.45	1.13	0.38	2.74
Euro	-0.84	-1.94	2.09	6.70	5.92	1.13	1.45	0.94
Pound Sterling	-0.17	-1.94	-1.60	0.36	1.37	0.24	-3.13	0.58
Yen	0.77	0.67	-1.80	6.89	4.91	3.98	3.30	0.10

Source: Morningstar. Data as of October 31, 2020.

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