TD Wealth


Cold Season
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Market sniffles

Brad Simpson, Chief Wealth Strategist

Back in February, we published a piece called "Relief Correction," which laid out the welcome mat for market volatility and attempted to shed some light on the turbulence we were experiencing. As we explained at the time, financial markets are part of an open, complex system and not the closed mechanical system that traditional finance experts had theorized. Markets, rather, are akin to biological systems. They have good and bad days, they learn, they adapt … and sometimes they get a bit sick.

Indeed, the early fourth quarter seems to have brought a new round of volatility, but if we're being honest, it's not something that we've really gotten accustomed to yet. Financial markets, after all, have enjoyed a long run of good health — rising stocks, falling yields, extremely low volatility — so the stumbles witnessed over the past year may seem extraordinary. They are not. In fact, these market shocks were largely inevitable, given the end of a prolonged period of intervention by central banks. Think of it this way: The markets had caught a bit of a cold but were until recently taking medication, in the form of ultra-low interest rates, to suppress the symptoms.

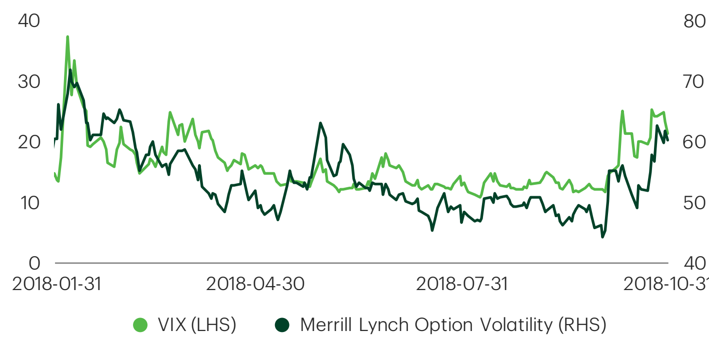
Anyone who's ever attempted to treat a cold this way knows that it's not sustainable. No amount of cough syrup will prevent your body from eventually giving up the charade and breaking down for a short recovery period. But before you fall into bed with a remote control for 24 hours of Netflix binge-watching, your system is going to become volatile. Your body temperature will change, the aches and pains will start to kick in, and the way you move will become more erratic. Markets are like this.

Consider Figure 1, which depicts volatility spikes in stock and bond markets that occurred in the winter and fall of 2018. For bond market volatility, we're using the Bank of America Merrill Lynch's MOVE Index, which tracks traders' expectations of swings in the $15-trillion U.S. Treasuries market. The equity component, meanwhile, is represented by the well-known CBOE VIX (aka the "fear index"), which measures how much equity volatility the market expects in the near term. (A higher index level means a higher level of expected volatility, and vice versa.)

In October, both indices spiked into moderately high territory, retracing the volatility that was present in the spring of this year. Our second graph (Figure 2) illustrates the same trend, with stock and bond prices declining at the same time, just as they did in the spring of 2018.

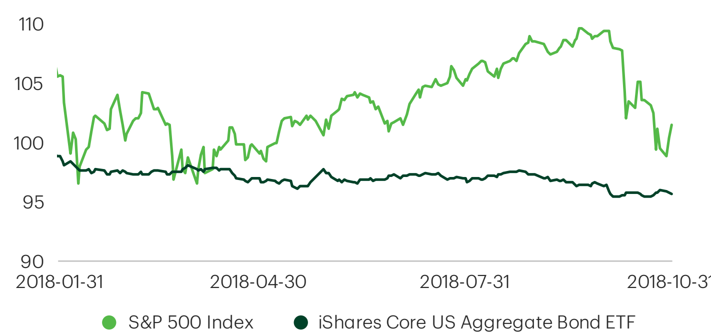
Our third graph (Figure 3), meanwhile, considers what would have happened if you had, at the beginning of the year, invested $100 in four major equity indices by region: the S&P 500 Total Return Index (in the U.S.); the S&P/TSX Composite Total Return Index (in Canada); the MSCI EAFE Total Return Index (internationally); and the MSCI EM Total Return Index in 2018 (in emerging markets). With three in considerable negative territory, and the S&P 500 just barely positive, it's hard not to conclude that our financial markets are a wee bit sick. The big question, though, is how sick?

Figure 1: Volatility on the rise
BAML Merrill Lynch's MOVE index vs. CBOE VIX



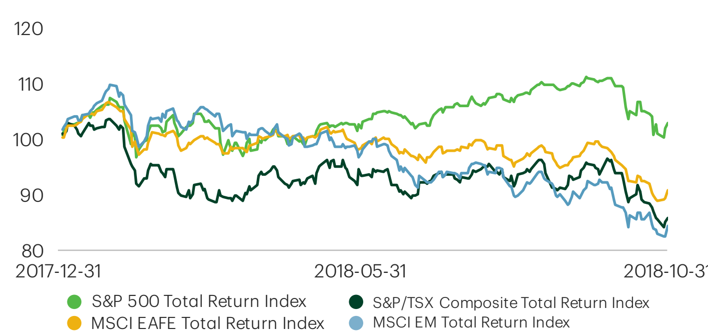
Source: Bloomberg Finance L.P. as at November 19, 2018.

Figure 2: New normal? Returns of S&P 500 Index and iShares Core US Aggregate Bond ETF



Source: Bloomberg Finance L.P. as at November 6, 2018.
Price was rebased to 100 and in USD.

Figure 3: Difficult global index returns YTD



Source: Bloomberg Finance L.P. as at November 19, 2018.
Price was rebased to 100 and in USD.

