# MARKET RECAP

October 2023

Rotman Commerce
Trading Group

# CONTENTS

# GLOBAL MARKETS INSIGHT

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- Market Snapshot – Geopolitical tensions, driven by the Israel-Hamas conflict and potential Iranian involvement, impact global markets with oil prices at ~$80/barrel. European markets face trade implications and inflationary pressures due to supply crunches. Meanwhile, housing markets show mixed performance, with rising mortgage rates, shrinking inventories, and struggling commercial office spaces, notably with WeWork's bankruptcy. Industrial and Multifamily properties, however, maintain defensive qualities amid lowered demand, supporting rent growth and occupancy levels.

- Fixed Income Markets – Global central banks, including the Bank of Canada, maintain a "higher for longer" stance on interest rates to control inflation. Weakening economic activity in Canada leads to a steady policy with rates at 5%. The US and China experience varying economic trends, with the Federal Reserve keeping rates unchanged amid strong Q3 activity. ECB interest rates remain stable. Treasury yields show an initially inverted curve but steepen later due to geopolitical events and a strong CPI report, ending with 2-year treasuries at 5.08%, 5-year yields at 4.86%, and 10-year yields at 4.93%.

- Commodity Markets – Gold prices rose to $1,994.3 per 100 troy ounces, driven by economic slowdown, weak corporate earnings, and geopolitical tensions. Silver also increased from $22.45 to $22.95 per 5,000 troy ounces. Investors may shift to commodities for inflation hedging amid persistent energy prices and market volatility. The commodity market outlook is influenced by OPEC+ oil output cuts and geopolitical events like Israel's occupation of Palestine. Top oil exporters, Saudi Arabia and Russia, commit to voluntary output cuts until next year, aiming to maintain market stability amid concerns over demand and economic growth.

- Equity Markets – the S&P 500 corrected by 2.20%, with small and microcaps underperforming, while geopolitical events boosted safe-haven assets; positive Q3 earnings were tempered by lower-than-average growth, and rising Treasury yields at month-end, prompting cautious investor sentiment despite steady central bank rates.

# MARKET SNAPSHOT

## Equity Market Snapshot

***as of October 31st, 2023***

| INDEX | MTD RETURNS | YTD RETURNS |
|---|---|---|
| S&P500 | -2.21% | 9.67% |
| NASDAQ | -3.43% | 23.72% |
| DJIA | -1.14% | -0.25% |

## Central Bank Watch

| Central Bank | Current Key Interest Rate | |
|---|---|---|
| Bank of Canada | 5.0% | The BoC decides against an October hike, holding rates steady at 5.0% once more. A slew of data pointing to a cooling economy - subdued consumption, softer demand for housing/durable goods - sees the bank more than happy to stand on the sidelines as inflation falls back to its 2% target by 2025. |
| U.S. Federal Reserve | 5.5% | The Fed holds interest rates steady for the second consecutive time. The November 1st meeting saw Chair Powell stress the need for a careful "wait-and-see" approach despite a tight US labour market and continued strong GDP growth. |
| European Central Bank | 4.50% | October saw the ECB put an end to an aggressive streak of 10 consecutive rate hikes as signs of easing price pressures permeate through the economy. ECB president Lagarde hinted at steady policy ahead, while leaving the door open to future hikes if necessary. |

# MARKET SNAPSHOT

## Macro News Spotlights

*Geopolitical Tensions on the Rise*

In early October, the Israel-Hamas war initially sent stocks to plummet with oil prices remaining mixed coming off various factors. As supply crunches continue to ripple markets, increased US oil production and relatively low impact from the Middle Eastern conflict have resulted in prices closing at ~$80/barrel on month's end. Participation from Iran on the Israel-Hamas conflict may result in surging prices however as the U.S. shared its sentiment on greater sanctions if involvement were to increase.

