Johnstone Wealth Management Market Commentary September 30, 2023

After an optimistic start to the third quarter, stock markets reversed course in September, where both bond and equity markets declined as the economy continued to show resilience and strengthen. While it doesn't happen often, good economic news is sometimes not good for the markets.

The Bank of Canada and the US Federal Reserve both raised their policy rate by 0.25% (to 5% and 5.5%, respectively) and kept their options open for more increases. Markets had been wrestling with the seemingly imminent possibility of a recession but, during the quarter, shifted their view to a soft-landing scenario (i.e. a slowdown without a recession). Investors now believe that policy interest rates will likely need to stay high for longer in order to keep inflation in check. Increased federal debt financing needs and political dysfunction in the United States also contributed to the increased uncertainty.

The Canadian bond market posted one of its historically worst quarters with a 3.9% loss. The longer the maturity, the worse the performance, with the FTSE Long-Term Bond Index down 9.5% while the Short-Term Bond Index was off by just 0.1%. Bonds of corporate issuers generally outperformed Federal bonds. Several factors contributed to the poor performance in the bond market, including disappointing Canadian inflation figures, a Fed that signaled its intention to remain restrictive for even longer, and, finally, a major ramp-up in debt issuance by the U.S. Treasury.

Momentum in global equity markets stalled in the third quarter as concerns around rising interest rates and energy prices hampered returns in most markets. Regionally, European stocks posted their weakest quarter in the past year, emerging markets were also negative, with post-pandemic recovery in China progressing slowly and ongoing concerns in property markets hampering investor sentiment. Canadian indices fared similarly to other developed global markets, with a positive return in the significant energy sector helping to offset negative results in other key sectors. US markets were also negative, with the technology sector pulling back after a strong run.

As we look forward at markets, there will be several key variables to monitor: the evolution of the economic conditions in China, inflationary dynamics, the outlook for interest rates, and the potential for a recession are all factors to evaluate in the upcoming months. The current economic climate remains highly uncertain, and investors should expect market volatility to continue for some time. We believe what's most important is being disciplined in adhering to the variables that we can control, such as risk management, active management and asset allocation. Given the wide range of possible scenarios, we remain balanced in our approach in an effort to build resilience over the long-term and not being overly exposed to any one outcome.

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