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I think most of us intuitively know that it's not a good idea to heap too much concern on the common cold. I'm not saying empathy and affection isn't good; I am just making the case that it should be dispensed with a spoon, not a fire hose. What is certainly not helpful is to engage in gross exaggerations like, "Oh my gosh, you poor thing, I'm sure you are going to die," or "I just took your temperature and have listened to your cough and I believe it would be wise to get your final affairs in order." Unfortunately, it seems that many market commentators and business reporters have yet to learn this rule.

We wrote about this in the spring of 2018 as well, but it does bear repeating: Market corrections, even modest ones, bring out the doomsday agents. Financial articles will be full of hyperbolic words like "rout," "rocketed," "imploded" and "convulsed." Strategists and portfolio managers who have made bearish predictions for years will come out of the woodwork, and their views will be validated by grave nods, despite their atrocious track records. The little benchmarked Dow Jones will be reported incessantly because it's the one with the big number and hence its numerical swings are large. Photos of distressed traders palming their faces will be everywhere. And, finally, charts will have truncated vertical axes to make small changes look big.

In the middle of all this, it's hard to keep things in perspective. Still, a little context may serve to expose the professional wailers for what they are.

Diagnosis: Correction, not capitulation

First things first. It is highly unlikely that we are in the early stages of an equity bear market. It is far more likely, rather, that we are in the middle of a correction in a long-running bull market that, while ridden hard, still has a ways to go. Correspondingly, it is likely that we are in the formative stage of a secular bond bear market, the severity of which will be determined by inflation and the direction of credit spreads.

Symptom 1: Valuations

The current S&P 500 P/E ratio is about 16.5x, which is by no means absurdly high. In fact, it's only slightly above an average of 16x since the 1950s. Similarly, most major global indices now sport valuations that range from fair to undervalued (Figure 4). Compare that to a 10-year Treasury yield that has averaged 5.6% and now sits at 3.25%.

That being said, let's address the elephant in the room: The S&P/TSX Composite Total Return Index so far this year has fallen 8.2% and has over the past 10 years consistently underperformed the S&P 500 Total Return Index. One hundred Canadian dollars invested 10 years ago in the S&P 500 is now worth $451, while the same amount invested in the S&P/TSX is worth $259 (as at November 20, 2018).

Headwinds include the indebtedness of Canadian households, overreliance on real estate as a driver of economic activity and continued underperformance of the Canadian resource sector. Perhaps the most important contributor to Canadian underperformance has been the broader trend that has seen growth assets outperform value assets, highlighted in Figure 6, which plots the performance of the Russell 1000 Value Index against the Russell 1000 Growth Index.

Figure 4: Major markets "fair valued"

	Fully Valued	Fair Valued	Under Valued
U.S. (S&P 500 Total Return Index)	○	●	○
Canada (S&P/TSX Composite Total Return Index)	○	●	○
World (MSCI EAFE Total Return Index)	○	●	○
Emerging Markets (MSCI EM Total Return Index)	○	●	○

Source: TD Asset Management Inc., Bloomberg Finance L.P.
As at October 22, 2018.

It's striking how similar these two graphs (Figures 5 and 6) are to one another. The past 10 years has seen the emergence of category killers and great disrupters — to state the obvious, names like Facebook, Apple, Amazon, Netflix and Google — that have gathered market share and investment dollars at record pace. Canadian constituents in this emergent growth category are few and far between, and this is reflected in the performance of our largest equity market index.

For all intents and purposes, the S&P/TSX is a value index, and value investing is about finding diamonds in the rough — companies whose stock prices don't necessarily reflect their intrinsic worth. Value investors seek businesses trading at a bargain. As time goes on, the market moves to properly recognize the company's value, and the price rises. This is equally true for the S&P/TSX, and it's precisely what happened in 2000 when hyper-growth U.S. stocks imploded, leading the S&P 500 to fall over 9% while the S&P/TSX rose over 6%.

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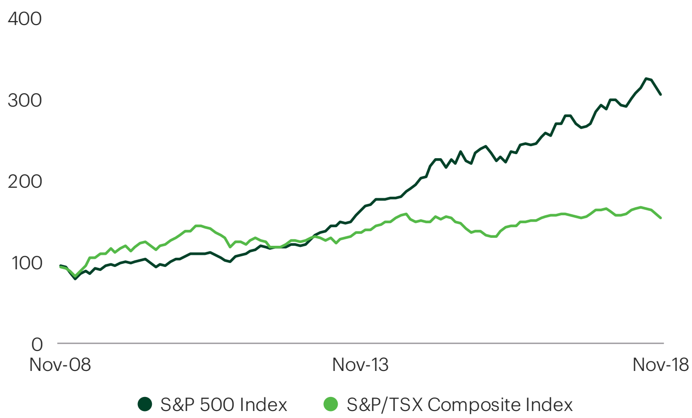
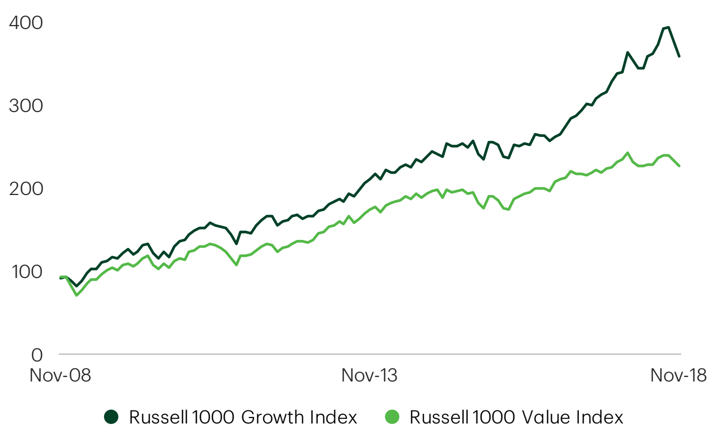
Figure 5: Long-term underperformance of the S&P/TSX



Source: Bloomberg Finance L.P. as at November 19, 2018.
Price was rebased to 100 and in CAD.