Trade implications remain to be a novel risk within European Markets, as regional trade routes will see less activity, while financial conditions tighten and higher energy prices drive inflationary pressures across the continent. A potential tension-spillover into Iran and Lebanon will see European markets struggle to adjust to rising commodity prices off of lower supply, however given the Euro areas limited export exposure to Israel and its peer groups, overall risk in the eyes of the EU economy remains moderate

*Housing Markets Revealing Mixed Performance*

Housing markets are churning trouble as mortgage rates continue to rise, while total inventories continue to shrink and market supply wanes. While borrowing remains expensive for buyers, consumers are still aiming to lock in current rates before potential increases - leading to some buying activity across markets. On the Commercial front, little has changed as Office performance continues to vastly struggle, most notably with the meteoric fall of WeWork. The leading provider of office space and workplace solutions filed for bankruptcy after hefty losses left them in a pool of debt they couldn't pay back. Industrial and Multifamily properties however continue to see their defensive qualities bolster performance, albeit with overall rent growth decreasing from lowered demand. Vacancy rates for industrial real estate sit below 20 year-averages, while Multifamily properties are supported by their income-producing nature, coming off record investment levels while still maintaining robustness across price and occupancy levels.

# MARKET SNAPSHOT

Bond yields retreated slightly this month as positive earnings and resilient economic data has eased selling pressure. Yields continue to remain high however as investor sentiment continues to fluctuate from the sticky inflation, rising valuations, relatively weak risk premiums, and geopolitical tensions. Rate risk continues to be a play-by-play environment, where the Fed has expressed their tone in slowing hikes for now and letting economic data/financial conditions dictate necessary action; this comes after a second consecutive pause announced at the end of October.

**October Deals**

Chevron headlined October with its agreement to acquire Hess Energy for $53 Billion, sparking a potential precedent for oil megamergers as analysts predict a 7% arbitrage spread on a 6 month timeframe for closing. While great for Chevron, midstream consumers are looking at price hikes resulting from the deal, pushing senators to urge the FTC into probing the acquisition. As price pressures move downstream, this could result in retail consumers feeling the effects of energy conglomerates as gas prices rise and total output shrinks. Other notable deals include ExxonMobil's acquisition agreement of Pioneer Natural Resource at a purchase price of $253 per share, and Stonepeak Capital acquiring Textainer – a leading marine cargo supplier – for $7.4bn on a 46% premium. Overall deal flow remains lower on a YTD basis, but October saw an uptick with ~$319bn in transactions recorded globally during the month.

# FIXED INCOME

## Interest Rates and Policy Decisions

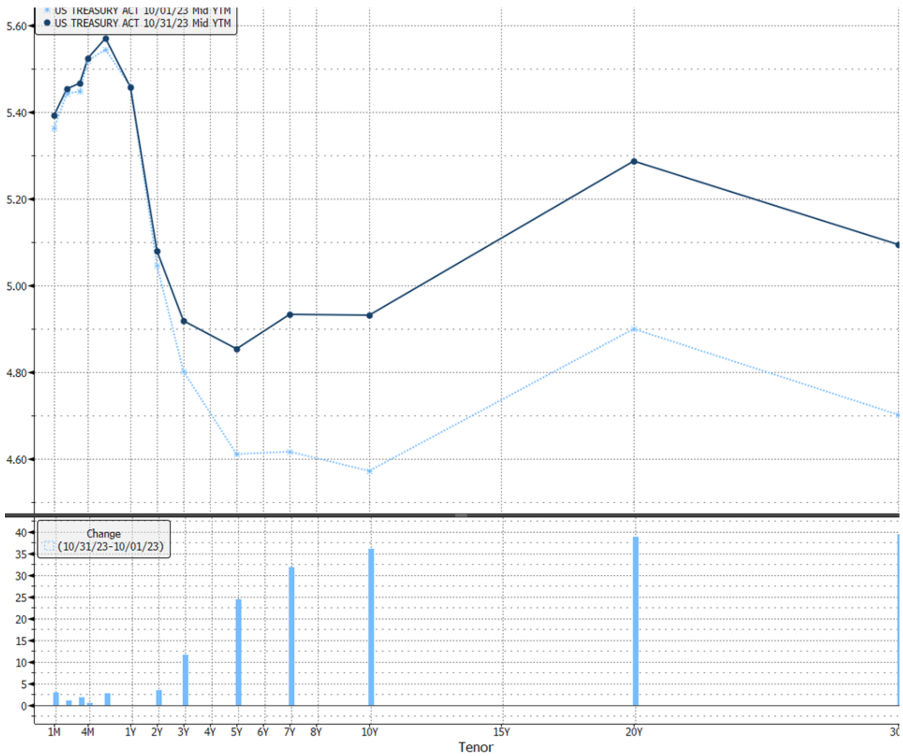
The “higher for longer” sentiment continues as Central banks fight to tame inflation; luckily, there are clear signs that previous rate hikes are coming into effect, demonstrated by the dampened economic activity. This month, Canadian consumption weakened, along with softer demand for durable goods, housing, and services, which helps to relieve price pressures. As a result, during the October meeting, the Bank of Canada indicated that policy rates will be maintained, and quantitative tightening will continue. The target for the overnight rate will be held at 5%, bank rate at 5.25%, and the deposit rate at 5%. Bank inflation projections remain around 3.25% until mid-2024, with expectations of returning to the 2% target in 2025. Although there is progress towards lower inflation, the Governing Council is concerned about its slow pace and possibility of increased inflationary risks. The bank remains vigilant and is prepared to raise policy rates further if needed. A notable factor in the difficult fight against inflation is consumer expectations, which surveys suggest are high.

