MONTRÉAL EXCHANGE

May 2023

Canadian Equities Supported by Low Volatility and Bank of Canada Pause

- The S&P/TSX 60 Index* Futures (Exchange symbol: SXF™; Bloomberg: PTA) has performed well and seen falling volatility in 2023 so far.
- Both business surveys and a tight labour market suggest the risks of a recession are low.
- Also, the Bank of Canada has stopped hiking. The S&P/TSX 60 Index has outperformed during previous pauses.

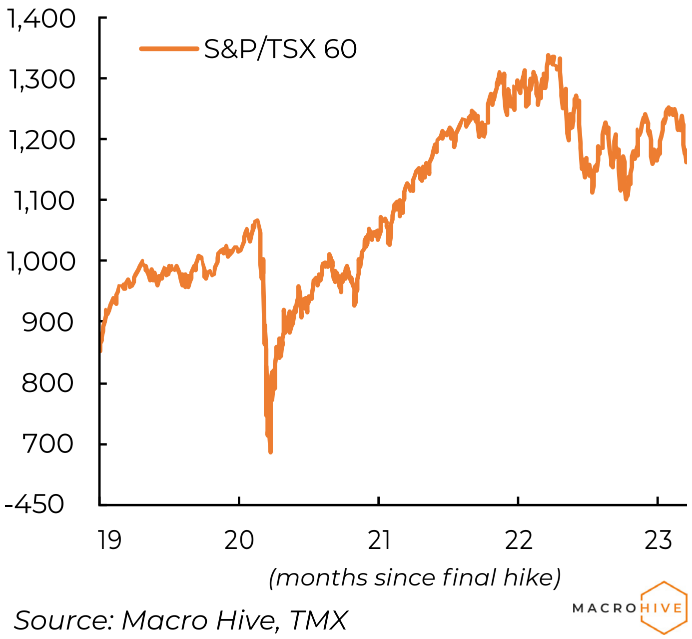
Canadian equities have performed well so far in 2023. The S&P/TSX 60 Index Futures traded on the Montréal Exchange has risen over 6% this year (Figure 1). Notably, this rally has occurred alongside falling volatility. The three-month (realised) volatility of the S&P/TSX 60 Index Futures has fallen from 17% at the start of the year to 11% at the start of May (Figure 2). This is the lowest since 2021 and lower than the current volatility in the US S&P 500(R) Index.

Importantly, the decline in S&P/TSX 60 Index volatility has happened despite Bank of Canada policy rates reaching 4.5% – the highest level in 16 years. We have also seen a US regional bank crisis, US debt ceiling fears and subdued oil prices. Given this backdrop, the returns and low volatility in S&P/TSX 60 Index Futures provide important diversification opportunities for international investors.

In terms of direction, the macro backdrop suggests a bullish outlook, which we outline below.

