Canada Outlook

Maintaining positive outlook, but choppy global waters encourage our defensive stance

Key takeaways

- Both the Canadian and US equity markets finished the third quarter slightly lower after rising and falling over the last three months.
- Fears of higher interest rates acting as a drag on future economic growth was the primary driver.
- The inflation picture is continuing to improve in developed markets, but sticky core inflation raises the probability of small additional rate hikes.
- The phrase "higher for longer" has emerged as the dominant view when it comes to describing the interest rate outlook in most markets.

Q3 review and outlook

Both the Canadian and US equity markets finished the third quarter slightly lower, after rising and falling over the last three months. Fears of higher interest rates acting as a drag on future economic growth were the primary driver. We maintain our forecast of recession in developed markets, with Canada facing the prospects of perhaps a milder recession than what is forecast in some other economies.

The inflation picture is continuing to improve in developed markets, but sticky core inflation raises the probability of small additional rate hikes. The phrase "higher for longer" has emerged as the dominant view when it comes to describing the interest rate outlook in most markets.

According to the OECD, the interest rate hikes already working their way through the global economy are projected to slow the pace of global expansion from 3% this year to 2.7% in 2024.

Central bankers in key markets continue to set the agenda

On September 6, the Bank of Canada held its target for the overnight rate at 5%. Economic growth in Canada was hampered in the second quarter by one-off factors such as severe wildfires and striking dockworkers in Vancouver, pushing the economy into a small contraction. An expected rebound in third-quarter economic growth will probably be fleeting, as higher interest rates continue to take their toll.

In a statement, the Bank of Canada's Governing Council said it "remains concerned about the persistence of underlying inflationary pressures, and is prepared to increase the policy interest rate further if needed." The Governing Council indicated it will continue to assess the dynamics of core inflation and the outlook for CPI inflation, reasserting that the Bank remains "resolute in its commitment to restoring price stability for Canadians."

Globally, the focus remains on persistent inflation

Tightened credit conditions are continuing to slow the eurozone economy. The European Central Bank increased policy interest rates by 25 basis points at its September 14 meeting. The deposit rate was adjusted to 4%. Our expectations are for a recession to potentially begin in the first quarter of 2024.

Meanwhile, in the US, economic activity is proving more resilient, but it's showing signs of moderating. The US Federal Reserve left the federal funds rate unchanged at 5.25-5.5% on September 20. We see rates staying higher for longer, which will undermine consumers and likely contribute to recessionary pressures. We forecast a US recession potentially starting in the fourth quarter of this year.

- In this economic and market environment, our portfolio strategy has not changed from the last quarter, and we remain defensive in our asset mix.
- While we believe a defensive portfolio positioning is still appropriate, it does not mean we are unenthusiastic about prospects for specific sectors and some of the attractive names they contain.
- We are slightly overweight Canadian equities compared with US and European equities, given attractive relative valuations in Canada.

The Bank of England left rates unchanged at 5.25% at its September 21 meeting—the first meeting without a hike since November 2021. Persistent inflation pressures are likely to limit the Bank of England's ability to ease rates and a recession is forecast to start early in 2024. But we see the potential for rate cuts during the second half of 2024.

In many emerging markets, inflation is much less of a concern. There are risks that a global slowdown may dampen trade revenues, but this could be partially offset by a weaker US dollar. China remains a source of some volatility, with ongoing pessimism connected to its indebted property market weighing on growth. Weaker Chinese growth has added implications for Canada's export-oriented economy. However, signs emerged from a July Politburo meeting that China's leaders are throwing more weight behind fiscal policies targeted to support economic growth.