Figure 6: Long-term outperformance of growth



Source: Bloomberg Finance L.P. as at November 19, 2018.
Price was rebased to 100 and in USD.

Symptom 2: Interest rates

Back in the good old days (several months ago), when the 10-year Treasury yield was below 3%, everyone was happy. Now, with the 10-year Treasury yield at about 3.25%, real yields above 1%, and the U.S. Federal Reserve (Fed) determined to tighten further, many market participants aren't feeling nearly as self-assured as they were in the past.

It is likely that the U.S. central bank will continue its hiking regime into 2019. Fed Chair Jerome Powell recently noted that rates are a "long way from neutral," and the Fed's dot plot indicates that it will be looking to push rates up to around 3% over the next year. Other central banks are likewise in tightening mode. The European Central Bank (ECB) left its key interest rate unchanged and is staying on course to wrap up its stimulus program by the end of the year, even as risks from trade protectionism, Italian populist policies and Brexit loom.

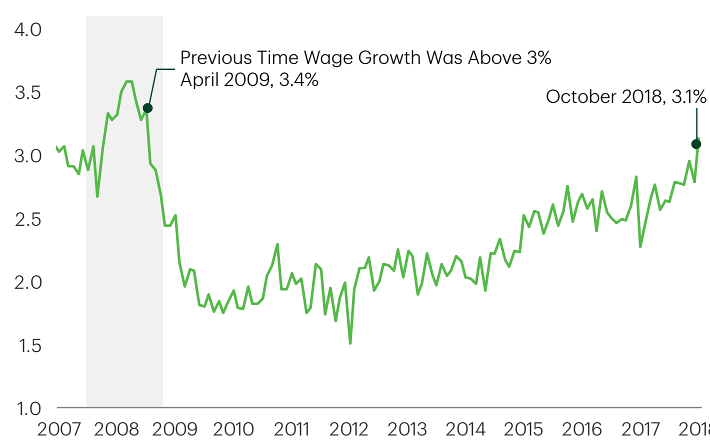
This is a critical area to watch and manage. The TD Wealth Asset Allocation Committee believes that the U.S. 10-year Treasury yield will hit a ceiling at the current range. A 10-year yield of 4%, while unlikely, is possible, but a margin for error is always wise and so we're maintaining a tactical strategy that pursues the advantages of short-term duration.

Symptom 3: Inflation

Inflation, while still below historical norms, is one of the key factors underlying the future health of financial markets. The most important factors underlying the inflation outlook, meanwhile, are employment, job growth and wage costs.

Employment is one of the real success stories of the global economy, particularly in the United States. After years of disappointment, these are halcyon days for workers in the U.S. In October, non-farm payroll grew by 250,000, the labour participation rate edged up to 62.9% and the unemployment rate fell to 3.7%, a level not seen since 1969 (Figure 7). Think about how long ago that was: 1969 was the year Neil Armstrong walked on the moon and, incidentally, the year I was born (or, in other words, ancient history).

Figure 7: Wage growth hits a new post-recession high
Average hourly earnings, year/year % change



Note: Shaded area represents NBER defined recession.
Source: TD Economics, NBER, BLS, as at November 19, 2018.

Despite the change in wage growth, inflation remains low, at around a 2%, and there are few signs that it's starting to boil over. Price pressures for core services can best be described as steady. Meanwhile, a strong U.S. dollar and a competitive retail sector are keeping core goods inflation weak.

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Symptom 4: Trade

After what often felt like interminable rounds of back and forth, an agreement to refresh NAFTA — now called the United States-Mexico-Canada Agreement (USMCA) — was finally reached on September 30, subject to legislative passage by the three national governments. Much of the new agreement was as expected: auto rules that largely mimic those agreed upon over the summer in U.S.-Mexican bilateral negotiations; a modest opening of Canadian dairy and poultry markets; and the preservation of Chapter 19 dispute panels for resolving anti-dumping complaints.

While far from perfect, the USMCA removes an overhang from the Canadian economy that may have inhibited foreign investment. Beyond our borders, global trade remains a sore spot and a key source of market volatility. Tensions between the United States and China continue to simmer. In early November, the U.S. Commerce Department barred American companies from doing business with a state-owned Chinese microchip manufacturer after it was accused of stealing trade secrets from an American company. This is consistent with the ongoing friction between these two nations as it pertains to the "Made in China 2025" program and will likely continue to be a source of friction and volatility going forward.

