GUARDIAN CAPITAL

Economic Outlook

SUMMARY

- It has now been seven months since the initial wave of COVID-19 caused the world to go on lockdown. Significant progress has been made in terms of an economic recovery but there remains plenty more lost ground to be made up.
- As it stands right now, it is arguable that the restart of business activity in much of the world has reached its limits under the current stages of restriction rollbacks, which stands to constrain the rate of future gains. Absent the continued unwinding of restrictions on all activity, there is limited scope for the overall economy to achieve pre-COVID-19 levels soon.
- That said, the expectation is that continued progress will be made, though future growth is anticipated to be much more moderate than the torrid pace recorded over the summer — and the likelihood is that the road to recovery will be bumpier than the recent experience.
- A positive trajectory, underpinned by the still ample monetary and fiscal stimulus, should continue to be constructive for financial markets and supports a continued tilt towards exposure to risk assets. These securities, however, are likely to find themselves much more susceptible to shocks that result from headlines over the coming months.
- Headlines will undoubtedly be abundant with the impending US Election providing a fertile source of material for news media over the next month with the rhetoric likely to heat up as November 3 approaches. Importantly, though, knee-jerk reactions to happenings on this front, sharp as they may be, tend to be short-lived with macro fundamentals ultimately regaining control.
- The risks of another round of lockdowns represent a clear downside, but there is an obvious source upside risk to expectations: ending or mitigating the ongoing pandemic. There is high conviction that a vaccine will be developed sooner rather than later, though the production and doling out of enough doses to all corners of the world will no doubt take time and likely make this a 2021 story.
- For the nearer future, further inroads on therapeutics that can help limit the potential worst outcomes from COVID-19 would also help reduce concerns about the negative implications of opening back up in full. Even more, development of rapid and frequent testing capabilities would help to better monitor and control outbreaks, providing greater confidence in pushing forward with the easing of restrictions on business activity.
- Until these are in place to push the growth pedal to the floor and move global growth into the express lane, the recovery will likely remain on its current trajectory and abide by posted speed limits — and markets will likely tread more carefully until there is more clarity on what comes next.

Legends of the fall

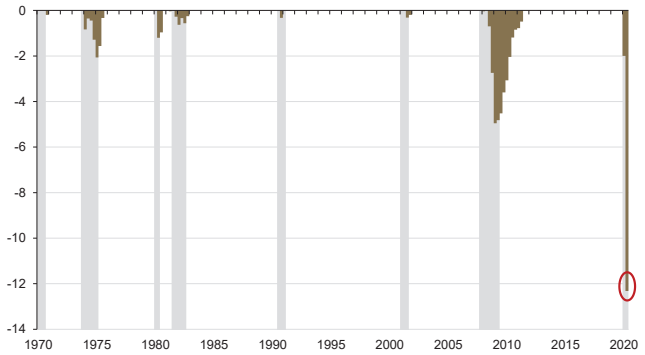
It has now been seven months since the initial wave of COVID-19 caused the world to go on lockdown – Monday, March 16 marked the first day out of the office (either working from home or unemployment) for many workers across the globe.

As such, it is a good time to reflect on where we have been and think about not only where we are going, but also how we are going to get there.

In terms of where we have been, the large-scale shuttering of economic activity dealt a historic blow to the global economy. Aggregated output across the G7 economies (Canada, France, Germany, Italy, Japan, US and UK) collapsing by a record-setting 12% in the first half of 2020 – that is more than double the peak-to-trough drop in the aftermath of the financial crisis in 2008/09.

CHART 1: UNPRECEDENTED TIMES

G7 real gross domestic product drawdown from peak
(percent)



Quarterly data to Q2 2020 Shaded regions represent periods of US recession
Source: OECD, IMF, Bloomberg, Guardian Capital

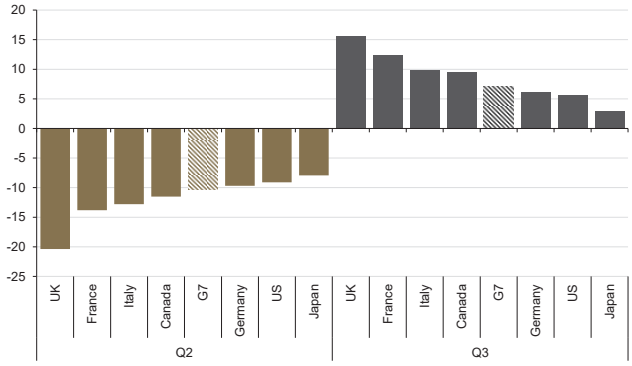
The easing of restrictions across many regions starting in late April, however, has allowed activity in some segments of the economy to return to something akin to normal is fairly short-order.

As well, the massive amounts of fiscal stimulus (the Center for Strategic & International Studies estimates G7 governments have committed $6 trillion or 15% of the group's GDP to COVID-19-related measures) and other initiatives (such as private loan payment deferral programs) have played a significant role in helping those unable to return to work keep their heads above water.

The result has been a robust economic rebound across the globe over the summer that has all but assured that the COVID-19-induced global recession will stand as one of the shortest in history. Current consensus forecasts put the G7 economies on track to post their biggest one-quarter gains on record in Q3.

CHART 2: GET BACK UP AGAIN

Growth in real gross domestic product
(quarter-over-quarter percent; non-annualized)

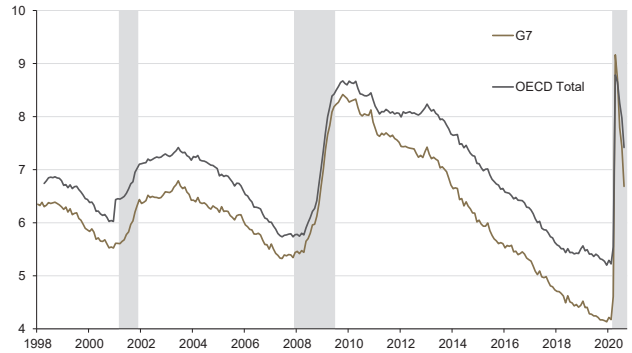


Q3 2020 data are Bloomberg consensus for the G7 as at October 20, 2020
Source: OECD, IMF, Bloomberg, Guardian Capital

These gains represent a material recovery of lost activity, however, they do not recapture everything. Plenty of slack still remains as evidenced by unemployment rates, though off peaks, remaining at historically elevated levels.

