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Red October

Stocks extended their slump this week, with the S&P 500 cracking well below its 200-day moving average and entering correction territory. The index fell 3.9%, while the TSX slid 3.8%. The recent breakdown looks like the most significant such turn since the 2015 trauma, and left U.S. equities down slightly on the year. If no one else is, we know that President Trump is still long, as shown by his agitation about rising rates. The President took a few more jabs at the Fed this week, saying that Chair Powell “almost looks like he’s happy raising interest rates”, and complaining that “every time we do something great, he raises the interest rates”. Well, a funny thing tends to happen when you pour fiscal stimulus and big budget deficits on the economy, late in the cycle when the labour market is tight and inflation pressures are already bubbling—it raises the interest rates. To be sure, the deepening tightening cycle is one factor tripping up stocks. As much as we love to point to strong growth and earnings today, the reality is that those future profits are getting discounted at a higher rate as monetary policy normalizes.

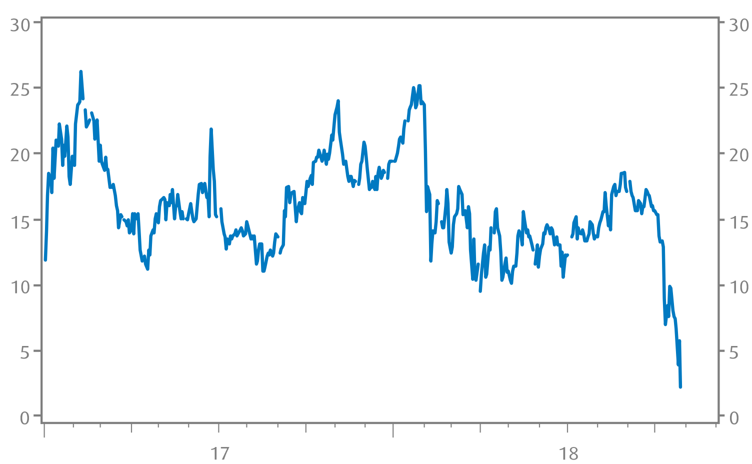
Market Performance as of October 26, 2018

	Current Price	Performance (percent)					
		1 Week	1 Month	3 Months	1 Year	YTD	2017
China CSI 300	3,174	1.2	-7.1	-10.3	-20.5	-21.3	21.8
FTSE 100	6,940	-1.6	-7.6	-9.4	-7.3	-9.7	7.6
CAC 40	4,967	-2.3	-9.9	-9.4	-8.9	-6.5	9.3
Dow Jones	24,688	-3.0	-6.4	-3.3	5.5	-0.1	25.1
DAX	11,201	-3.1	-9.6	-12.6	-14.7	-13.3	12.5
S&P/TSX	14,888	-3.8	-7.9	-9.5	-6.3	-8.1	6.0
NASDAQ	7,167	-3.8	-10.3	-8.7	9.3	3.8	28.2
S&P 500	2,659	-3.9	-8.5	-6.3	3.8	-0.6	19.4
NIKKEI 225	21,185	-6.0	-11.9	-6.2	-2.6	-6.9	19.1

Source: Bloomberg

S&P 500: Index [Blm]