Globally, there remains similar inflation and rate trends in the US, China, and Europe. Although there was stronger than expected US economic activity, which was fueled by consumers, China experienced weaker demand. During the latest FOMC meeting, rates are left unchanged, staying in the 5.25-5.5% target range. Economic activity was reported to be expanding at a strong pace in Q3, while the reduction pace of treasury and MBS holdings will remain the same. ECB interest rates, similarly, remained unchanged this month, at a deposit facility rate of 4.0%

## Treasury Yields

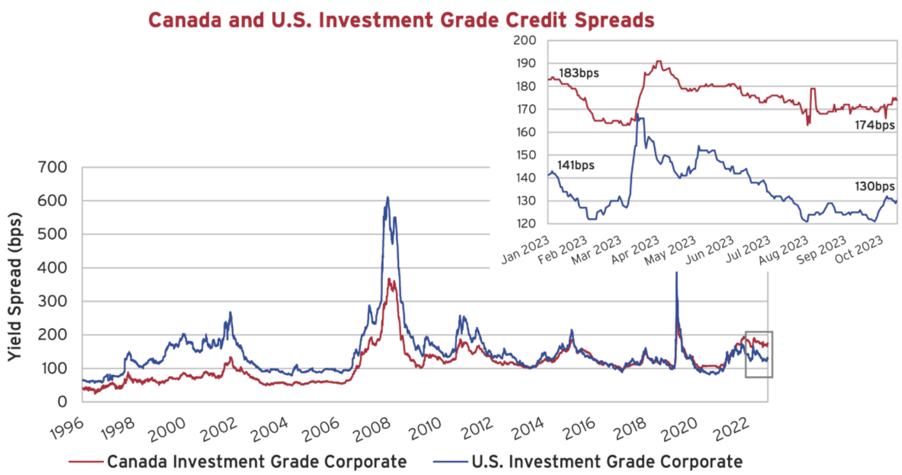
The month started off with an inverted yield curve, with 2-year yields being well above 5 and 10-year yields. In the first half of October, yields retreated slightly due to the conflict in the Middle East and the Federal Reserve suggesting an end to rising rates. However, a strong CPI report fueled expectations that interest rates will remain elevated and that the government will further increase bond sales due to widening deficits. This led to treasury yields, especially longer tenors, to climb for the rest of the month, effectively steepening the yield curve. The month ended with 2-year treasuries up 3.4 bp to 5.08%; 5-year yields up 24.4 bp at 4.86%; and 10-year yields up 36 bp to 4.93%.