CHART 3: DOWN BUT STILL OUT OF WORK

Unemployment rate
(percent)



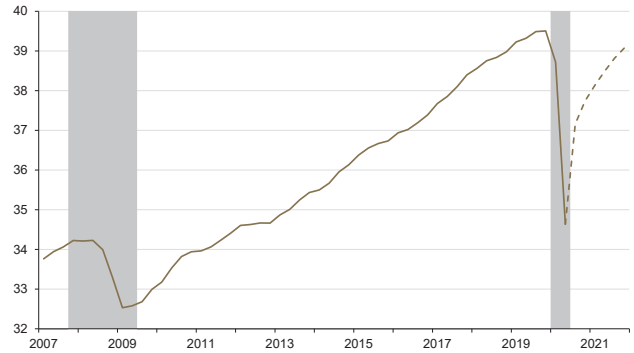
Monthly data to August 2020
Shaded regions represent periods of US recessionSource: OECD, IMF, Bloomberg, Guardian Capital

While that suggests the scope for growth rates to remain above the trends that prevailed prior to this public health and economic crisis, expectations are for future growth to be much more moderate than the torrid pace recorded over the last few months.

For example, current consensus forecasts do not show output recapturing its pre-crisis peak by the end of 2021.

CHART 4: STILL A LONG WAY TO GO

G7 real gross domestic product
(trillions of 2015 US dollars)



Dashed line represents forecast based on Bloomberg consensus for G7
Quarterly data to Q2 2020; forecast data from Q3 2020 to Q24 2021
Shaded regions represent periods of US recession
Source: OECD, IMF, Bloomberg, Guardian Capital

Not in uniform

The big reason behind these more muted growth projections in the coming months primarily relates to factors restricting consumers' ability to return to normal levels of activity.

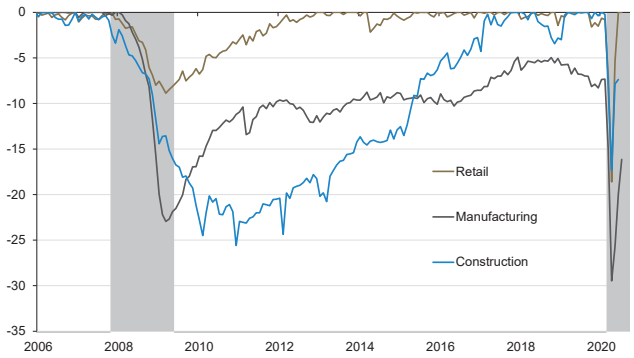
Consumer spending accounts for nearly two-thirds of economic output across the major developed markets and the rapid rebound of consumption expenditure from its April lows has been the key driver behind the broader snapback in economic growth in Q3.

Construction and manufacturing still have plenty of ground to cover to get back to pre-crisis levels, as business' have held back capital expenditures against the still highly uncertain earnings backdrop, despite costs of capital evaporating thanks to massive amounts of central bank policy stimulus.

Retail spending, in stark contrast, has been robust and fully reversed its lockdown-induced drawdown.

CHART 5: DIFFERENT SPEEDS

Change in G7 economic activity volumes from peak
(percent)

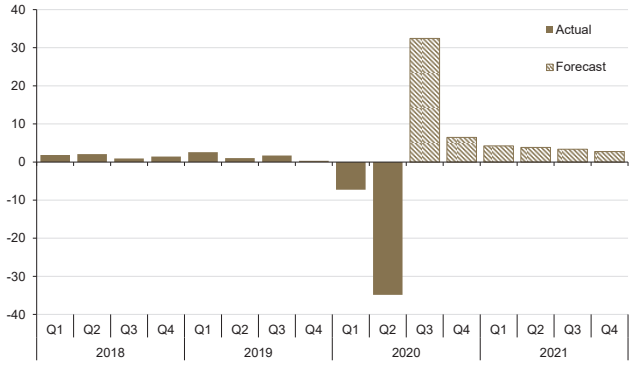


Monthly data to July 2020
Shaded regions represent periods of US recession
Source: OECD, Bloomberg, Guardian Capital

Unfortunately, there is not exactly tremendous hope for gains of this magnitude to continue over the near-term. While forecasters have penciled in 7% quarter-over-quarter increase in consumption for the G7 as a whole in Q3 (a 32% annualized rate), that is expected to moderate to just under 2% in Q4 (7% annualized rate) and below 1% in a year's time (3½% annualized rate).

CHART 6: SLOWING DOWN WITH AGE

G7 real gross domestic product growth
(annualized quarter-over-quarter percent change)



Forecasts are Bloomberg consensus for the G7 as at October 20, 2020
Source: OECD, IMF, Bloomberg, Guardian Capital

For starters, the bulk of the boom in consumer spending has been a product of pent-up demand.

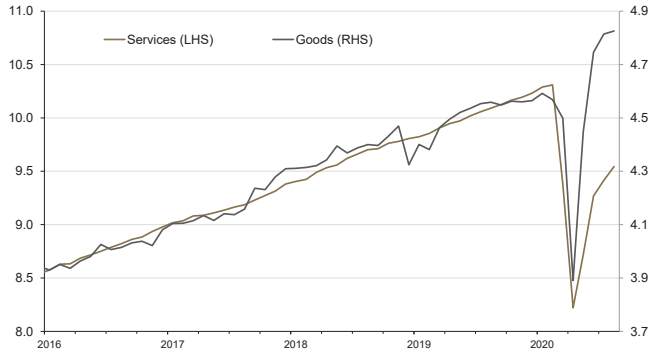
Retail spending predominantly reflects tangible goods and the bounce since April reflects consumers making purchases of items that were delayed at the onset of the crisis either because of concerns about cash flows, or an inability to actually make a transaction due to lockdown-driven supply change constraints or forced store closures.

As this pent-up demand is sated, growth in goods' spending will moderate to more "trend-like" rates.

In contrast, spending on services (which account for nearly two-thirds of consumer spending) experienced a more significant hit as a result of business closures and event cancelations, and has seen more modest improvements in recent months.

CHART 7: OUT OF SERVICE

US personal consumption expenditure by type
(trillions of US dollars)



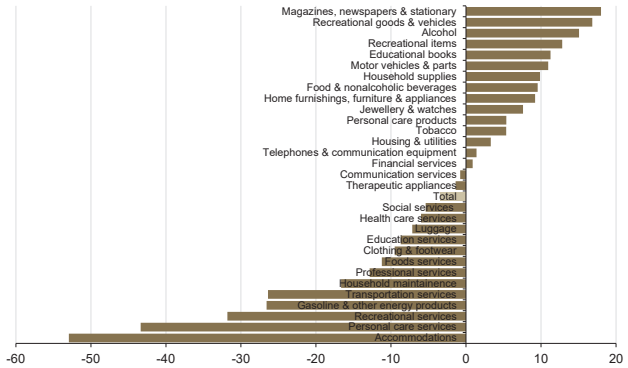
Monthly data to August 2020
Source: US Bureau of Economic Analysis, Bloomberg, Guardian Capital

Unlike goods, pent-up demand plays a diminished role with services. While consumers can go back and buy a car that was intended to be purchased earlier, they will not get all of the haircuts that would have otherwise been had if not for self-isolation.

As well, most services do not lend themselves to home delivery — online shopping during lockdown can replace buying something at a brick-and-mortar shop but tourism cannot exactly be ordered-in.