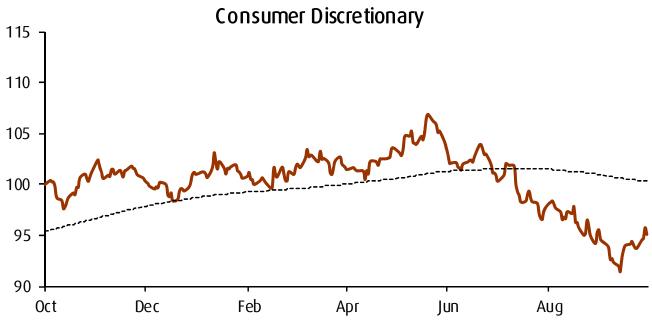
% Change - Year to Year

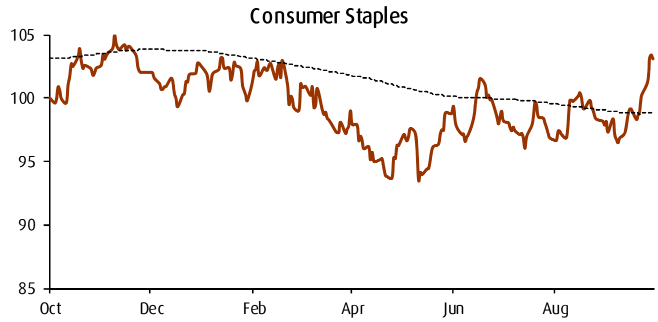


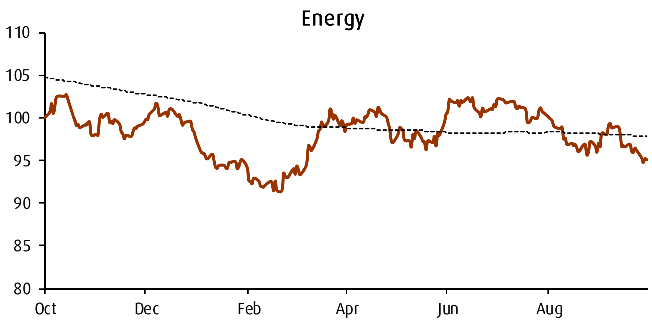
Another factor behind the weakness is that the market is always looking 6-to-12 months down the road, and doing so now would almost certainly leave peak economic and earnings growth behind it. On the growth front, we’ve just seen Q2/Q3 real GDP average a honking 3.8%, but by mid-2019, as fiscal stimulus fades and monetary stimulus evaporates, we’re looking at a slowdown of at least 1.5 ppts. On the earnings front, the Q3 reporting season has been solid, with growth impressively holding up around 20% y/y. Like with the broader economy, however, the caution is that we’ve now seen the highs—sequential growth has begun to fade, and 30%-plus q/q growth in 2017Q4 and 2018Q1 almost guarantees that year-over-year earnings growth is set to slow meaningfully. Meantime, the chatter this season has been more cautious, with a number of companies—see Caterpillar, 3M, Harley-Davidson—highlighting the negative impact of tariffs and/or the need to raise prices. Two technology stalwarts in Google and Amazon also disappointed with their top line/sales guidance this week. And, the overall share of S&P 500 companies beating revenue expectations has slumped to about 45% over the past 30 days, down from nearly 70% around the middle of the year—this suddenly looks a lot more normal.

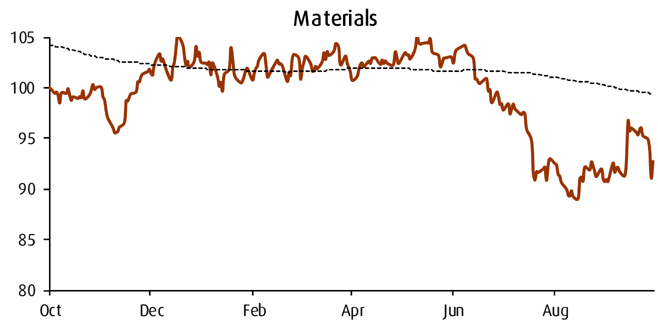
All told, with the market looking ahead at an environment where fiscal stimulus fades, interest rates are no longer stimulative, price and wage pressures are stronger and the earnings backdrop is ‘less good’, it’s understandable why equities are now consolidating big 2016-2017 gains.