# FIXED INCOME




## Credit Spreads

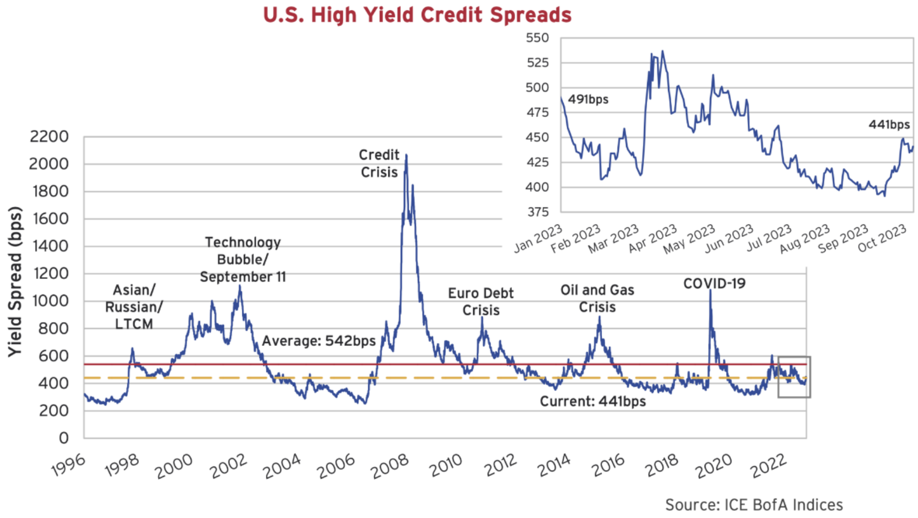
In contrast to recent volatility in government rates, corporate credit spreads have remained fairly steady through October. Canadian investment grade spreads were 171 basis points at the end of the quarter, while U.S. spreads were 127 basis points.




Source: ICE BofA Indices

# FIXED INCOME

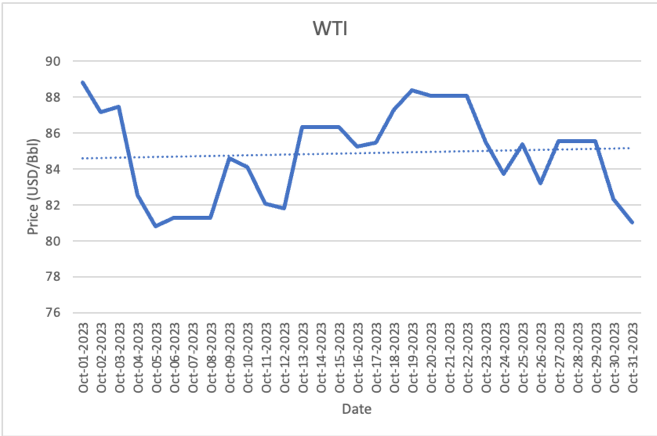
High yield credit spreads were also relatively stable during October. High yield spreads in the U.S. closed out at 416 basis points, a tightening of 9 basis points at the end of the quarter. It appears that spreads are not offering enough of a risk premium to compensate investors in these current market conditions by being well below its long-term average.