CHART 8: GOOD FOR GOODS AT LEAST

Change in US consumer expenditure, August versus January
(percent)



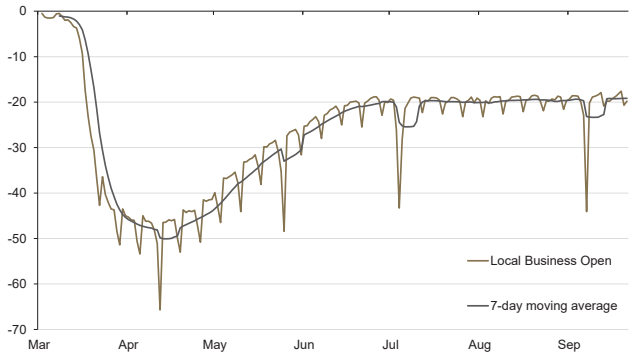
Source: US Bureau of Economic Analysis, Bloomberg, Guardian Capital

This last point is important in terms of the near-term outlook because it is increasingly looking as though business re-openings have reached their limits under the current stages of restriction rollbacks, which stands to constrain any future gains.

Data indicate that the number small businesses in operation in the US has largely flat-lined at levels that are still well below pre-crisis norms.

CHART 9: BUSINESSES STAGNATING

US local businesses open
(percent change from median weekday from January 4 to 31)

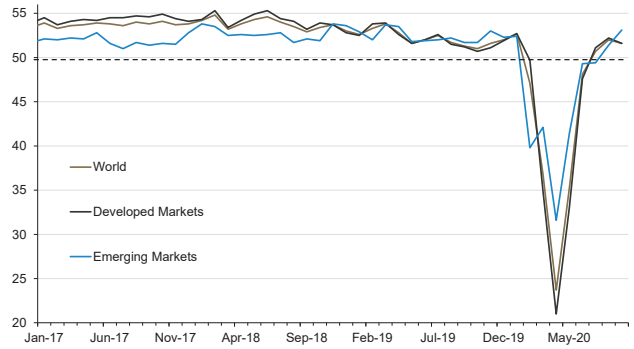


Weekly data to September 21, 2020
Source: Homebase, Bloomberg, Guardian Capital

Absent the continued unwinding of restrictions on all activity (especially those businesses that face larger issues implementing social distancing mandates), there is limited near-term scope for services spending to achieve pre-COVID-19 levels. There are already signs that the sharp upswing in growth momentum that came with the initial easing of COVID-19 restrictions is ebbing as services purchasing managers' indexes (PMI) across the globe moderated in September.

CHART 10: PAST THE PEAK?

Services purchasing managers' indexes
(index; >50 denotes expansion)



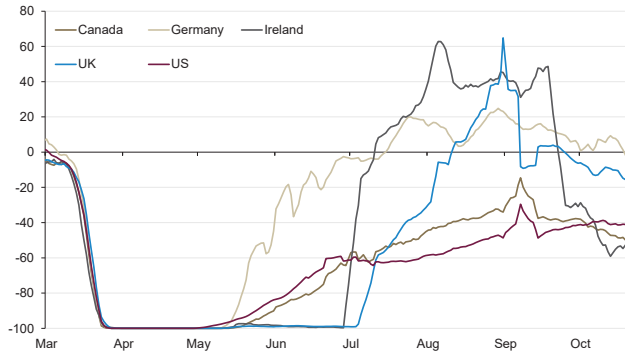
Monthly data to September 2020
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

Moreover, there are rising risks that supply-side constraints are going to worsen before they improve.

The resurgence of contagion following lulls over the summer has paused reopening plans, and in several cases resulted in a reversal of some easing of restrictions — particularly the scaling back of the allowable crowd sizes and re-imposing restrictions on indoor commercial activities such as dining.

CHART 11: DINERS HAVING RESERVATIONS

Seated diners at restaurants on the OpenTable network
(year-over-year percent change, seven-day moving average)



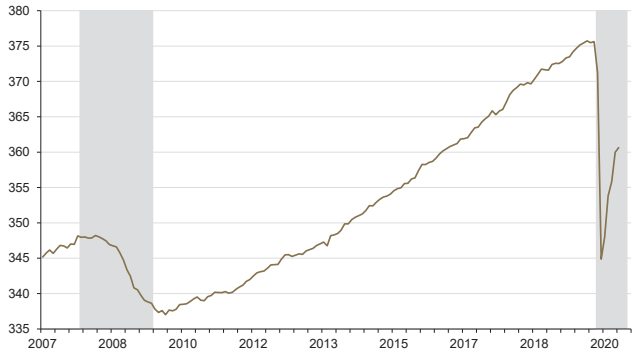
Daily data to October 20, 2020
Source: OpenTable Data Centre, Guardian Capital

On top of that, the demand side of the equation is facing pressure as well.

While labour markets have improved markedly, the pace of gains has slowed recently in tandem with the moderation in the expansion of activity and unemployment remains elevated — half of people across the G7 that were sidelined with the economic shutdowns in March and April still remain among the ranks of the unemployed.

CHART 12: OOOOH, WE'RE HALF WAY THERE

G7 Total Employment
(millions)

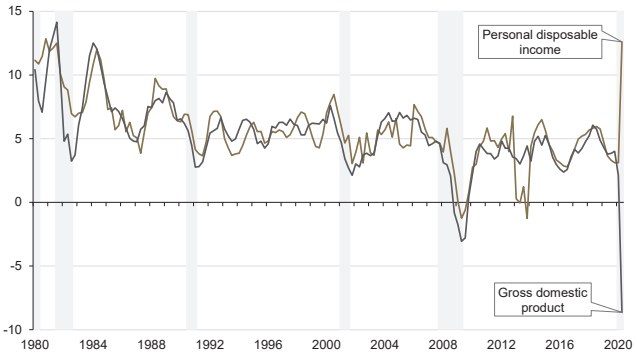


Monthly data to September 2020 Shaded regions represent periods of US recession Source: Bloomberg, Guardian Capital

The flow of fiscal support undoubtedly helped cushion the impact of the unemployment tied to the initial wave of stringency measures and underpinned the recovery to date — a glaring example is that US disposable income surged in Q2, despite the collapse of output. These funding bridges for households, however, are starting to slow.

CHART 13: TWO ROAD DIVERGED…

US real GDP & personal disposable income
(year-over-year percent change)



Quarterly data to Q2 2020
Shaded regions represent periods of US recession
Source: US Bureau of Economic Analysis, Bloomberg, Guardian Capital

In particular, the expiry of wage subsidies in the UK at the end of October will likely spur job loss. As well, the US Congress' inability to reach an agreement on another round of support to Americans will have an adverse impact on spending in the world's largest economy. However, a spate of European countries as well as Canada have extended support programs.

The (at minimum) pausing of the easing of the social distancing measures, along with diminished income support and a slower recovery of lost jobs, provide added headwinds for the consumer sector that will set a speed limit on how fast the broader recovery is able to proceed over the near-term.