S&P/TSX Composite Index and Sector Performance
(period ended September 30, 2023)

	3-Month	1-Year	3-Year*	5-Year	10-Year*
S&P/TSX Composite Index	-2.20%	9.54%	9.88%	7.27%	7.54%
Healthcare	14.48%	3.37%	-22.47%	-30.76%	-22.84%
Materials	-3.76%	4.75%	-0.44%	9.19%	4.81%
Energy	10.27%	17.38%	33.82%	9.08%	4.08%
Real estate	-6.05%	3.42%	4.53%	1.71%	7.14%
Information technolog	-7.52%	53.63%	-5.85%	15.69%	18.33%
Financials	-2.61%	4.40%	13.38%	6.45%	9.23%
Consumer discretionary	-7.08%	12.52%	11.67%	6.48%	9.30%
Consumer staples	-1.18%	12.60%	9.69%	12.01%	13.14%
Communication services	-12.55%	-5.27%	3.98%	3.76%	7.01%
Utilities	-11.96%	-14.26%	-0.79%	7.67%	7.22%
Industrials	-4.22%	11.81%	9.64%	9.40%	12.57%

*Compound annual rate of return. Source: Bloomberg as at September 30, 2023. Performance stated in Canadian dollar total returns.

Defensive positioning does not rule out potential opportunities associated with a longer-term view of value

In this economic and market environment, our portfolio strategy has not changed since the last quarter, and we remain defensive in our asset mix. Some riskier asset classes such as equities and higher-yielding fixed income continue to suggest they are pricing in a soft economic landing. This is inconsistent with our central global scenario of economic recession.

But while we believe a defensive portfolio positioning is still appropriate, it does not mean we are unenthusiastic about prospects for specific sectors and some of the attractive names they contain.

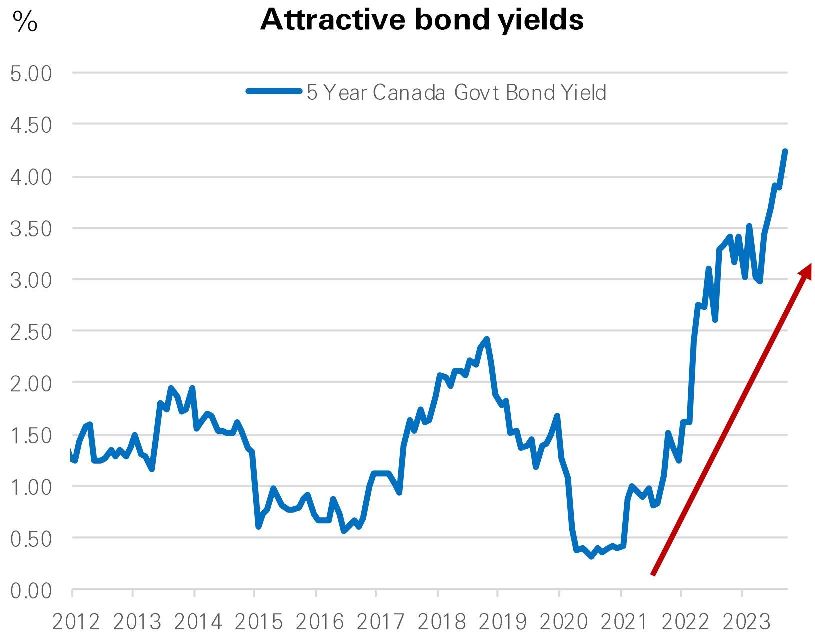
We are slightly overweight Canadian equities compared with US and European equities, given attractive relative valuations in Canada. Our fixed income positioning is taking advantage of higher short-term rates balanced with an overweight to corporate bonds to capture the higher yields they offer over government bonds. Select companies in the Canadian energy and industrial sectors are trading at attractive prices, and Canada's banks continue to offer exceptional yield opportunities.

- Short-duration government bonds are attractive and can outperform when a recession materializes.

These encouraging views are important for investors to consider as they contemplate moving to cash or potentially attractive GIC rates in the 5% range. Cash carries the downside of being reduced in value by inflation. Earning a solid return on a GIC could mean missing out on more attractive capital growth opportunities in fixed income.

Fourth-quarter outlook: Recessionary pressures mount but do not preclude taking advantage of yield opportunities

Short-duration government bonds are attractive and can outperform when a recession materializes. When central bankers finally begin to cut interest rates, bond holders will be positioned to enjoy the ensuing capital gains. Investment-grade fixed income can also be a good portfolio addition, offering higher yields with reduced default risk.



Source: Bloomberg as of September 29, 2023. Past performance is not indicative of future returns.

- We retain our ongoing commitment to building diversification and resilience into our portfolios in order to encourage investors to remain confidently invested for the long term.

