



October 2017: Wall Street Sets New Highs as TSX Turns a Corner

The month of September was a surprisingly buoyant period for global equities. Underpinned by strong institutional demand, U.S. stocks rose to fresh records, with the Nasdaq Composite Index leading the way higher. In Canada, the TSX posted its biggest single-month gain in over a year as heavyweight financials rallied.

Significant developments in monetary policy were also observed last month, with the Bank of Canada and Federal Reserve leading the global shift toward gradual tightening.

North Korea's nuclear program and Catalonia's push for independence from Spain were the major geopolitical themes last month. Political developments have been a source of angst all year long, as evidenced by multiple spikes in the CBOE VIX Volatility Index. However, each major dip has been quickly bought by investors, a sign that the bull market remains firmly intact. Political unrest had no major bearing on equities last month.

Canadian Stocks Bounce Back

After a dismal summer, Canadian stocks turned in solid gains for September, led by a resurgent financial sector. The benchmark S&P/TSX Composite Index added 2.8% for the month to close at its highest level since May. September marked the biggest monthly advance since July 2016,¹ a sign that the TSX was finally emerging from a year-long funk.

The TSX, which has lagged most of the developed world since January, has been bogged down by a slumping energy sector following a multi-year downturn in oil prices. Even with the September gain, the index is still the third-worst performer among 24 developed market gauges tracked by Bloomberg.

Some analysts say there is "excess pessimism" priced into Canadian stocks on account of a rising dollar and tighter interest rates. Although the outcome of NAFTA renegotiation remains up in the air, the TSX is likely due for a rebound.² A 20% rebound in oil prices since June³ has also fueled optimism that Canadian markets are primed for a comeback.

Wall Street Forges New Highs

September was another record-breaking month for U.S. stocks, with Wall Street's benchmark indexes posting consecutive all-time highs. The S&P 500 Index finished the month at record highs, while the Dow Jones Industrial Average closed out its first eight-quarter winning streak in two decades.⁴

The technology-laded Nasdaq Composite Index also rose to record territory, and has now returned more than 21% year-to-date. The gauge's year-long rally highlights the role of information technology in sustaining the post-election bull market. The CBOE VIX Volatility Index, Wall Street's preferred measure of investor anxiety, closed at two-month lows. The VIX finished the month below 10.00, signaling a level of complacency in the market rarely seen historically

CBOE's volatility gauge trades on a scale of 1-100, with 20 representing the historic mean.

Central Banks Press Forward with Policy Normalization

The Bank of Canada caught investors by surprise last month by raising interest rates for the second time in as many meetings. Policymakers hiked rates in July for the first time in seven years after Canada became the G7's fastest growing nation in the first half.

Analysts say the BOC is not done yet, with markets pricing one more upward adjustment before year's end.

In Washington, the Federal Reserve held off on raising interest rates last month, but said October would be the start of the "great unwind." That's when policymakers will begin to wind down their \$4.5 trillion balance sheet at a rate of \$10 billion per month.

The Fed's balance sheet expanded to record levels following the 2008 financial crisis, as officials pumped trillions of dollars into the economy in support of economic growth and inflation.

The central bank's now infamous "dot plot" chart suggested that one more rate hike is expected this year. CME Group's FedWatch Tool implies a nearly four-in-five chance of liftoff in December.⁵

The Month Ahead

Wall Street's bull market shows few signs of letting up, as the institutions continue to drive equities to record highs. In Canada, the TSX appears to be finally playing catch up, although investors will need more than a one-month sample to confirm whether the uptrend is sustainable.

Studies of seasonality imply that we are heading for the best six months of the year for investing. The so-called "Halloween Indicator" tells us that Oct. 31 marks the beginning of the seasonal uptrend. Time will tell whether the market will continue higher, or whether range bound trading will take over.

Sincerely,

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- 1 Chuck Mikolajczak and Fergal Smith (September 29, 2017). "The close: TSX notches 4-month high; gains 2.8% for month." The Globe and Mail.
 - 2 Kristine Owrarn (October 2, 2017). "Will the TSX tally last? Here's what four strategists predict." The Globe and Mail.
 - 3 Al Jazeera (September 30, 2017). "The oil market's rebalancing act."
 - 4 Evelyn Cheng (September 29, 2017). "Dow posts first 8-quarter win streak in 20 years." CNBC.
 - 5 CME Group. CME FedWatch Tool.