Calling for backup

Of course, while consumers account for the bulk of global economic activity, they are not everything.

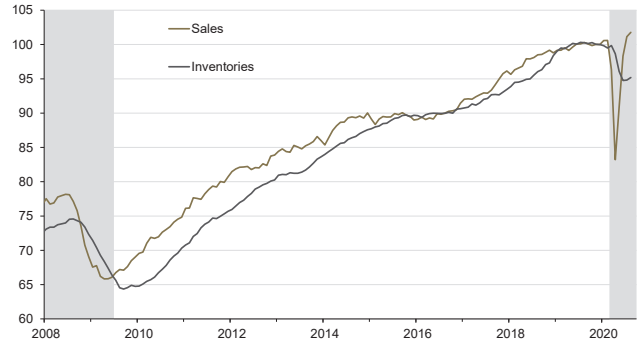
There are, thankfully, reasons to anticipate that these other areas will help provide something of a counterbalance to moderating household spending.

It is, understandably, the case that businesses remain hesitant to commit to longer-term capital projects given the current backdrop, but their hands look likely to be forced to engage at least in increased investment in working capital in the coming months.

As consumer spending on goods rebounded sharply over the summer, producers and suppliers of those products did not fully keep up with demand resulting in a substantial drawdown in inventories.

CHART 14: PLAYING CATCH-UP

US business sales & inventories excluding petroleum
(index; December 2019 = 100)

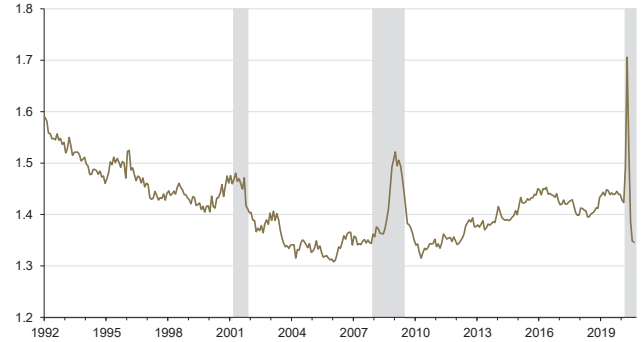


Monthly data to August 2020. Shaded regions represent periods of US recession. Source: Bloomberg, Guardian Capital

As it stands currently, the ratio of inventories to sales for US manufacturers, retailers and wholesalers (excluding those dealing in petroleum) has fallen to its lowest levels since 2012 and is near its lowest levels of the last two decades.

CHART 15: RUNNING OUT OF STOCK

US business inventories-to-sales ratio, excluding petroleum
(index; December 2019 = 100)



Monthly data to August 2020 Shaded regions represent periods of US recession Source: Bloomberg, Guardian Capital

Even in the absence of further increases in sales to end-consumers, the depleted inventory levels suggest that companies need to increase efforts to rebuild stockpiles back to more normal levels.

For example, even if sales stay flat, US inventories would need to rise 6% (or by $100 billion) to bring the inventory-to-sales ratio back in line with its pre-crisis five-year average.

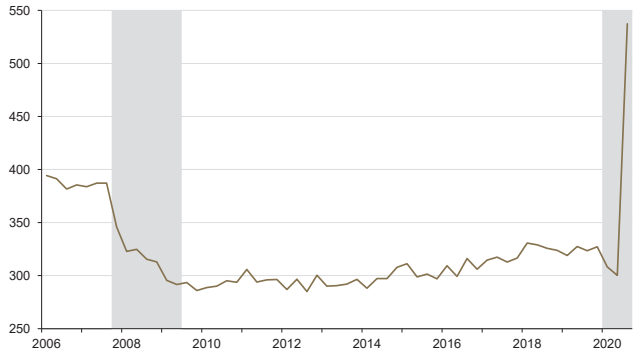
Moreover, given the recent experience, there would be good reason for businesses to target even higher inventory levels as a precaution against any potential shocks to the global supply chain resulting from future pandemic-induced shutdowns or the re-escalation of trade tensions.

The scope for a material upswing in the global inventory cycle is quite constructive for industrial production and international trade flows, and in combination with the record low costs of capital, could spur increases in capital investment.

Another potential tailwind for business investment is the surprising surge in start-ups. Though business re-openings have stagnated at the moment, applications for new businesses jumped in Q3 to record high levels in the US with overall filings topping 1.5 million while those for “high propensity” businesses (those that are likely to turn into a firm with a payroll) accounted for a third of the total.

CHART 16: APPLYING ONES’ SELF

US applications for new high propensity businesses
(thousands)



Quarterly data to Q3 2020. Shaded regions represent periods of US recession. Source: US Census Bureau, Bloomberg, Guardian Capital

The factory sector is already experiencing a bit of a renaissance. The global manufacturing PMI has increased for five straight months and is at its highest level in more than two years.

CHART 17: ONWARDS & UPWARDS

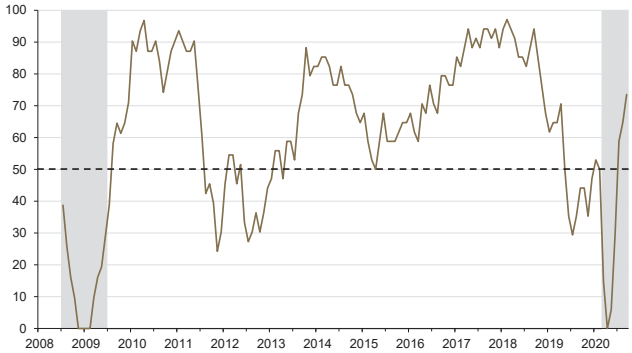
Global manufacturing Purchasing Managers' Indexes
(index; >50 denotes expansion)

Monthly data to September 2020 Shaded regions represent periods of US recession Source: Bloomberg, Guardian Capital

Furthermore, this acceleration in manufacturing activity has been extremely broad-based across the globe with the PMI for 74% of the countries for which the metric is produced coming in above the growth break-even threshold in September. That is the best breadth in two years and a stark change from the zero share registered in April.

CHART 18: NO LONGER GASPING FOR BREADTH

Share of countries with manufacturing PMI above 50
(percent)



Monthly data to September 2020 Shaded regions represent periods of US recession Source: Bloomberg, Guardian Capital

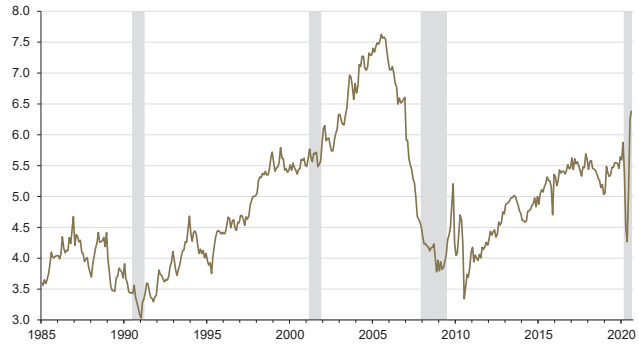
There's no place like home

Another area where low inventories appear supportive of increased activity is housing.