Symptom 5: Credit spreads

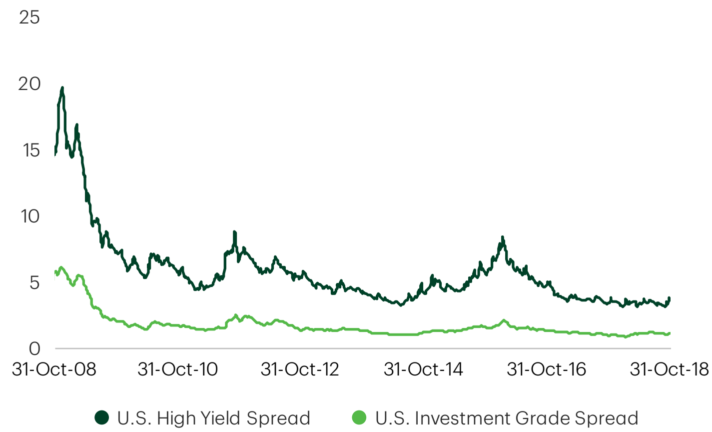
Frequent readers of *Monthly Perspectives* will be aware of my ongoing concern over debt levels and credit spreads. In the past few months, credit spreads have widened, but modestly so. The current difference in yield between junk bonds and Baa bonds has increased about 25 basis points (bps) in the past few weeks, and the interest payment difference between junk bonds and Baa is about 2.65%.

In times past, when volatility in credit markets was intense, such as the Great Credit Crisis of 2008-2009, the eurozone financial strains of 2011-2012 or the precipitous drop of oil prices in 2016, the spread has exceeded 500 bps. The spread usually begins to rise before any recession, and that is not happening either — yet. This is consistent with what we wrote about last month in "Economic Jenga," that the precursors we've seen in past recessionary environments are not in place.

Treatment Plan: Seasonal defensiveness

In the fall of 2018, the numerical grade we used to describe our approach to the current financial environment was changed from category 2 (cautious) to category 1 (defensive).

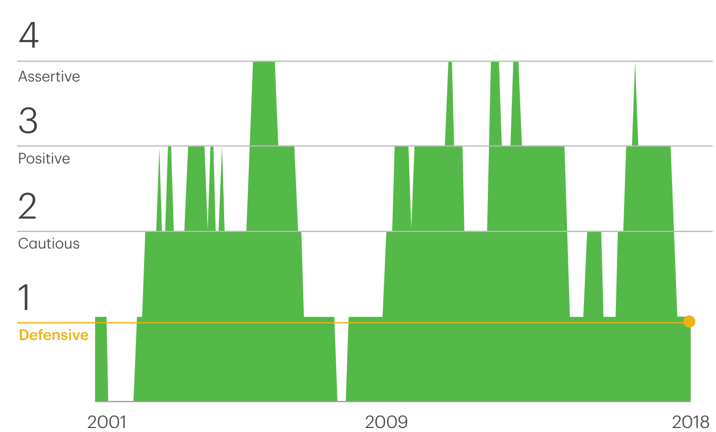
Figure 8: Credit spreads hanging in there. Back to normal? Corporate bond spreads (%)



Source: Bloomberg Finance L.P. as at October 11, 2018.

The inputs underlying this decision include: (a) the conditions of the current private credit cycle; (b) market potential based on various valuation metrics; (c) the level and trend of purchasing sentiment of public corporations; and (d) the breadth of factors behind market returns. All four of these inputs continue to be positive but have shown symptoms of being late-stage. (For more about the current state of these four inputs, please see "Economic Jenga" in last month's *Monthly Perspectives*).

Figure 9: Defensive stance



Source: Thomson Reuters Datastream, TD Asset Management Inc.

To bring this full circle: when an organism begins to have new symptoms, one needs to pay attention. Cold season is no fun and maybe even a little painful. The good news is that the symptoms so far point to a normal seasonal setback and not something more sinister. □

The ailing Canadian energy sector

Insights from Maria Bogusz, Equities Analyst

Canada's energy sector has struggled mightily to find its footing in 2018. Even before global energy prices collapsed in November, Canadian oil producers were failing to keep pace with their American peers.

By the end of October, the iShares S&P/TSX Capped Energy ETF had fallen 14.3%, compared to a 6.6% decline for its American counterpart, the iShares U.S. Energy ETF. That represents a painful 7.7% underperformance for northern oil and gas producers. And it's even worse, at 11.8%, if you take the falling Canadian dollar into account.

So far this year, little has been able to whet the market's appetite for Canadian energy. Even as the price of West Texas Intermediate rose 7.9% through September, the S&P/TSX Capped Energy Sector declined 2.5%. Even when approval was granted, on October 1, for a B.C. terminal that would launch a new era of overseas liquefied natural gas (LNG) exports, investors found little reason to celebrate, pushing shares up for a single day before losing it all again.

As of November 9, multiples in the Canadian energy sector (enterprise value to estimated forward annual earnings before interest taxes depreciation and amortization, or EBITDA) had fallen to 5.9x, compared to 7.55x for the U.S. sector, and the divergence has left some observers scratching their heads and wondering what exactly is going on.

As TD Wealth analyst Maria Bogusz explains, Canadian energy this year has been hit by a powerful one-two punch: (1) the Trans Mountain political debacle; and (2) the oil price differential.

Early in the year, business headlines in Canada were dominated by the Alberta-B.C. dispute over Kinder Morgan's Trans Mountain pipeline expansion. The tug of war eventually led the company, on April 8, to cut off all non-essential spending, which prompted the federal government to announce, on May 29, that they would pay $4.5 billion to acquire the project.

