Canada Outlook

October 2020

Using a "swoosh-onomics" lens to assess the recovery

Key takeaways

- We retain our view that the most likely scenario is a "swoosh-shaped" recovery
- The Canadian economy continued to expand in July and August, but the pace of growth slowed
- We will continue to patiently make selective investments in equities that are priced for good long-term value
- We continue to expect policymakers will remain at the core of an emerging recovery

Q3 review and outlook

We retain our view that the most likely scenario is a "swoosh-shaped" recovery for the global economy. Economic activity has picked up quickly from exceptionally depressed levels. However, after the initial surge, growth is now set to moderate as economies enter the next phase of the recovery—the "flattening of the swoosh."

Strong third-quarter data supports the view that we are entering a flatter part of the swoosh as this pickup in economic activity plays out. The Canadian economy continued to expand in July and August, but the pace of growth slowed, according to Statistics Canada.

Monetary and fiscal policies continue to support household incomes and businesses. But the growth trajectory is now set to flatten out amid abnormally high unemployment, low consumer and business confidence, and high savings rates.

Support from central bankers and other policymakers remains key to the swoosh recovery

The swoosh recovery depends to a great extent on the global economy continuing to receive ongoing support. The uncertainties around COVID-19, US politics, and the rate at which stimulus will be reduced loom large. The biggest risk to this swoosh scenario is a policy mistake that undercuts investor confidence, such as reducing stimulus too soon. While we are closely monitoring this risk, it seems unlikely stimulus will be withdrawn too soon.

We continue to expect that central bankers and other policymakers will remain at the core of an emerging recovery. The signs remain hopeful so far. Bolder-than-expected policy support around the world has improved the economic outlook and investor mindsets.

At its September 15-16 meeting, the Federal Open Market Committee of the US Federal Reserve left the target range for the federal funds rate at 0.00-0.25%. This was in line with market expectations. The Fed also maintained its guidance on asset purchases: "…over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities at least at the current pace." This commitment to stimulus and keeping rates lower for even longer comes despite the economy recovering more quickly than the Fed had expected.

The Bank of Canada struck a similar tone on September 9 when it maintained its target for the overnight rate at the effective lower bound of 0.25%. In the statement announcing the policy rate, the Bank noted: "As the economy moves from reopening to recuperation, it will continue to require extraordinary monetary policy support."

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Canadian market and economic highlights

- Markets remain extremely volatile, and we continue to cautiously rebalance our portfolios
- Caution dictates that we emphasize building resilience in our portfolios
- The S&P/TSX Composite Index was up 4.73% in the third quarter
- The FTSE Canada Universe Bond Index finished the third quarter up 0.44%

Investment strategy highlights

Markets remain extremely volatile, and we continue to use opportunities created by this volatility to cautiously rebalance our portfolios. This rebalancing has also provided opportunities to upgrade the quality of our portfolio holdings.

In fixed income, we have eliminated BBB-rated credit in favour of higher-quality corporate bonds. In equities we continue to concentrate on companies with strong balance sheets that should be well positioned to take advantage of a recovering economy. We will continue to patiently make selective investments in these and other equities that are priced for good long-term value.

We maintain our view that the economic fallout from COVID-19 is likely to be shorter term in nature as aggressive policy moves help to support markets and economies. But caution dictates that we also emphasize the importance of building resilience in our portfolios to position them to withstand a more significant and protracted global economic slowdown. Focusing on good-quality names remains central to our approach.

Market highlights

Canadian equities, as measured by the S&P/TSX Composite Index, were up 4.73% in the third quarter and down 3.09% year-to-date. Canadian bonds, as measured by the FTSE Canada Universe Bond Index, finished the third quarter up 0.44% and were up 8.0% year-to-date.