Cautiously positioned and fully focused on quality opportunities for capital appreciation

On balance, we believe the way to navigate uncertain markets is by being fully focused on quality in ways that encourage long-term capital appreciation while retaining the ability to act decisively when conditions warrant. We also retain our ongoing commitment to building diversification and resilience into our portfolios in order to encourage investors to remain confidently invested for the long term.

Important Information:

Sources include HSBC Global Research, Statistics Canada and the Bank of Canada.

This document or video has been prepared by HSBC Global Asset Management (Canada) Limited ("AMCA") and is distributed by and/or made available to clients of HSBC Investment Funds (Canada) Inc. ("HIFC"), HSBC Private Investment Counsel (Canada) Inc. ("HPIC") and the HSBC InvestDirect division within HSBC Securities (Canada) Inc. ("HIDC") ("we" refers to AMCA, HIFC, HPIC, and HIDC collectively).

The contents of this document or video may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose or otherwise, without the prior written permission of AMCA. All non-authorised reproduction or use of this document or video will be the responsibility of the user and may lead to legal proceedings.

The material contained in this document or video is for general information purposes only and does not constitute advice or a recommendation to buy or sell investments. Some of the statements contained in this document or video may be considered forward-looking statements which provide current expectations or forecasts of future events. Such forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. We do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document or video has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed herein are those of AMCA at the time of preparation and are subject to change at any time. These views may not necessarily indicate current portfolios' composition. Individual portfolios managed by AMCA primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document or video is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held, the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Economies in emerging markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade.

We accept no responsibility for the accuracy and/or completeness of any third-party information obtained from sources we believe to be reliable, but which have not been independently verified.

This information has been prepared for informational purposes only and is not intended to provide and should not be relied on for accounting, legal or tax advice. You are advised to obtain appropriate professional advice where necessary.

All products and services of HIFC, AMCA, HIDC and HPIC are only available for sale to residents of Canada, unless the laws of a foreign jurisdiction permit sales to its residents. Please contact one of our mutual fund representatives or HPIC Investment Counsellor for more details. The contents of this report should not be considered an offer to sell or a solicitation to buy products or services to any person in a jurisdiction where such offer or solicitation is considered unlawful.

Important Information about HSBC Global Asset Management (Canada) Limited ("AMCA")

HSBC Asset Management is a group of companies in many countries and territories throughout the world, including AMCA, that are engaged in investment advisory and fund management activities, which are ultimately owned by HSBC Holdings plc. AMCA is a wholly owned subsidiary of, but separate entity from, HSBC Bank Canada.

Important Information about HSBC Investment Funds (Canada) Inc. ("HIFC")

HIFC is the principal distributor of the HSBC Mutual Funds and offers the HSBC Mutual Funds and/or the HSBC Pooled Funds through the HSBC World Selection® Portfolio service. HIFC is a subsidiary of AMCA, and indirect subsidiary of HSBC Bank Canada, and provides its products and services in all provinces of Canada except Prince Edward Island. Mutual fund investments are subject to risks. Please read the Fund Facts before investing.

Important Information about HSBC Private Investment Counsel (Canada) Inc. ("HPIC")

HPIC is a direct subsidiary of HSBC Bank Canada and provides services in all provinces of Canada except Prince Edward Island. The Private Investment Counsel service is a discretionary portfolio management service offered by HPIC. Under this discretionary service, assets of participating clients will be invested by HPIC or its delegated portfolio manager, HSBC Global Asset Management (Canada) Limited ("AMCA"), in securities, including but not limited to, stocks, bonds, mutual funds, pooled funds and derivatives. The value of an investment in or purchased as part of the Private Investment Counsel service may change frequently and past performance may not be repeated.

Important Information about HSBC InvestDirect ("HIDC")

HIDC is a division of HSBC Securities (Canada) Inc., a direct subsidiary of, but separate entity from, HSBC Bank Canada. HIDC is an order execution only service. HIDC will not conduct suitability assessments of client account holdings or of the orders submitted by clients or from anyone authorized to trade on the client's behalf. Clients have the sole responsibility for their investment decisions and securities transactions.

Past performance is not an indication of future returns.

Expiry Date: 31 January 2024

DK2300283A / H202310012 / PA2310001