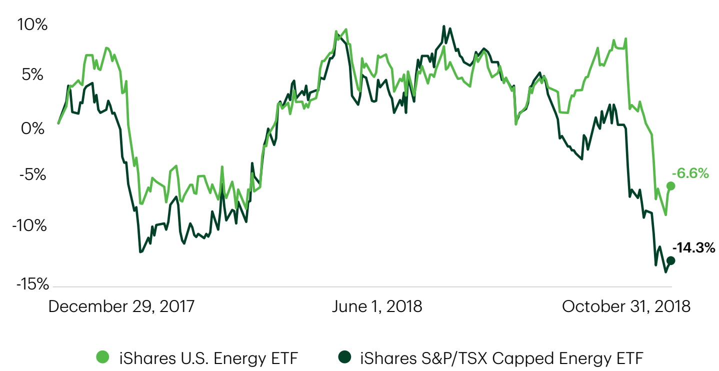
Trans Mountain may have just been one project, but Bogusz says the effect on investor sentiment has been stunning. Jurisdictional bickering, along with the threat of a prolonged courtroom battle, demoralized the market and raised serious concerns about Canada's regulatory framework. "It's just such a huge sentiment shift," says Bogusz. "It's unfortunate, but I guess that's what happens. Investors get frightened." She attributes about half of the overhang this year to the Trans Mountain fiasco.

The other half, she says, has to do with the gaping price differential between Canadian and American oil benchmarks. On October 11, the spread between Western Canada Select and West Texas Intermediate grew to its widest in over a decade, with Canadian barrels selling at a US$50 discount to American ones.

Of course, the WCS-WTI price differential — averaging US$17 over the past five years — is natural to some extent. WCS is a heavy sour crude, whereas WTI is a light sweet crude, and transport costs demand a further discount. Still, the unusually large differential this year has raised fears that a structural shift is underway, prompting calls for export diversification away from the United States.

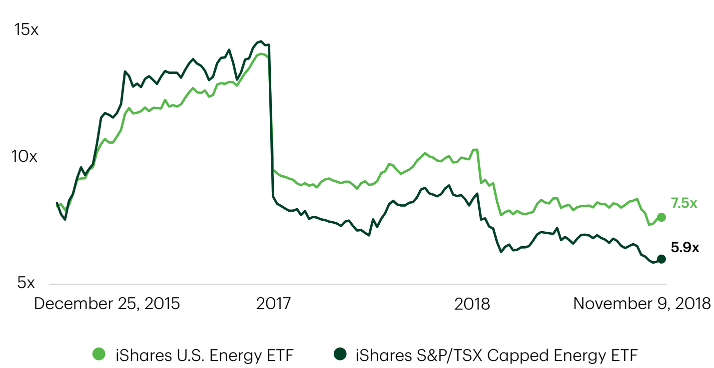
Bogusz, for her part, says that fears of a structural shift are unfounded. What's happened this year, rather, is that prices north of the border have been hit by a severe, albeit temporary, imbalance of supply and demand.

Figure 10: Canadian vs. American energy sectors



Source: Bloomberg Finance L.P. as at October 31, 2018

Figure 11: Canadian vs. American energy sector multiples (EV/EBITDA)



Source: Bloomberg Finance L.P. as at November 9, 2018

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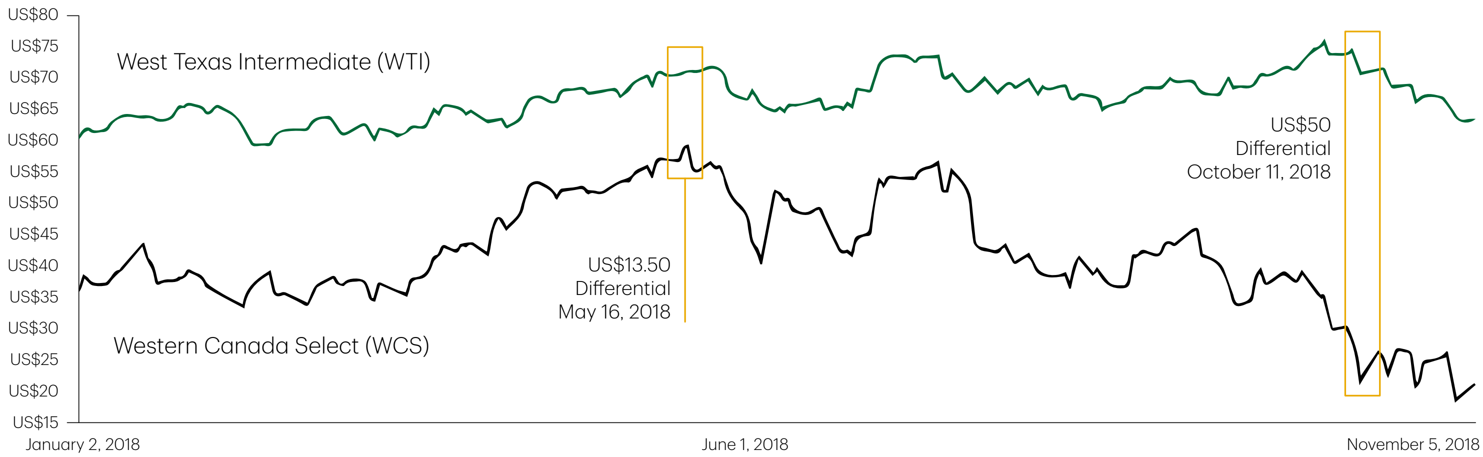
Figure 12: WCS-WTI oil price differential



Source: Bloomberg Finance L.P. as at November 5, 2018.

On the supply side, a ramp-up of activity from the Syncrude project outside Fort McMurray has coincided with a faster-than-expected expansion of the Fort Hills oil sands project. Meanwhile, on the demand side, a shortage of refining capacity in the U.S. Midwest district (PADD II) took about 1.1 million barrels per day (bpd) offline in October, representing one-quarter of the region's refining capacity.