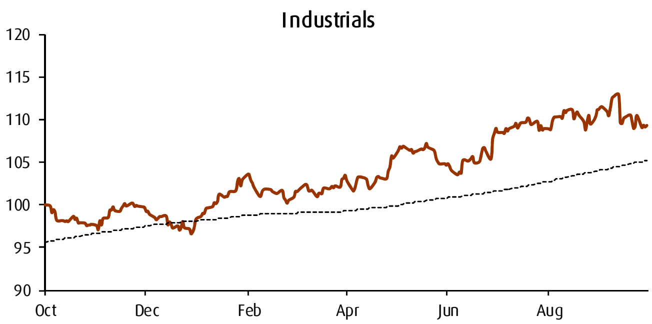
TSX Sector Performance (Relative to the index, year-ago = 100, dashed line = 200-day m.a.)

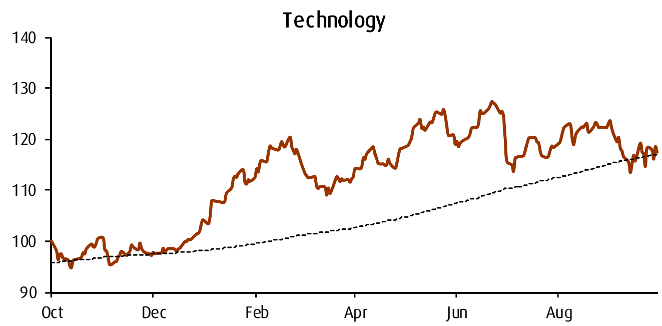


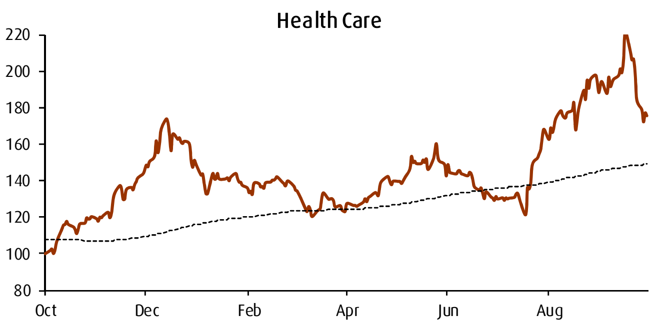


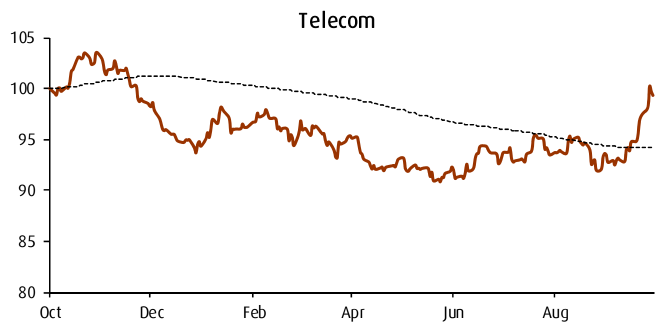


