Talking Points

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The latest view on the economy

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Who Let The Bulls Out?

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Let's be entirely clear**. Just a little more than two weeks ago**, global financial markets were reeling, with the S&P 500 close to full correction terrain for the first time in nearly three years, the TSX was down 11%, 10-year U.S. bond yields were sub 2%, and volatility was surging. This was all happening against a backdrop of mounting concerns about renewed deterioration in Europe, sliding oil prices, a slowing China, a staggering Japan, the imminent end of QE3, and fear of Ebola. **Sixteen days later**, the Dow and S&P 500 are at all-time highs, the TSX is on the mend, and 10-year bond yields have forged above 2.3%. This is all happening against a background of renewed deterioration in Europe, sliding oil prices, a slowing China, a staggering Japan, the end of QE3, and fear of Ebola. Just as long as we're all clear.

That's a roundabout way of saying: what just happened? The final push in equities today is the easy part to explain, with global stocks charged by the surprising moves from Japan. While an extra dose of QE from the Bank of Japan is a nice bonus (an added ¥10 trillion to ¥80 trillion), the real news was the plan by the massive Government Pension Investment Fund to shift out of JGBs and into Japanese and global equities. This will see an eventual enormous shift into stocks starting next April. For example, we estimate that roughly C$7.6 billion will find its way into Canadian equities, and about 13 times as much into U.S. stocks. The news boosted the Nikkei by nearly 5% (lifting it into a small year-to-date gain), and spilled over to North American stocks after solid advances earlier in the week.

What changed to calm the market even before Japan stepped up? In part, it was a **steady stream of reassurance about the world's largest economy**—the U.S.—and still-solid **Q3 earnings**. U.S. real GDP topped expectations with a solid 3.5% pace, and while consumer spending ended the quarter on a soft note, a snap-back in October consumer confidence suggests that activity will remain healthy in Q4. And, lower oil prices are not negative for U.S. growth, given that the nation is still a significant oil importer. Indeed, insofar as they are caused by rising supplies, lower oil prices are a net positive for global growth. In fact, the very economies that have caused so much market angst—Europe, China, Japan—are all big net winners from falling oil prices.

The rollicking rebound in equity markets in the past two-and-half-odd weeks (and they have been odd) has spilled into other markets. The snap-back in **Treasury yields** has been most notable, although 10-year yields are still down almost 20 bps in October, even as U.S. equities have managed moderate advances. The **U.S. dollar** has been another big winner, plowing up to ¥112, while the euro has sagged to US$1.25 and the Canadian dollar has dropped back close to its low for the year at 88.4 cents. There's no mystery behind the loonie's lunge lower, with **WTI** drooping to $80, **gold** walloped to $1,165 (partly on the BoJ's measures), and **Canadian GDP** disappointing with a 0.1% drop in August (and headed for 2% growth or less for all of Q3). However, **we are not turning more bearish on the Canadian economic outlook**—the growth dampener from oil producers will be partly offset by a lower

C$, and by modest government stimulus (i.e. Ottawa's tax relief) and a firming U.S. economy. Ultimately, it is that very U.S. economy that helped pull financial markets through the recent stress test, and we believe it will continue to forge ahead.