At least some of these seasonal outages were to be expected. As Bogusz explains, Midwest refineries will occasionally take advantage of the lull in October and November — following the summer driving season — to shut down for maintenance and renovation. In a typical year, this might result in reduced utilization of 500,000 to 800,000 bpd. This year, however, the drawdown was bigger than usual, as 10 Midwest refineries shut down simultaneously, "so clearly this year there's been a lot more refining capacity offline," she says. The good news for Canadian energy exporters is that the majority of Midwest refining capacity was expected to be back online by mid-November.

Meanwhile, a number of other positive developments next year are also likely to boost Canada's export capacity. By the second half of 2019, the Enbridge Line 3 pipeline replacement project is expected to come online, which should carry 375,000 bpd to Wisconsin's refinery on Lake Superior. TransCanada's Keystone XL project, meanwhile, is expected to carry an incremental 230,000 bpd to Texas and Oklahoma.

A shortage of pipeline capacity may also create opportunities for crude by rail, with negotiations underway between rail companies and oil producers on longer-term contracts that could secure 300,000 bpd by end of year and, some estimates suggest, 400,000 by the end of 2019. These new pipeline and rail outlets could add upwards of 900,000 bpd to Canada's 3.9 million bpd of takeaway capacity, which should significantly alleviate the imbalance underpinning the price differential.

So, while media reports may suggest a dire need to diversify Canada's energy export market, Bogusz says the real problem isn't so much in finding a willing buyer, but rather in getting oil exports to southern markets. "They have more refining capacity than they need," says Bogusz, "so as long as Canadians can move their oil to the U.S., it bodes very well for Canada."

Natural gas, on the other hand, is another story altogether. The U.S. already produces 71 billion cubic feet of natural gas per day — just enough to meet their needs — so Canadian exporters will have to search abroad, in Asia and Europe, for more sustainable demand. To that end, projects that will see LNG export terminals built in B.C. and Nova Scotia have made significant progress this year.

The prospects of a tighter differential, increased takeaway capacity and new export options for natural gas suggest an improved environment moving into 2020. But if the current overhang represents a buying opportunity, it's one that doesn't leave Bogusz pounding the table: "It's hard to know. There's always a chance that something could go wrong." Other factors — exchange rates, international oil prices, regulatory concerns — may all contribute to the "sell Canada" theme that has weighed on the sector this year.

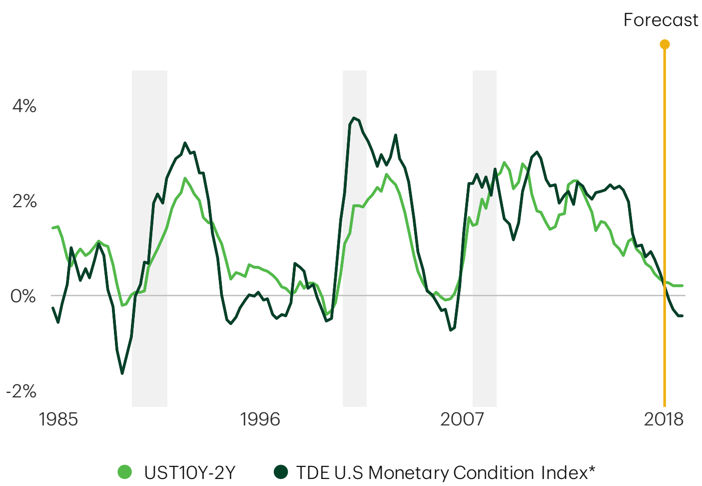
That being said, if there is a silver lining to be found in sentiment-driven market weakness, it's that negative sentiment, where it's unfounded, tends to fade away in time. As Bogusz points out, integrated Canadian energy producers actually traded at a premium to their U.S. peers until around 2016, "so who's to say that we won't go back to trading at a premium at some point?" □

Slippery slope

Beata Caranci, SVP & Chief Economist
James Orlando, Senior Economist

The slope of the U.S. Treasury yield curve has steadily flattened with every successive policy rate hike by the U.S. Federal Reserve (Fed). The spread between the U.S. 10-year and 2-year Treasury yields hit a low of 18 bps in August, down from a high of 266 bps when the Fed signaled the end of its quantitative easing program (QE) in 2013 (Figure 13). The spread last reached these depths in July 2005, offering an early warning to the Great Recession.

Figure 13: Hikes pressure the 10-2 spread



Estimate of time variant r - effective ffr - core CPI.
Source: FRB, TD Economics.

Because the yield curve spread has a strong track record as an early predictor of recessions, market chatter over the timing of a downturn in the economic cycle has become more mainstream. There is no question that the Federal Reserve is on alert to the market sentiment embedded within the shape of the yield curve to the point that there has been significant analysis published by various Fed researchers on the topic over the years.

With such a slim margin of error before inversion, we believe the Fed will respect this market signal. If there is not a re-adjustment in the long end of the Treasury curve, the Fed will likely need to temper the pace of rate hikes in 2019.

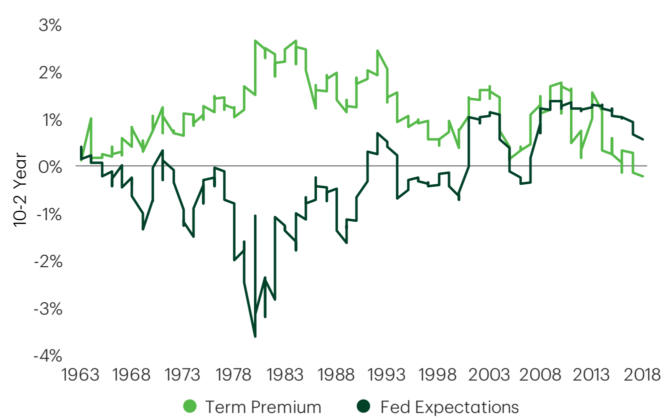
The forces behind the flat yield curve

As an important reminder, the flattening slope of the Treasury curve is completely normal. Once the Fed signaled it would shift from monetary accommodation to normalization in 2013, the UST 10-year yield rose quickly (132 bps from May to September of 2013). This occurred because investors priced the expected rise in rates by the Fed over the next decade. Conversely, the UST 2-year yield responded much more slowly, by 32 bps over that same period. As the Fed was able to successfully raise its policy rate in subsequent years, the 2-year yield moved higher (249 bps since 2013), whereas the UST 10-year has barely pushed on that 2013 high.