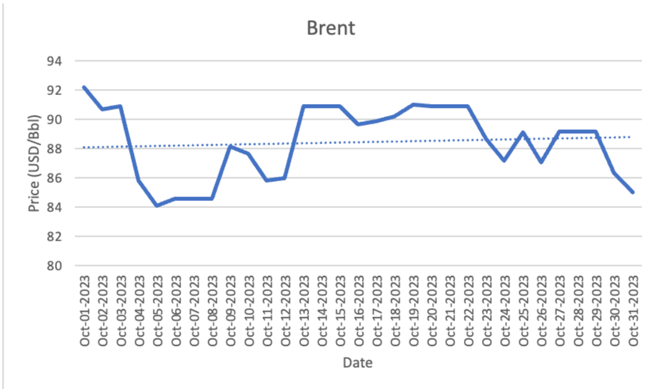


# COMMODITIES

## Crude Oil

At the onset of the month, oil priced high leading off from September gains. Over the month prices greatly fluctuated with a total drop of around 8%. OPEC output rose 180,000 bpd from September. With a sharp escalation in geopolitical risk stemming from the Middle Eastern conflict, traders priced in a $3-4/bbl premium on October 7th. This premium has since settled off, with no further impacts on the current oil prices. The conflict's impact on crude oil markets might escalate if the surrounding oil producing countries are involved. Furthermore, higher prices can boost inflation leading to further rate hikes from the Fed and BOC. Saudi Arabia and Russia confirmed their voluntary cuts through until December. This was contrasted with Nigeria's increased output by ~50,000 bpd. Angola also saw output increases this month lowering prices. The US and Venezuela agree to provide relief from oil sanctions in exchange for more open elections next year. Brent traded at an average $88.46 USD/bbl as prices saw a 7.79% fall. WTI traded at an average of $84.86 USD/bbl as prices fell by 8.76%.



# COMMODITIES

## Gold

The heightened slowdown in economic activity combined with the continued mounting of macro risks, have been reflected in the price movement of gold for the month of October. Weakness in corporate earnings, volatility in Canadian inflation data, and heightened geopolitical tensions guided investors to a flight to quality in commodities. Gold Forward Contracts finished up $1,994.3 for 100 troy ounces compared to $1,866.1 at the beginning of the month. Much like gold, Silver Forward Contracts experienced an appreciation in price from $22.45 at the beginning of the month to $22.95 per 5,000 troy ounces. While silver demonstrated an increase in the forward price, the mean forward price for the year is $23.27/5000 troy oz. With a rise in energy prices and volatility across debt and equity capital markets, investors will look to allocate a larger proportion to commodities as a method to hedge against the sustained higher levels of inflation being combated by elevated interest rates. As a result, demonstrable appreciations in commodity prices enable the possibility of returns likely to be above the settlement price in forward contracts. Thus, it is perhaps that the price action for most precious metals reveals weaknesses in the 'soft landing' outcome that policymakers across the world have been determined to achieve since the hiking of rates in early 2022. That being said, volatility in equity markets may produce temporary rallies and investors may look to pick up stocks over commodities.

## Forward Outlook

The commodity market is heavily dictated by the global political scene. Currently, two distinct events will carry the market's course for the next months: OPEC+ countries introducing additional voluntary oil output cuts and Israel's occupation of Palestine.

With lingering effects from the Russian-Ukraine war, oil prices overall have not been falling. These hikes have been supported by the precautionary efforts of top oil exporters, Saudi Arabia and Russia, who have confirmed additional voluntary oil output cuts until the end of the year. The decision arises from the countries' concern over demand and economic growth continuing to weigh on crude markets, cutting their output in a way to support the market's stability and balance. Despite the promise to evaluate the need for this action every month, it appears that OPEC+ countries will continue to stick with output cuts till the beginning of next year as tensions persist and rise in Russia and the Middle East.

# COMMODITIES

The Israeli conflict has only surged the commodity markets further as fear of the war's impact on the oil supply from the Middle East heightened, and the demand for safe-haven assets such as gold boomed. With the Middle East encompassing nearly a third of the global oil supply, the global economy could face severe repercussions if the conflict expands in magnitude, particularly to Iran. Bloomberg Economics estimates a rise in oil prices up to $150 a barrel and a drop in global growth down to 1.7%, resulting in a potential recession that takes approximately $1 trillion off world output. Consequently, the market can expect to experience higher oil prices, higher inflation, and slower growth, with the effect being at risk of reaching a global status.

# EQUITIES

## North America

Continuing the trend from September, the S&P 500 was in correction mode and down 2.20%. The index's YTD still remained positive at 9.23%, but nonetheless a drop from its July 2023 high. For the third straight month, US equities continued to fall with small and microcaps being the worst performers. The Russell 3000 dropped by 2.7%, while the Russell Microcap booked a 7.2% decline. The Nasdaq Composite slipped by 2.80%, while the Dow Jones Industrial Average declined by 1.40%. The S&P/TSX index dropped to its lowest point in October since a year ago after US job opening data suggested continued strength in the economy and the potential for higher rates. The US budget gap increased to $1.7 trillion due to growing deficit spending, with the expectation of higher Treasury bill issuances.