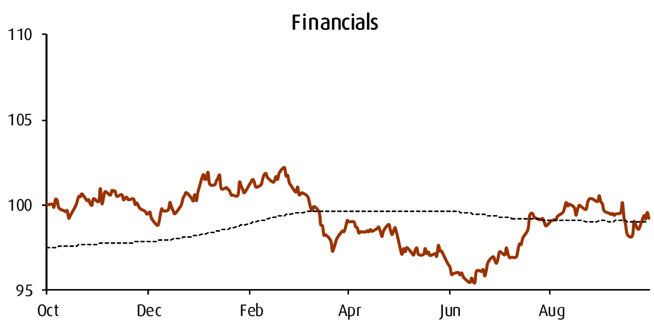


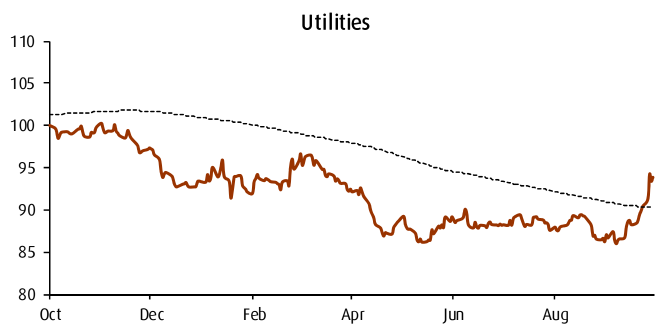




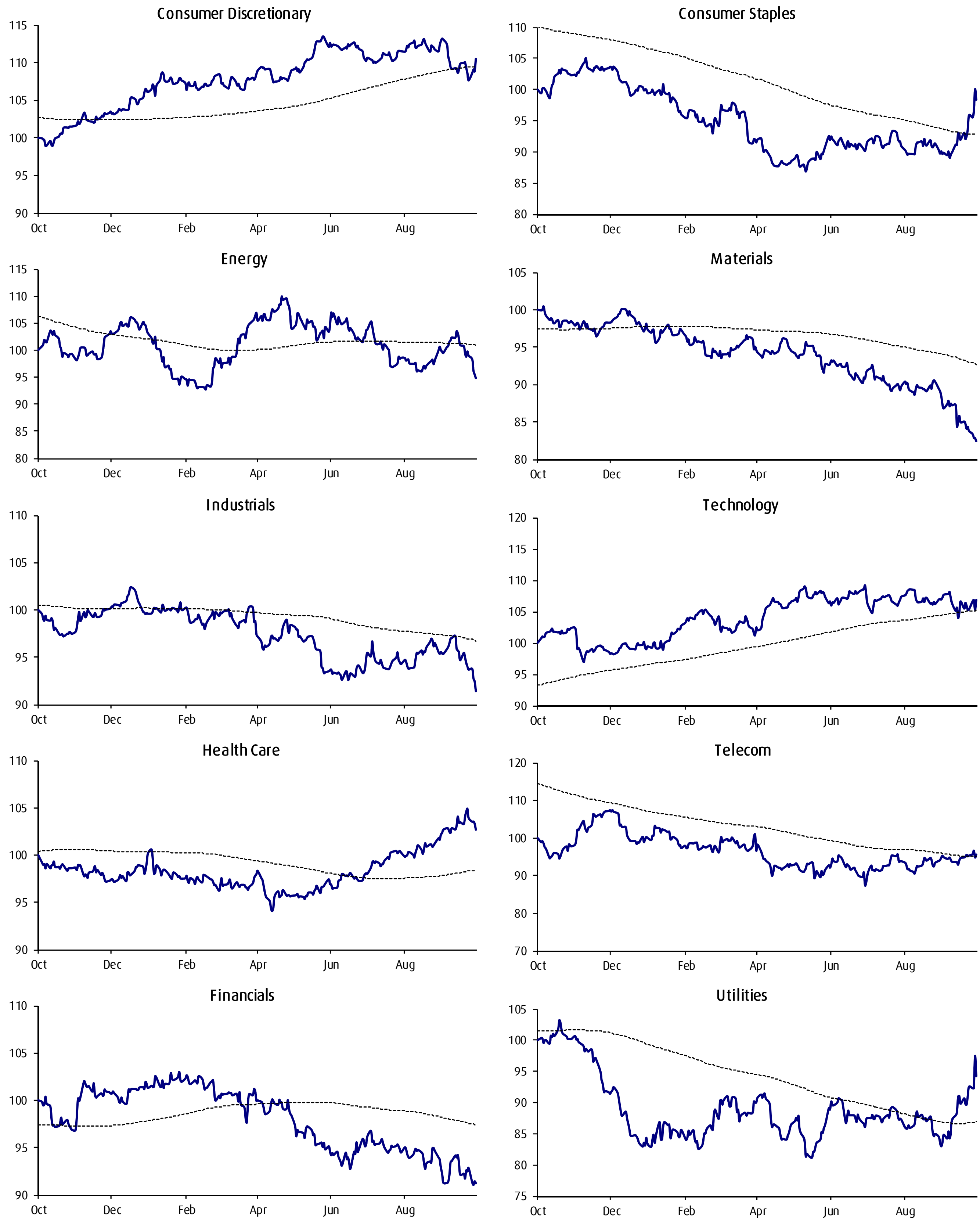








S&P 500 Sector Performance (Relative to the index, year-ago = 100, dashed line = 200-day m.a.)