This dynamic will continue, as we are not yet at the finish line for this hiking cycle. The Fed has clearly communicated its intention to raise rates further. Their Summary of Economic Projections in June and September depicted a median value of 3.1% for the fed funds rate by the end of 2019, edging further to 3.4% in 2020. With inflation already at target and the economy arguably at full employment, ongoing strong economic growth will require the Fed to lean against inflationary pressures.

But lifting rates towards those projected target rates presents its own risk of causing curve inversion. If the UST 10-year stays bound around 3%, the curve could invert in short order (Figure 14). Put another way, the Fed can comfortably raise rates through 2018, but will have to be increasingly cautious thereafter to signals coming from the bond market. There seems to be a nod to this outcome coming through Federal Open Market Committee Minutes and various speeches. Atlanta Fed President Raphael Bostic went so far as to state that it is the Fed's job to make sure inversion doesn't happen.

Figure 14: Term premium holding down spreads



Source: NBER, FRBNY, TD Economics.

The 10-year needs to get out of the Fed's way

The stubbornness of the UST 10-year yield makes the execution of the rate hike cycle tricky from here on out. While long-maturity Treasury yields are actually doing a decent job of pricing the Fed path, the issue comes from a stubborn anchor on yields due to a very low term premium — i.e., the premium

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for locking into 10 years of prevailing interest payments. This is rooted in several factors that are expected to give way in the months ahead within our forecast:

1. High global liquidity from QE and regulatory pressure on commercial banks has caused outsized demand for Treasuries. In this way, the long end of the Treasury curve has been pushed lower, meaning the yield on Treasuries is not necessarily reflecting economic fundamentals. These factors are starting to unwind with the Fed normalizing its balance sheet (the ECB is also ending QE purchases) and the regulatory burden on U.S. banks is being reduced. Over time, this should continue to shift and could add 10 additional bps to long yields.

2. There is a strong historical relationship between inflation and the term premium. As inflation pressures heat up (core personal consumption expenditure reaching 2.2% in the next six months), a typical term premium response would equate to an additional 10 to 20 bps lift to the 10-year Treasury yield.

3. The U.S. Treasury has focused issuance in the short end and belly of the curve, which is exacerbating the curve-flattening forces. However, with the need to issue large amounts of debt in the coming months due to a widening deficit, the Treasury could opt to increase issuance of longer tenor Notes and Bonds. If the Treasury started to adjust its issuance preference towards longer-dated maturities, where demand is greater, instead of shorter issuances, this too would cause the slope of the yield curve to steepen. Our estimates suggest a possible impact of 5 to 10 bps. However, this influence is not directly embedded into our forecast, as it requires a shift in an existing approach that has not yet been telegraphed.

In contrast, factors 1 and 2 are already in the works — the Fed is normalizing and inflation is picking up. These are the factors that should raise the term premium and push the 10-year yield higher. Our forecast embeds another 30 bps in upside from current levels, but we are mindful that if the long end doesn't respond to these forces, the pace of Fed rate hikes in 2019 may come into question, or at least heighten the scrutiny offered by bond market participants.

How the Fed is impacting the dollar

The greenback is receiving support by a Fed that has a big head start in the normalization cycle relative to other regions (in particular, eurozone, UK and Japan). Consequently, U.S. Treasuries have become "high-yielding" sovereign bonds relative to global peers, which attracts capital flows and demand for U.S. dollars.

In talking about the Fed's lead, we can't help but notice just how far ahead it is. The EU, Switzerland, Sweden and Japan still maintain negative policy rates and are actively keeping yields low. Case in point, the Bank of Japan has repeatedly stepped in to prevent the Japanese 10-year yield from rising too far beyond its imposed upper bound of 10 bps.

This reinforces the notion that monetary accommodation by other major central banks is one factor helping to suppress yields in America through cross-correlations. But this policy also helps keep a strong bid for greenback, further enhanced recently by flight to safety behaviour when trade and geopolitical tensions heat up. If major central banks accelerate the removal of policy stimulus, the U.S. dollar would subsequently depreciate and global yields would rise, including U.S. Treasuries.

How the Fed is impacting Canada

Canadians know all too well that what happens abroad is felt domestically. On this note, the Bank of Canada is faced with a closed output gap and inflation at its target rate. Despite ongoing risks related to trade and household debt, the Bank must respond to the reality of the actual data. As such, it has already raised the policy rate 100 bps in the span of a year, and we believe the window has opened for another rate hike this January. Second-quarter economic growth is coming in at around 3% annualized. Some of this strength is related to one-off factors, but not the majority. The economy defies risks with a demonstration of solid investment growth and strong household income growth.

A rate hike in January followed by two more in 2019, however, does put the Bank of Canada in a similar situation as their U.S. counterpart. In fact, the Canadian yield curve is currently narrower than its U.S. equivalent. The same global dynamics that are holding U.S. Treasury yields down are also impacting Canadian yields. In this way, the compression of the slope of the Canada yield curve will in large part be dependent on what happens with the repricing of U.S. term premiums.

