



October Market Update: U.S. Stocks Post Best Quarter Since 2013; NAFTA 2.0 Crosses Finish Line

U.S. stocks rounded out a stellar third quarter on a softer note, as trade tensions and political turmoil in Washington weighed on investor sentiment in the final week of September. Nevertheless, the S&P 500 Index rounded out its best quarter in five years thanks to pro-growth optimism and upbeat quarterly earnings.

After a stellar first half of the month, Canadian stocks declined sharply in the final week of trading. Toronto's benchmark TSX Composite Index pared its monthly gain all the way down to 0.5% after setting fresh highs on Sept. 21. Reprieve for the TSX is likely on the way after Canada and the United States struck a last-minute deal to replace the North American Free Trade Agreement (NAFTA).

U.S. Stocks Hit Record Highs

September was a record-setting month for the S&P 500 Index and Dow Jones Industrial Average. The gains were more impressive given the historical context of September being the worst month of the year for U.S. markets. The S&P 500 Index returned 0.4% for the month after paring more than half its gains in the final week. The Dow added 1.9% in all of September while the Nasdaq fell 0.8%.¹

North of the border, the TSX Composite Index closed at 13,236.44 on Sept. 21, its highest on record. A panic sale would hit the market the following week, sending Canadian shares sharply lower. The TSX continues to lag considerably behind its U.S. peers. In the first nine months of 2018, the benchmark index has returned just 2.5%. By comparison, the S&P 500 Index is up 9.4% for the year.



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NAFTA 2.0

After an arduous negotiation round, Canada has agreed to join the United States and Mexico in a new continental trade agreement that will replace the decades old NAFTA accord. The deal was reached Sept. 30, mere hours before a self-imposed deadline by the Trump administration. The deadline allows U.S. Congress to begin the mandatory 60-day review period before sign-off by President Trump. This crucial window also allows Mexico's out-going president to ratify the agreement before leaving office.

The new deal that will replace NAFTA will be named the United States-Mexico-Canada Agreement (USMCA). While Canada got to keep the Chapter 19 dispute resolution mechanism, it agreed to open its dairy market to U.S. farmer. In exchange, Washington promised Canada special accommodation if President Trump decided to implement auto tariffs.

Foreign Affairs Minister Chrystia Freeland U.S. Trade Representative Robert Lighthizer issued a joint statement shortly after the deal was announced:

“Today, Canada and the United States reached an agreement, alongside Mexico, on a new, modernized trade agreement for the 21st Century: the United States-Mexico-Canada Agreement (USMCA).

“USMCA will give our workers, farmers, ranchers, and businesses a high-standard trade agreement that will result in freer markets, fairer trade and robust economic growth in our region.”²

Fed Raises Interest Rates, BOC Stands Pat

The Federal Reserve moved forward as expected last month with its third interest rate hike of the year, as officials became increasingly convinced that the economy is moving in the right direction. However, the decision didn't come without controversy after central bankers dropped “accommodative” language from their official statement. Some investors took this to mean that the Fed no longer views its policy as accommodative, which could temper expectations for future rate hikes. In response, Federal Reserve Chairman Jerome Powell reiterated that the change in language “does not signal any change in the likely path of policy.”³

Meanwhile, the Bank of Canada (BOC) kept its trend-setting interest rate on hold last month but left the door wide open to a possible rate hike in October. This is more likely now that NAFTA uncertainty is out of the way. At the September meeting, central bankers said they were “monitoring closely” the process on NAFTA negotiations.⁴

The Month Ahead

Corporate earnings season is back in focus during the month of October with U.S. companies opening the books on Q3. Corporate America is coming off its second-best quarter of earnings growth since Q3 2010.

With NAFTA 2.0 wrapped up, the Trump administration will shift its focus to more hostile trade negotiations with China. The world's two largest superpowers are embroiled in a tit-for-tat trade war that is already beginning to weigh on the Chinese economy.

Sincerely,

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¹ Sue Chang and Ryan Vlastelica (Sept. 28, 2018). "S&P 500 posts strongest quarter since 2013 as stocks close mostly unchanged." MarketWatch.

² Katie Dangerfield (Sept. 30, 2018). "NAFTA deal reached: Canada, U.S., Mexico reach trade agreement under new name." Global News.

³ Sam Bourgi (Sept. 26, 2018). "Market Update: U.S. Stocks Fall After Fed Decision; XRP Back in the Driver's Seat." Hacked.com

⁴ Erica Alini (Sept. 5, 2018). "Bank of Canada holds interest rates steady, but October hike looms." Global News.