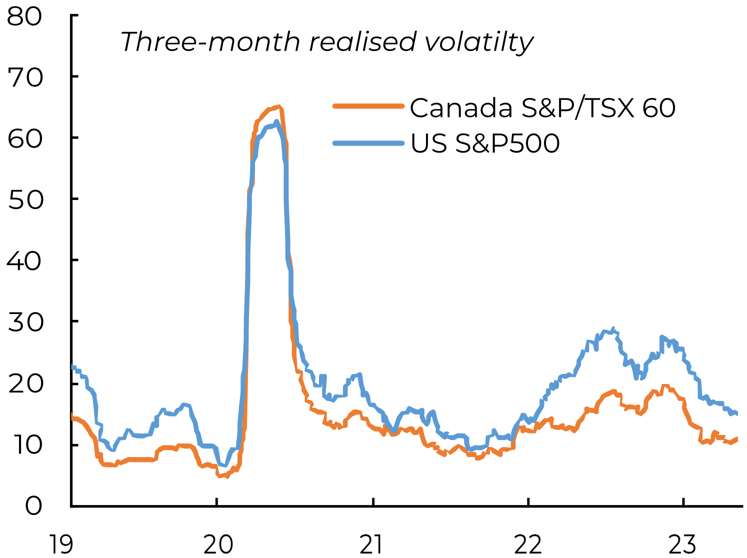
FIGURE 1

Canadian Equities Up 6% YTD



Source: Macro Hive, TMX

FIGURE 2
Subdued 3M Realised Volatility

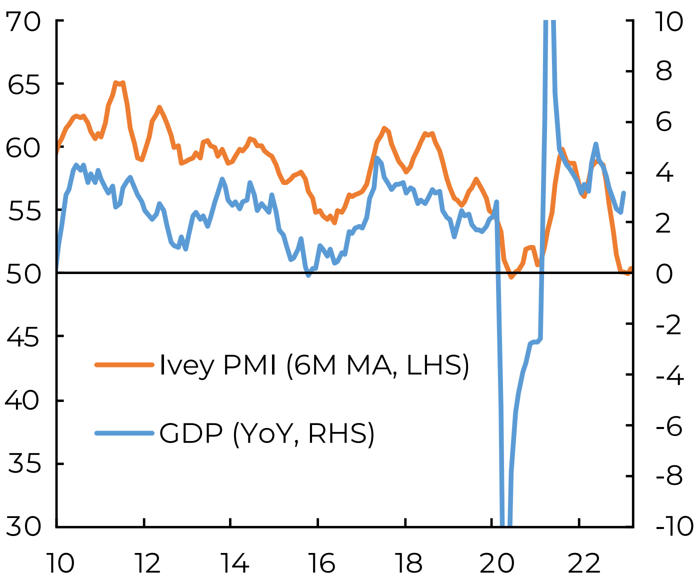


Source: Macro Hive, TMX, Bloomberg

Canadian Economy Returning to Trend

The risks of a recession in Canada are low. Business surveys like the PMIs suggest the economy will inch higher over the next few months (Figure 3). This sits on top of a tight labour market, with the unemployment rate near its lowest level in the modern era (Figure 4).

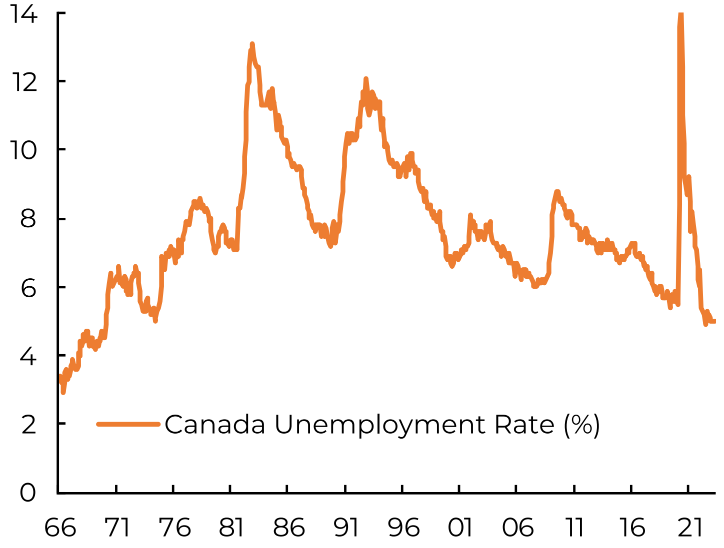
FIGURE 3
Canadian Economy Will Continue to Grow