This month, we have seen more buying than selling in the equities market amidst instability. Although the market tends to overlook geopolitical events, inflation, and oil prices can be heavily impacted by regional conflicts. Following the October 7th attacks and a war breaking out in the Gaza Strip, safe-haven assets became a more attractive investment option.

In the second half of the month, Q3 earnings began to roll out. With 57% of S&P 500 companies reporting earnings, 80% have a positive EPS surprise. Once again, Consumer Discretionary stocks reported the highest EPS upside, beating expectations by 14.20%. Although the blended earnings growth of around 2.80% is beating expectations, the magnitude of those surprises is lower than the 5-year average. With most investors carrying a bearish sentiment, any potential rallies were quickly sold. Toward the end of the month, the 10-year Treasury yield was traded above 5% for the first time since 2007. Accompanied by strong retail sales and Q3 GDP, investors had to adapt to the potential of higher rates for a sustained amount of time. This idea inevitably hurt stock sentiments.

On the last day of the month, the Federal Reserve announced that the target rate would be held steady in the range of 5.25%-5.50%. A similar decision was made by the Bank of Canada on the 25th of October. Canada's unemployment rate rose to 5.70%, marking the fourth consecutive month of rising jobless rate and suggesting that we are nearing the end of rate hikes. Historically, November has been the best-performing month of the year for stocks. With the remainder of Q3 earnings as well as key economic data being released in November, the consensus looking ahead remains optimistic.

# EQUITIES

## Europe, Middle East, and Africa (EMEA)

On October 7th, around 6:30 AM local time, the Palestinian militant organization Hamas launched its most significant attack in 50 years against Israel, firing over 5,000 rockets from the Gaza Strip. This aggressive move had a notable impact on international markets, causing a surge in oil prices by at least 3%. The EMEA region witnessed a substantial drop in key stock indices, with Israel's TA-35 stock index taking a significant hit, plummeting by 6.4%. Additionally, the Tadawul All Shares Stock in Riyadh fell by 1.6%, and stocks in Qatar, Kuwait, Oman, and Bahrain also experienced weakening. The decline in equity futures, especially in the EMEA region, indicates that investors are wary of the economic impact of this conflict, with Israel's stock index taking a particularly hard hit.

Airlines stocks, including Delta, United, and American Airlines, as well as European carriers like International Airline Group and Lufthansa, all saw declines owing to the geopolitical instability which can reduce travel demand and operational challenges.

On a different note, European markets displayed strength as investors eagerly awaited the next interest rate decision from the U.S. Federal Reserve. Furthermore, the Euro's inflation rate fell to a two-year low of 2.9% in October. The STOXX 600 index ended 0.7% higher, maintaining positive momentum despite a lackluster performance in September 2022. Some sectors including retail stocks climbed by 1.7% after NEXT, a U.K. clothing and homeware company, increased its profit outlook for the fourth time in six quarters.

## Asia Pacific (APAC)

In the third quarter, China's GDP displayed robust growth, accelerating at an annualized rate of 4.9%. This uptick was primarily attributed to a series of stimulus measures implemented by the Chinese Communist Party (CCP), including interest rate reductions and increased liquidity within the banking system. These measures were intended to bolster economic activity and alleviate some of the challenges brought about by the COVID-19 pandemic.

# EQUITIES

However, beneath this economic growth lies a troubling issue within China's real estate sector. Major real estate developers, such as Evergrande and Country Garden, are grappling with spiraling debt problems. Over-leveraged firms, both in the commercial and residential real estate segments, have experienced an unprecedented wave of defaults and bankruptcies. This crisis in the real estate industry is compounded by a sluggish post-pandemic recovery in China. High youth unemployment, a lack of consumer confidence, and a decline in foreign investments have all contributed to the challenging economic landscape.