With the Bank of Canada representing the only other major central bank pursuing a rate-normalization path similar to that of the Fed, the narrowing slope of the yield curve could give Governor Poloz reason to reassess the pace of policy next year if longer yields don't realign to economic fundamentals. Or, conversely, the Bank may find itself spending a lot more time addressing questions related to bond market pricing and the implications it offers on the economic outlook. □

Market performance

		(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
Canadian Indices ($CA) Return	Index	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs	20 Yrs
S&P/TSX Composite (TR)	51,304	-6.27	-7.87	-5.00	-3.41	6.67	5.44	6.52	7.56	7.10
S&P/TSX Composite (PR)	15,027	-6.51	-8.56	-7.29	-6.23	3.56	2.38	3.40	4.41	4.52
S&P/TSX 60 (TR)	2,474	-5.73	-7.89	-4.33	-2.57	7.24	6.25	7.27	7.36	7.23
S&P/TSX SmallCap (TR)	914	-7.60	-9.26	-11.68	-9.06	6.75	1.82	1.66	7.02	-
U.S. Indices ($US) Return	Index	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs	20 Yrs
S&P 500 (TR)	5,369	-6.83	-3.25	3.01	7.35	11.52	11.34	14.25	13.24	6.62
S&P 500 (PR)	2,712	-6.94	-3.71	1.43	5.30	9.25	9.07	11.89	10.84	4.62
Dow Jones Industrial (PR)	25,116	-5.07	-1.18	1.60	7.44	12.45	10.07	11.11	10.42	5.51
NASDAQ Composite (PR)	7,306	-9.20	-4.77	5.83	8.59	13.07	13.26	16.28	15.56	7.34
Russell 2000 (TR)	7,509	-10.86	-9.26	-0.60	1.85	10.68	8.01	12.51	12.44	8.60
U.S. Indices ($CA) Return	Index	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs	20 Yrs
S&P 500 (TR)	7,057	-5.41	-2.32	7.91	9.42	11.69	16.61	18.62	14.12	5.77
S&P 500 (PR)	3,564	-5.52	-2.79	6.25	7.33	9.42	14.24	16.17	11.70	3.79
Dow Jones Industrial (PR)	33,008	-3.63	-0.23	6.44	9.51	12.62	15.28	15.36	11.27	4.67
NASDAQ Composite (PR)	9,602	-7.82	-3.86	10.87	10.69	13.24	18.62	20.73	16.45	6.49
Russell 2000 (TR)	9,868	-9.50	-8.38	4.13	3.82	10.85	13.12	16.81	13.31	7.74
MSCI Indices ($US) Total Return	Index	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs	20 Yrs
World	8,309	-7.32	-5.57	-1.86	1.71	8.52	7.40	10.98	10.65	5.82
EAFE (Europe, Australasia, Far East)	7,414	-7.95	-8.90	-8.86	-6.39	4.13	2.50	7.19	7.39	4.69
EM (Emerging Markets)	2,132	-8.70	-11.58	-15.45	-12.19	6.92	1.15	3.48	8.20	9.13
MSCI Indices ($CA) Total Return	Index	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs	20 Yrs
World	10,920	-5.91	-4.66	2.81	3.67	8.69	12.49	15.23	11.50	4.98
EAFE (Europe, Australasia, Far East)	9,744	-6.55	-8.02	-4.52	-4.58	4.29	7.35	11.29	8.23	3.85
EM (Emerging Markets)	2,802	-7.31	-10.74	-11.42	-10.49	7.08	5.94	7.44	9.04	8.26
Currency	Level	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs	20 Yrs
Canadian Dollar ($US/$CA)	76.09	-1.50	-0.95	-4.54	-1.90	-0.15	-4.52	-	-0.77	0.80
Regional Indices (Native Currency) Price Return	Index	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs	20 Yrs
London FTSE 100 (UK)	7,128	-5.09	-8.01	-7.28	-4.87	3.87	1.15	4.73	5.20	0.01
Hang Seng (Hong Kong)	24,980	-10.11	-12.61	-16.51	-11.56	3.33	1.48	8.06	5.98	4.60
Nikkei 225 (Japan)	21,920	-9.12	-2.81	-3.71	-0.41	4.73	8.88	18.17	9.84	2.43
Benchmark Bond Yields		3 Month		5 Yr		10 Yr		30 Yr		
Government of Canada Yields		1.73		2.41		2.48		2.52		
U.S. Treasury Yields		2.31		2.96		3.14		3.38		
Canadian Bond Indices ($CA) Total Return		Index	1 Month	3 Months	YTD	1 Yr	3 Yrs	5 Yrs	Since 1/1/2012	10 Yrs
FTSE TMX Canada Universe Bond Index		1,027	-0.61	-0.84	-0.96	-0.59	1.48	2.92	2.58	4.46
FTSE TMX Canadian Short Term Bond Index (1-5 Yrs)		700	-0.10	0.04	0.44	0.11	0.67	1.46	1.60	2.67
FTSE TMX Canadian Mid Term Bond Index (5-10 Yrs)		1,110	-0.36	-0.52	-0.87	-1.14	0.94	2.90	2.83	5.07
FTSE TMX Long Term Bond Index (10+ Yrs)		1,652	-1.51	-2.28	-3.02	-1.25	2.88	4.98	3.68	7.03

Sources: TD Securities Inc., Bloomberg Finance L.P. TR: total return, PR: price return. As at October 31, 2018.