S&P/TSX Composite Index and Sector Performance

(period ended September 30, 2020)

	3-Month	1-Year	3-Year*	5-Year*	10-Year*
S&P/TSX Composite Index	4.73%	-0.03%	4.26%	7.16%	5.80%
Energy	-8.07%	-31.44%	-13.78%	-4.62%	-3.78%
Materials	9.08%	35.68%	14.07%	17.40%	-0.05%
Industrials	13.62%	14.95%	11.78%	14.22%	13.95%
Consumer Discretionary	8.44%	-5.53%	-0.69%	3.82%	9.83%
Consumer Staples	9.08%	6.18%	11.02%	8.52%	15.56%
Healthcare	-14.25%	-44.26%	-13.36%	-39.52%	-6.55%
Financials	3.99%	-12.05%	0.45%	6.52%	8.39%
Information Technology	3.63%	86.04%	47.90%	33.54%	15.71%
Communication Services	2.04%	-6.26%	2.75%	6.14%	10.00%
Utilities	11.02%	11.35%	11.94%	11.95%	8.31%
Real Estate	4.14%	-18.76%	3.37%	5.17%	8.79%

*Compound annual growth rate. Source: Bloomberg as at September 30, 2020. Performance stated in Canadian dollar total returns.

Q4 outlook: Market valuations appear broadly reasonable

- While we appear to be past the worst, the situation is far from normal

- We do not see irrational exuberance in market pricing, and valuations seem broadly reasonable

Investors questioning the rally in everything

While we appear to be past the worst, the situation is far from normal. Many investors have commented that there is an "eerie vibe" in markets due to the worry that the "rally in everything" might be on shaky foundations.

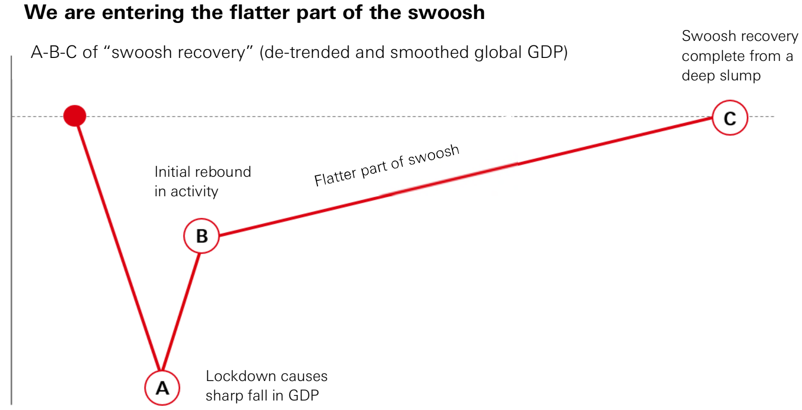
Is this "rally in everything" disconnected from economic fundamentals? Our analysis says no, and we do not see any irrational exuberance in market pricing. Pricing in many markets now discounts a swoosh-style recovery. Based on our analysis, that seems like an acceptable baseline scenario, and it means we see market valuations as broadly reasonable at this point.

A swoosh recovery with range-bound markets and periodic volatility

Our scenario for a swoosh recovery points to periodic volatility in otherwise range-bound markets. There is upside potential, linked to better news and momentum, while the downside risks are around the US election, the re-emergence of the virus, policy error, or long-term damage to economies. We view these competing pressures as roughly balanced, which could mean markets are range-bound in the coming months.

Swoosh-onomics

We are entering the flatter part of the swoosh



Source: HSBC Global Asset Management, Macrobond, September 2020

Our base-case scenario still assumes a ramp-up of testing and tracing, only isolated COVID-19 outbreaks, and a vaccine becoming available in the middle of 2021. This means the global economy will likely continue to build on the recovery that began in the second quarter and be fully established on a new, lower trajectory but with a roughly similar trend growth rate by the end of 2021.

Important Information:

All quoted returns are total returns as at September 30, 2020 in Canadian dollars. Sources include HSBC Global Research, Bloomberg, RIMES, Statistics Canada and the Bank of Canada.

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