On a different note, Japan's stock market saw positive results following the Bank of Japan's decision to allow greater flexibility in controlling long-term bond yields. This move was aimed at managing the impact of rising U.S. bond rates, which had led to a flow of money towards the U.S. dollar. By permitting some flexibility in the 1% cap on long-term bond yields, the central bank aimed to discourage speculative trading and address Japan's own inflation concerns. This policy shift has had a positive impact on consumption and investment behaviors in Japan, particularly among younger demographics who have shown a willingness to accept price increases without altering their purchasing habits, thereby supporting capital expenditure and capacity expansion

In India, the Adani Group found itself embroiled in controversy as Hindenburg Research made allegations against the conglomerate, implicating Prime Minister Narendra Modi and raising concerns in the lead-up to upcoming elections. The allegations revolved around complex offshore accounts used to manipulate share prices. As a response, India is tightening transparency rules for "high-risk" foreign investors, and regulators are refining their disclosure policies to facilitate investigations into suspicious investors. The Indian government's actions are a response to the significant foreign investments in Indian equities, with some investors holding up to 50% of Indian assets under management in one company or corporate group, or having invested over $3 billion USD in Indian equities.

## Mergers & Acquisition

The global economy is currently experiencing a slowdown, largely due to the recent hikes in interest rates. These increases have led to a tightening of financial conditions, which in turn has put a damper on economic activity. Furthermore, there is a palpable sense of fear in the market, with investors becoming increasingly cautious. This caution is manifesting itself in reduced spending and investment, further contributing to the economic slowdown.

In the midst of this economic climate, one significant development has been the agreement between “Broadcom Inc” and “VMWare Inc”. Broadcom, a leading technology company, announced its decision to acquire software maker VMWare for $61 billion. This acquisition is noteworthy for several reasons. Firstly, it represents a major consolidation in the tech industry, potentially leading to increased efficiencies and synergies. Secondly, it signals Broadcom’s strategic shift towards software, which could have far-reaching implications for its future growth. Finally, despite the economic slowdown and market fears, this deal demonstrates that significant investments and acquisitions are still taking place. This could be seen as a sign of confidence in the long-term prospects of the tech industry.

## Initial Public Offerings (IPO)

In October 2023, the renowned footwear company, Birkenstock Holding Limited, went public. The company completed its Initial Public Offering (IPO) on October 10, raising approximately $1.48 billion. This IPO is particularly interesting as Birkenstock is a well-established brand since 1774. The company’s decision to go public could be seen as a strategic move to raise capital for further expansion and growth. Moreover, Birkenstock’s wide range of products, including sandals, shoes, closed-toe silhouettes, skincare products, and accessories for men, women, and kids, indicates a diverse product portfolio that could appeal to a broad investor base.

On the other hand, WeBuy Global Ltd, a Southeast Asian community-oriented e-commerce retailer, also announced its IPO in October 2023. The company priced its initial public offering of 3.8 million ordinary shares at $4.00 per share, raising approximately $15.2 million. This IPO is noteworthy due to WeBuy Global’s unique business model. The company focuses on building a strong community network and offers a wide range of products on its platform, including food and beverage, fresh produce, as well as lifestyle and other personal care items. Its operations in Singapore, Indonesia, and Malaysia highlight its presence in the rapidly growing Southeast Asian e-commerce market. This could potentially offer investors an opportunity to tap into this growth.

# PICKS OF THE MONTH

## TRENDS IN CHINA REAL ESTATE

- Policy Pivoting to positive tone – turn from "house not for speculation" to "optimizing policy adopt major changes in new demand and supply dynamics". September stimulus is expected to help boost the nation's property market and consumer confidence to strengthen the falling yuan.

- Fundamental issues remaining – low average disposable income, high unemployment rate and oversupply haven't been resolved yet. In October, the real estate data is not as effective as what people think.

- Tier 1-2 cities are enjoying the policy tailwind while the lower cities are lagging – top-tier cities in China are still attractive to most of the population, and citizens continue to be wealthy there. They benefit from the policy tailwinds, while the low-tier cities remain disappointed. Additionally, baby boomers' upgrading demand drives the real estate market in top-tier cities.

- SOE is benefiting while POE is suffering – SOE has more land banks in top tier cities while less leverage given government assistance, surviving the crackdown and consolidating the market share from POE.

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