Source: Macro Hive, Statistics Canada, Ivey Business School

FIGURE 4

Very Low Canadian Unemployment



Source: Macro Hive, Statistics Canada

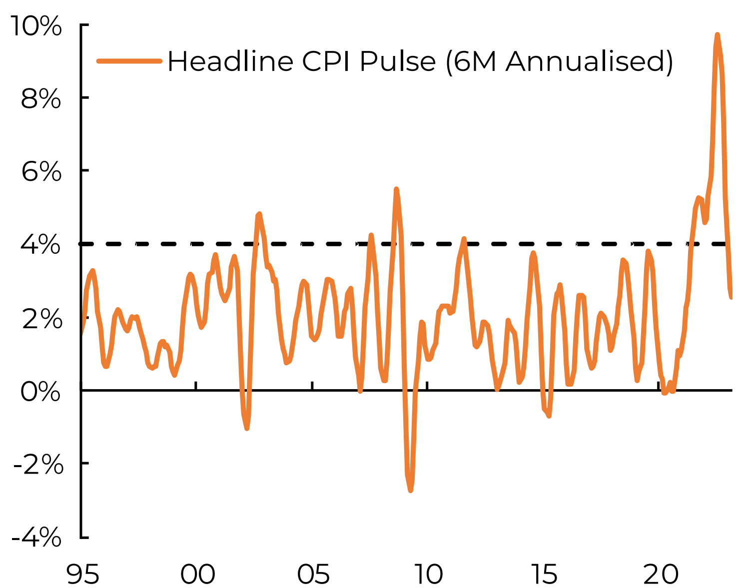
Bank of Canada Pause Supportive for Canadian Equities

One risk to Canadian equities is further rate hikes by the Bank of Canada. However, having hiked rates to 4.5% in January, the central bank has since paused. Governor Macklem has insisted the bar to raise rates again is much higher than before. He has argued it would need an accumulation of sticky inflation expectations and service prices, elevated unit labour costs, and elevated corporate pricing behaviours to force another hike. Yet recent monthly changes in inflation have been annualising nearer the historic norm of 2%, suggesting inflation risks are moderating (Figure 5).

Consequently, the Bank of Canada will likely remain on hold for an extended duration, like in 2006-2008 or 2018-2020. During these pauses, Canadian equities performed well (Figure 6). This suggests the macro backdrop is a bullish S&P/TSX 60 Index in the coming months.

FIGURE 5

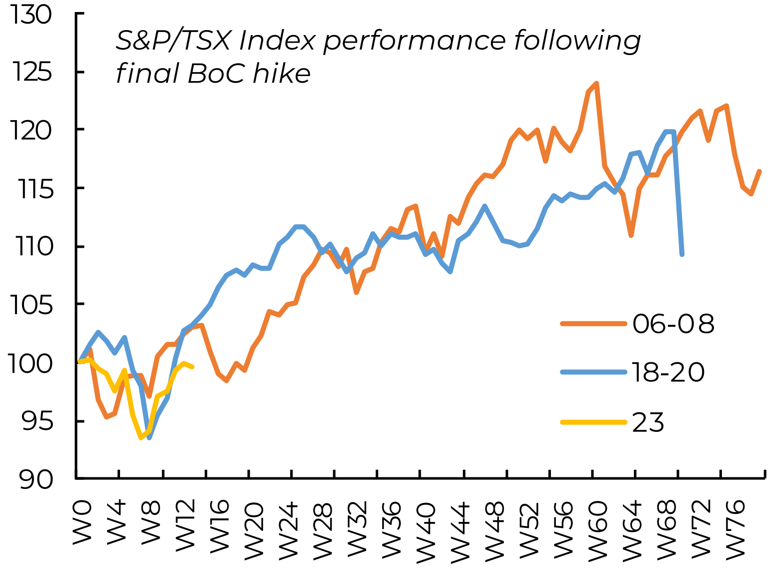
Inflation Pulse Moderating



Source: Macro Hive, Statistics Canada

FIGURE 6

Canadian Equities Fare Well in BoC Pauses



Source: Macro Hive, TMX

Bilal Hafeez is the Founder and CEO of Macro Hive – a leading independent research firm. Prior to MacroHive, Bilal was Global Head of International Fixed Income Strategy at Nomura between 2016 and 2019. Before that, Bilal held various senior roles at Deutsche Bank between 2002 and 2015, including Head of Multi-Asset Research, Advisor to the CEO, Head of Asia Research in Singapore and Global Head of Foreign Exchange Research. Bilal started his career at J.P. Morgan in 1998. During his sell-side career, Bilal was rated #1 market strategist by Euromoney and Institutional Investor for most years between 2004 and 2013. He also pioneered FX investment and smart beta benchmarks. Academically, Bilal was an Honorary Visiting Professor of Finance at Cass Business School. He studied Economics at St John's College, Cambridge.

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