Big Picture

Fed Minutes Reveal Growing Sentiment to Slow Rate Increases

U.S. stocks retreated Monday, weighed down by Covid protests across China and hawkish comments from Fed officials about the future path of interest-rate increases. Monday's sell-off picked up speed in afternoon trading after Fed officials indicated that rates could be higher for longer as the battle against inflation continues. By Monday's close, the Dow was off by nearly 500 points, while the S&P 500 and Nasdaq fell 62 and 177 points, respectively. In Canada, the TSX fell 163 points in mixed trading across sectors.

U.S. stocks closed mostly lower Tuesday as investors hit the pause button ahead of Fed Chair Jerome Powell's planned remarks at the Brookings Institution on Wednesday. The Dow and S&P 500 finished flat, while the Nasdaq dropped 66 points. The TSX closed modestly higher, up half of a percent, on strength in materials and energy.

In U.S. bond markets, the yield curve on Tuesday remained inverted, with 10-year Treasurys climbing to 3.75%, while two-year Treasurys were up to 4.47%. Tuesday's gap between 10- and 2-year notes is the largest in decades, signalling that interest rates could be nearing their peak and that a recession could be looming.

North American indexes rallied Wednesday after Fed Chair Powell signalled a potential slowdown in interest-rate hikes. Powell's remarks sent the Dow more than 700 points higher, while the S&P 500 and Nasdaq jumped 3.1% and 4.4%, respectively. The TSX rose 176 points in Canada, hitting its highest close since early June. By Wednesday's close, all four indexes had ended November with a second consecutive month of gains.

Stock indexes were mixed in Thursday trading as investors began pricing in a potential recession and its impact on corporate earnings. By the day's close, the Dow dropped roughly half a percent, while the S&P 500 was essentially flat, and the Nasdaq registered minor gains. In Canada, the TSX rose slightly on strength in energy and materials.

Markets Register Modest Gains

For the four trading days covered in this report, the Dow increased 50 points to close at 34,397; the S&P 500 rose 51 points to settle at 4,077, while the technology-heavy Nasdaq added 256 points to close at 11,482. In Canada, the TSX gained 141 points to end at 20,525.

Strategy

The Canadian economy grew more than expected in 3Q, but momentum appears to be slowing.

Canadian GDP rose 0.1% in September, led by growth in the goods-producing sector (+0.3%), while the services industry was little changed. Third-quarter annualized GDP was up 2.9%, nearly doubling consensus estimates of 1.5%, while 2Q GDP was revised slightly lower by 0.1%. The quarterly increase was supported by strength in exports (+8.6%) and government spending (+5.3%) but offset somewhat by weakness in consumer spending (-1.0%), which registered its first decline since 2Q21. Business spending also contracted by 5.1%, its second consecutive quarterly decline. While the 3Q data presented a positive surprise, the Canadian economy appears to be losing steam. Advance estimates from Statistics Canada revealed that GDP was essentially unchanged in October as an uptick in the public, transportation/warehousing, and construction/wholesale trade sectors were offset by manufacturing and oil/gas declines. Indeed, economists surveyed by Bloomberg predict that the Canadian economy will slip into a technical recession in 2023 as GDP is expected to contract in the first two quarters of the year. The Bank of Canada (BoC) also alluded to this in its Monetary Policy Report released in October. While not explicitly forecasting negative GDP, the Bank said that mildly positive or stagnant growth could just as likely turn into a modest contraction, a nod to a possible technical recession. In light of this, the BoC has begun to slow the pace of rate hikes, recently downshifting to 50 bps in its last meeting. The better-than-expected reading for 3Q GDP may cause the BoC to consider another 50 bps increase in borrowing costs at its meeting next week.

On the other hand, nominal wage growth geared down to 1.2%, the slowest growth since 2Q20, when compensation declined sharply. Slower wage growth will likely be seen as a welcome sign for the BoC and might cause them to consider shifting down to 25 bps. At the time of this writing, markets are favouring a half percentage point increase as the most likely scenario.

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