In spite of the jump in unemployment, low interest rates and people spending more times in their homes than ever before, has clearly supported a sharp rise in demand for greener pastures. Sales of new and existing single-family homes in the US have jumped to their best levels in 14 years and are among their highest on record.

CHART 19: ON THE MOVE

Sales of new & existing single-family homes
(millions of units, annualized rate)

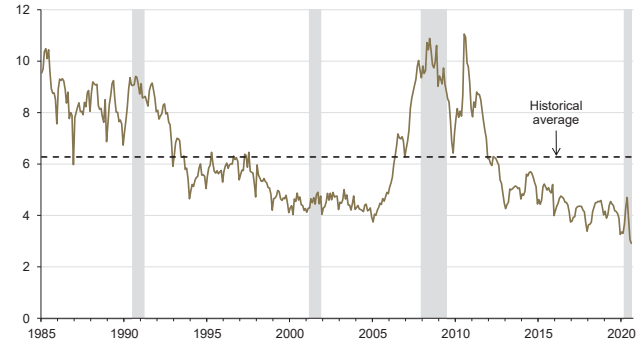


Monthly data to August 2020
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

At the same time, the lockdown-induced lull in homebuilding combined with the reticence of people putting their homes on the market amid a pandemic has generated a dearth of homes that are actually available for sale. The months' supply of new and existing single-family homes on the market has plunged to levels not seen at any point over the last three-and-a-half decades.

CHART 20: LOOKING TO SELL?

Months' supply of new & existing single-family homes for sale
(months)



Monthly data to August 2020
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

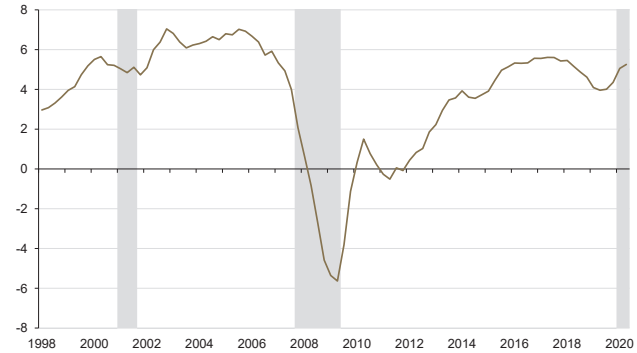
The scarcity principle that underpins economics indicates that when the supply of something is scarce while demand is high, prices rise — and that is what has been happening in housing markets across developed economies (not just the US).

Data covering the 37 market economies that make up the Organisation for Economic Co-operation and Development (OECD) show that home prices were

up 5% year-over-year in Q2 despite much of the group being locked down — and the trend gains have been accelerating.

CHART 21: HOME PRICES MOVIN' ON UP

OECD house price index
(year-over-year percent change)



Quarterly data to Q2 2020
Shaded regions represent periods of US recession
Source: OECD, Guardian Capital

Rising home prices are a clear draw for new residential construction. As well, the historically low supply (even in absolute terms) and the nature of homebuilding that lends itself well to social distancing protocols (suggesting it can avoid restrictions), provides scope for a pickup in activity to help offset softness in the nonresidential space even if housing demand were to take a step back.

CHART 22: HOME IS WHERE THE GROWTH IS

US construction spending by type
(billions of US dollars)

Monthly data to August 2020
Source: US Census Bureau, Bloomberg, Guardian Capital

The elephant (and donkey) in the room

In terms of near-term market and macro event risks, the impending US Election will, no doubt, be a fertile source of material for news media over the next month — especially with the rhetoric likely to heat up as November 3 approaches.

Polling is strongly tilted against the incumbent in the White House with the gap widening against the rush of recent developments. Recent history, however, has shown that pre-election polling does not guarantee future performance.

CHART 23: POPULARITY CONTEST

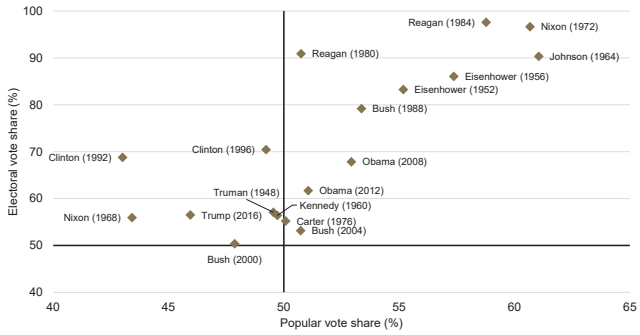
2020 US Presidential Election national polling averages
(percent)

Daily data to October 21, 2020
Source: FiveThirtyEight, Guardian Capital

Further to this, a candidate that received less than 50% of the popular vote has won seven of 19 Presidential elections in the post-WWII era — it is the Electoral College votes that ultimately matter.

CHART 24: MORE THAN JUST IF THEY LIKE YOU

US Presidential Election winners

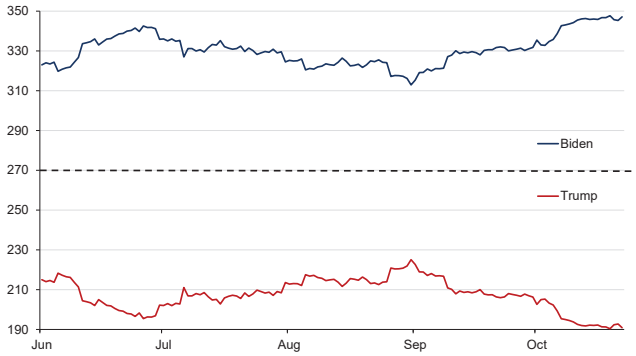


Source: Federal Elections Commission, Bloomberg, Guardian Capital

As it stands, state-level forecasts also favour the challenger in terms of Electors, and even taking into consideration that the race remains tight in some key states, it appears that there is a clear path to a Biden victory.

CHART 25: THE OLD COLLEGE TRY

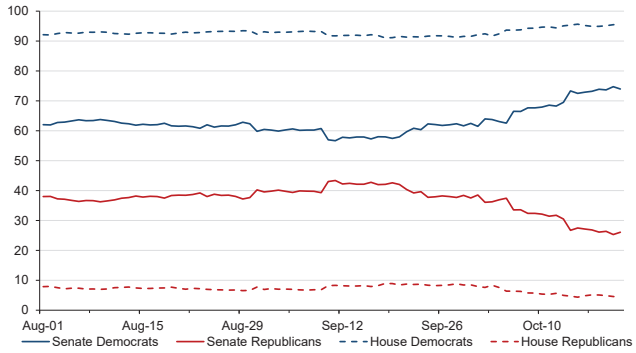
Electoral Vote forecast
(number of Electors)



Daily data to October 21, 2020
Source: FiveThirtyEight, Guardian Capital

CHART 26: WILL A BLUE WAVE CREST?