North American Sector Performances as of October 26, 2018

S&P 500 Sectors	1 Week	1 Month	3 Months	1 Year	YTD	2017
Cons Staples	**-1.4**	0.0	1.5	0.5	-5.6	10.5
Utilities	**-2.1**	3.9	1.2	-2.3	1.4	8.3
Information Technology	**-2.7**	-8.7	-7.2	13.1	8.1	36.9
Cons Discretionary	**-3.2**	-12.1	-7.8	13.5	4.6	21.2
Telecom Services	**-4.3**	-8.3	1.0	-2.1	-11.8	-6.0
Health Care	**-4.5**	-7.4	-1.2	6.5	5.8	20.0
Materials	**-4.5**	-13.9	-14.8	-14.6	-16.1	21.4
Banks	**-4.9**	-9.8	-11.8	-5.3	-9.9	20.0
Financials	**-5.2**	-9.8	-10.0	-5.8	-9.6	20.0
Industrials	**-5.6**	-11.8	-9.0	-5.2	-8.9	18.5
Energy	**-7.1**	-12.4	-13.4	-1.2	-7.7	-3.8
S&P 600 Small Cap	**-2.2**	-11.0	-11.2	3.3	0.5	11.7
S&P 100 Large Cap	**-3.8**	-7.8	-5.0	5.5	0.5	19.3
S&P 400 Mid Cap	**-4.1**	-10.8	-10.1	-1.9	-5.5	14.5
S&P 500	**-3.9**	**-8.5**	**-6.3**	**3.8**	**-0.6**	**19.4**

TSX Sectors	1 Week	1 Month	3 Months	1 Year	YTD	2017
Utilities	**-0.4**	-1.1	-4.7	-13.0	-12.0	6.2
Information Technology	**-1.3**	-11.5	-14.6	9.9	10.7	16.2
Cons Staples	**-1.4**	-3.8	-5.8	-4.6	-7.6	6.4
Cons Discretionary	**-2.2**	-7.9	-14.8	-11.4	-12.6	20.4
Telecom Services	**-2.5**	-2.7	-3.9	-8.2	-8.2	9.9
Financials	**-3.1**	-9.0	-7.0	-7.4	-8.4	9.4
Banks	**-3.2**	-9.1	-6.3	-5.4	-6.8	10.4
Industrials	**-3.3**	-9.0	-8.4	1.4	1.6	17.9
Energy	**-4.6**	-8.3	-14.8	-8.4	-12.0	-10.0
Gold	**-6.8**	2.9	-13.1	-18.7	-19.4	-2.6
Materials	**-7.5**	-6.6	-15.1	-13.4	-16.3	6.3
Health Care	**-15.8**	-17.9	21.6	63.7	8.1	32.7
REITs	**0.3**	-2.8	-0.4	6.1	3.4	3.8
Income Trusts	**-1.4**	-4.1	-2.9	-0.7	-2.5	4.5
S&P/TSX Small Cap	**-3.4**	-6.9	-9.8	-8.5	-12.7	0.3
S&P/TSX 60 Large Cap	**-3.7**	-7.8	-9.6	-6.0	-7.9	6.6
S&P/TSX Mid Cap	**-4.0**	-8.2	-9.2	-7.2	-8.9	4.2
TSX	**-3.8**	**-7.9**	**-9.5**	**-6.3**	**-8.1**	**6.0**

Source: Bloomberg