Estimated probability of control of Chamber
(percent)



Daily data to October 21, 2020
Source: FiveThirtyEight, Guardian Capital

The last four year have taught it would be foolish to count the President out, but the data points to a (hopefully peaceful) transfer of power in the offing.

Of course, while the Presidency gets the bulk of the attention, the ability to govern via Executive Order is limited, especially with respect to spending and tax measures. Therefore, it is important to recognize that the ability of a President to achieve their policy goals is dependent on having a Congress that is willing to cooperate.

Presidents Obama and Trump were able to push through major legislation early in their first terms (the *Affordable Care Act* and tax cuts, respectively) thanks to the fact that their Party also held both the Senate and the House for the first two years of their tenure. Significant action was stymied thereafter under a split Congress with difficulties passing a renewed COVID-19 relief bill the latest example.

In tandem with fading popularity of the Commander in Chief, the down-ballot races for the House of Representatives and Senate have moved against his Party — odds are increasing that Democrats may be able to wrest control of the Senate from the Republicans and end up with a unified government.

Such a result would enable the US government to push through material changes to fiscal policy relative to the Trump platform of more of the same.

The net balance of the new measures in the Biden plan appears to be growth positive — increased spending (particularly investment in infrastructure and education), more COVID-19 fiscal stimulus and reduced protectionism arguably more than offset the impacts of higher taxes and increased regulations — but the impacts may not be felt immediately.

A split Congress under either candidate will limit the ability for anything significant on the policy agenda to fully materialize over the next two years, which would be less than ideal given the hope of government support to help the economy weather the ongoing public health and economic crisis.

A final outcome worth considering is that US Election Day ends without a clear and decisive victory, leading to the results being contested in the courts.

Such an environment (which is increasingly likely as it will potentially take added time to count up all absentee/mail-in ballots that are likely to be more prevalent than ever before thanks to the pandemic) would undoubtedly drive a spike in uncertainty, and likely result in a delay in progress with stimulus measures. However, there would likely be limited lasting impact once a decision was rendered.

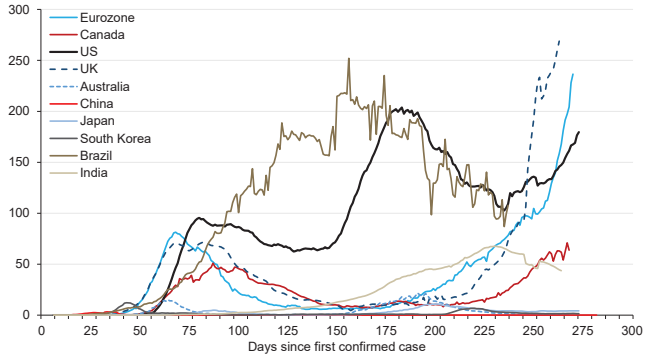
Down with the sickness

When it comes to risks to the outlook, developments with respect to COVID-19 remain paramount.

The potential of another round of lockdowns represent a clear downside and, though there is limited political appetite, the aggressive resurgence of spread could well force governments' hands.

CHART 27: WE'RE GOING THE WRONG WAY!

New confirmed cases of COVID-19
(case per million people, seven-day moving average)



Data to October 20, 2020
Source: Bloomberg, Johns Hopkins University, Guardian Capital

With that said, there is an obvious source of upside risk to expectations: ending or mitigating the ongoing pandemic.

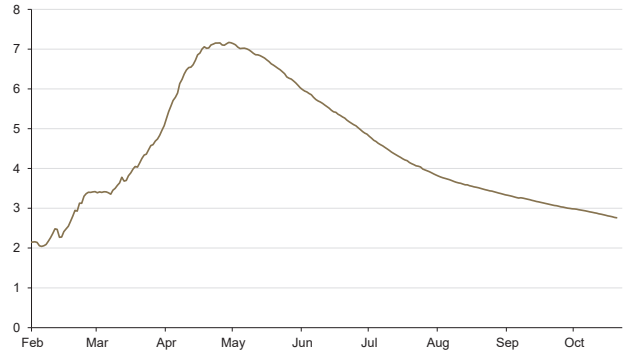
There appears to be high conviction that a vaccine will be developed sooner rather than later, though the production of enough doses and dispensing them to all corners of the world will undoubtedly take time and likely makes this a 2021 story.

For the nearer future, further inroads on therapeutics that can help limit the potential worst outcomes from COVID-19 would also help reduce concerns about the negative implications of opening back up in full.

The persistent decline in the observed case fatality rate of COVID-19 would appear to suggest that medical professionals are getting better at managing cases and avoiding the worst-case outcomes.

CHART 28: SIGNS OF IMPROVING MANAGEMENT

Globally observed COVID-19 case fatality rate*
(percent)



**COVID-19-related deaths as a share of confirmed cases worldwide*
Daily data to October 20, 2020
Source: Johns Hopkins University, Bloomberg, Guardian Capital

Even more, development of rapid, frequent and accurate testing capabilities would help to better monitor and control outbreaks, providing greater confidence in pushing forward with the easing of restrictions on business activity.

Until these are in place to really help global growth move into the express lane and push the growth pedal to the floor, the economy will likely abide by posted speed limits and as it continues along the road to recovery from this historic crisis.

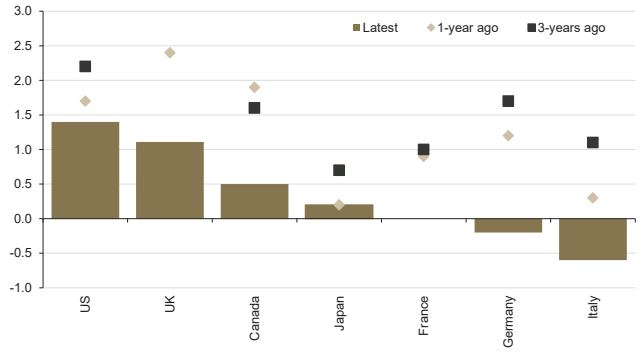
Inflation forgotten but not gone

One of the byproducts of the jump in excess capacity across the economy due to activity restrictions, and the consequent slack in job markets, is that price pressures have fallen by the wayside.

Measures of headline inflation have plunged across the globe and overall consumer prices are actually either on the cusp of deflating or actually in decline across the majority of G7 economies.

CHART 29: INFLATION DEFLATED

Consumer price inflation rates
(year-over-year percent change)



As of September 2020
Source: Bloomberg, Guardian Capital

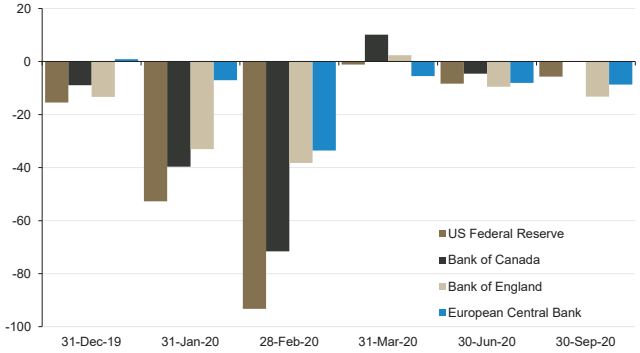
Given central banks' concern over inflation getting out of hand, these limited indications of price pressures bubbling up within economies means there is little impetus for monetary policy authorities to try to reverse course from their extremely accommodative stances for the foreseeable future.

At the same time, many central banks have emphasized that they view the current level of interest rates as the zero lower bounds and expressed limited appetites for further cuts.

Against this, market are effectively pricing in no further actions over the coming year — though a mild easing bias generally remains, particularly in the UK despite Bank of England Governor Andrew Bailey's recent assertion that a move into negative interest rates is not in the offing near-term.

CHART 30: STEADY AS SHE GOES

OIS-implied* change in policy rates over next 12 months
(basis points)



**Difference between 12-month overnight index swap rate and policy rate*
Source: Bloomberg, Guardian Capital

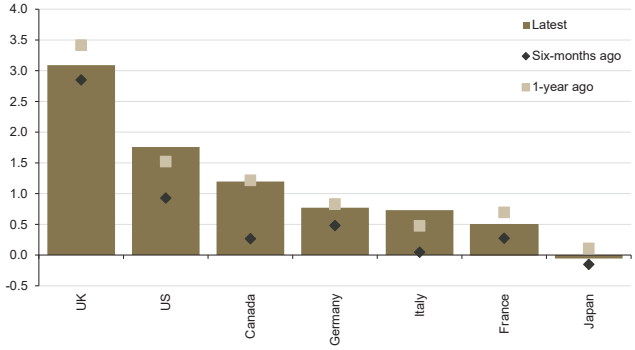
Of course, while inflation may not be top of mind at current that does not mean that it is gone. Much like the brown spots on a banana, by the time the signs are obvious, it is too late to salvage the fruit.

Price pressures may be nonexistent currently, but the anticipation of sustained lax monetary policy and above-trend growth suggests that this will not last.

With the exception of Japan, where the decades' long struggle with deflation is expected to continue, 10-year break-even inflation rates are now effectively retracing their crisis-induced collapse.

CHART 31: LOWERED EXPECTATIONS

10-year break-even inflation rates
(percent)



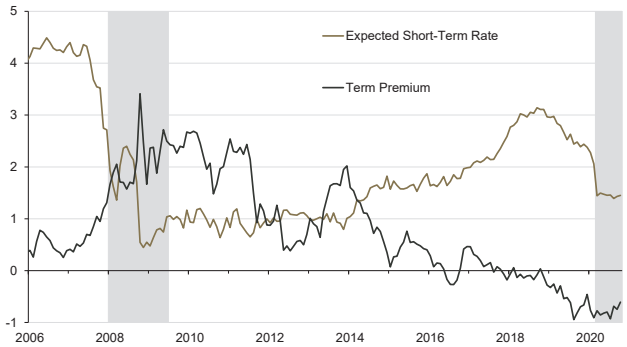
As at October 22, 2020 Source: Bloomberg, Guardian Capital

Rates of return and the return of rates

Inflation expectations remain anchored at benign and below target levels, but this move higher in market pricing has been one factor that has underpinned the drift higher in term premia and pushed market yields to nine-month highs.

CHART 32: TERM PREMIUM STILL DISCOUNTED

Decomposition of 10-year US Treasury note yield
(percent)



Monthly data to October 2020 (October 21, 2020 used). Shaded regions represent periods of US recession. Source: Bloomberg, Guardian Capital

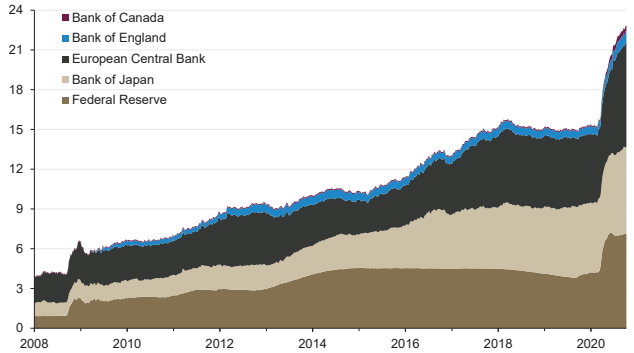
Any further move toward normalization — in more normal times, investors would require a premium to compensate for risks tied to adverse movements in inflation, interest rates and credit quality — would mean further upward pressure on yields and clearly represent a headwind for government bonds' performance.

Of course, the continued dominant presence of central banks in the bond market will ensure that there is a cap on the upside for rates.

The combination of the US Federal Reserve, European Central Bank, Bank of Japan, Bank of England and the Bank of Canada together hold a cumulative $23 trillion worth of assets on their balance sheets roughly equivalent to 36% of the global bond market. With asset purchase programs continuing for the foreseeable future, that share is likely to continue to get larger.

CHART 33: BIG BOND BUYERS

Central Bank Balance Sheets
(trillions of US dollars)



Weekly data to October 14, 2020 Source: Bloomberg, Guardian Capital

This means that government bonds will likely continued to be stuck in a range with limited upside in the coming months. Performance is likely to be in line with the coupon on offer, which remains paltry and provides negligible cushion for even modest rate increases.

Corporate credit, however, appears to offer a better tradeoff between risk and reward.

While these debt issuers have lower credit quality than governments and, therefore, carry a greater risk of default, there are other key aspects that make them appealing.

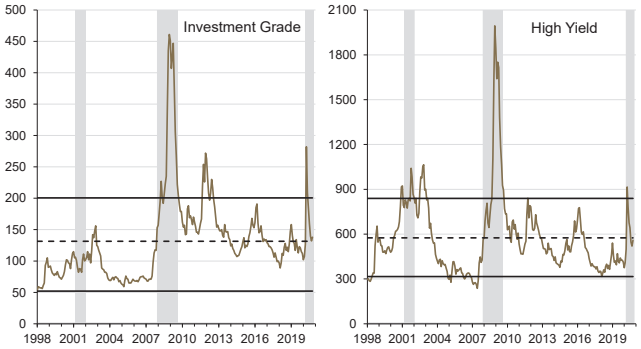
Yields on both Investment Grade and High Yield corporate debt (which have comparably lower durations on average than government bonds) have fallen sharply from the crisis highs thanks to the improved risk sentiment that has been underpinned by several central banks' expanded scope of their bond buying programs including these securities (including some speculative grade bonds).

Even with the declines and resultant narrowing of credit spreads, however, the yield premia over government debt remain well above their recent lows and generally in line with long-term averages.

In other words, corporate credit as an asset class does not appear to be expensive and may, therefore, provide the opportunity for outperformance over the traditionally "risk free" government debt.

CHART 34: SPREAD 'EM

ICE Bank of America Global Option-Adjusted Yield Spreads
(basis points)



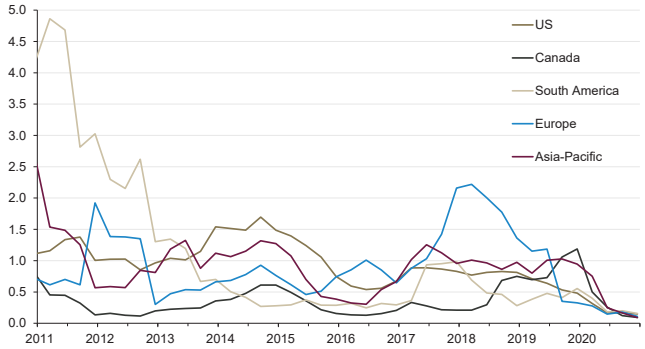
Dashed line represents series average; solid bars +/-1 standard deviation
Monthly data to October 2020 (October 21, 2020 used)
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

On the risk front, the abundance of uncertainty and growth headwinds expected over the forecast horizon suggest that a continued tilt toward higher quality issuers would be prudent.

It is indeed the case that credit ratings agencies have been downgrading corporate bond issues, as the concerns about the economic outlook weigh on earnings expectations and place pressure on debt servicing capability and thus credit quality.

CHART 35: CREDIT CHECK

Ratio of S&P Credit Ratings Upgrade-to-Downgrades
(ratio)

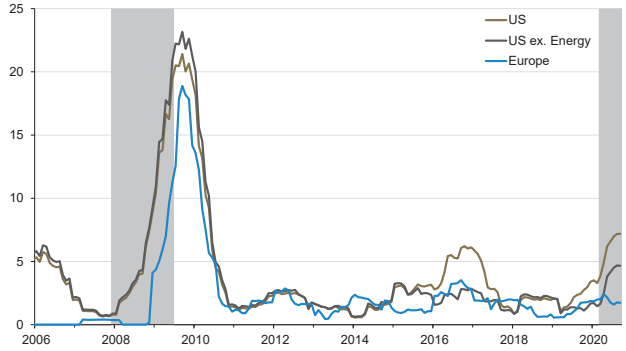


Quarterly data to Q2 2020
Source: Bloomberg, Guardian Capital

As well, defaults rates have moved higher in recent months. It is worth, however, noting that there are nascent signs of stabilization outside of the Energy sector — a segment of the market sideswiped by idiosyncratic issues and carries a disproportionate weight within High Yield (Energy accounts for 13% of the ICE Bank of America Global High Yield Index but less than 3% of the MSCI All-Country World Index).

CHART 36: DEFAULT SETTING

High Yield Bond Par-Weighted Default Rate
(percent)



Monthly data to Septmeber 2020
Shaded region represents period of US recession
Source: Bank of America Merrill Lynch, Guardian Capital

Furthermore, the flood of low-cost lending facilities and credit enhancement programs established by policymakers worldwide to help businesses weather this ongoing this crisis — in addition to the central bank bond buying — are helping to mitigate pressures by reducing the liquidity strains on businesses, which could help reduce the rate of corporate defaults and underpin credit quality.

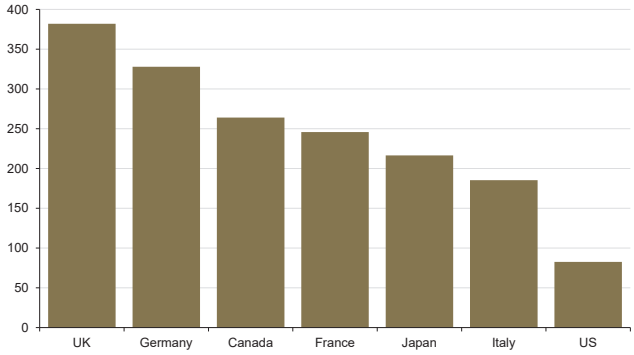
Taking stock

Of course, there are other areas of the financial market where investors can find comparatively elevated yields, namely equities.

The dividend yields offered on the broad stock market indexes worldwide remain well above 10-year government bond yields — and that is not even adopting an explicit concentration on companies that pay above average dividends.

CHART 37: OVER AND ABOVE

MSCI Index Dividend Yield v. 10-Year Sovereign Bond Yield
(basis points)

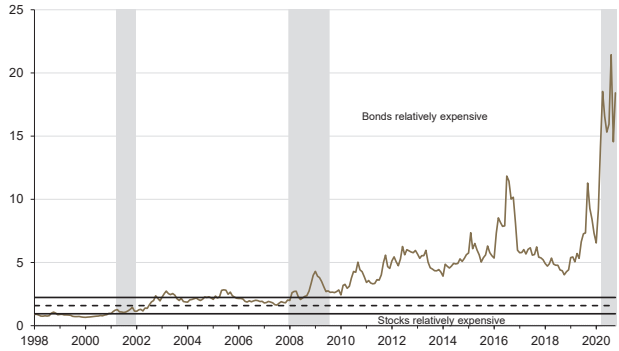


As at October 21, 2020
Source: Bloomberg, Guardian Capital

Moreover, equities continue to look attractive on a relative valuation basis — even in the context of diminished earnings expectations and continued uncertainty over the outlook, relative to where yields on government bonds currently sit, equities still look historically inexpensive.

CHART 38: IT'S ALL RELATIVE

MSCI World Earnings Yield-to-Global Government Bond Yield
(ratio)



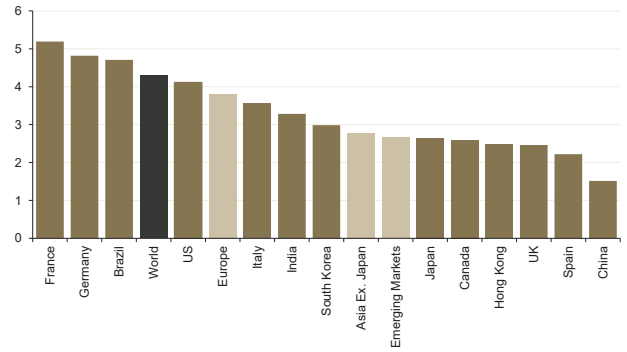
Dashed line is pre-financial crisis average; bars +/-1 standard deviation
Monthly data to October 2020 (October 21, 2020 used)
Shaded regions represent periods of US recession
Source: Bloomberg, Guardian Capital

That said, equities are not an asset class devoid of risk. Indeed, there is rising concern over valuations for the asset class on an absolute basis given the robust performance seen since the March market lows.

For example, the forward price-to-earnings (P/E) ratio for the MSCI World Index is 23x, which is more than four standard deviations above its 15-year average as the rebound in market prices has outpaced that of earnings expectations.

CHART 39: A LITTLE RICH FOR MY TASTE

MSCI Country Index Forward Price-to-Earnings Ratio
(standard deviations from 15-year average)



As at October 21, 2020
Source: Bloomberg, Guardian Capital

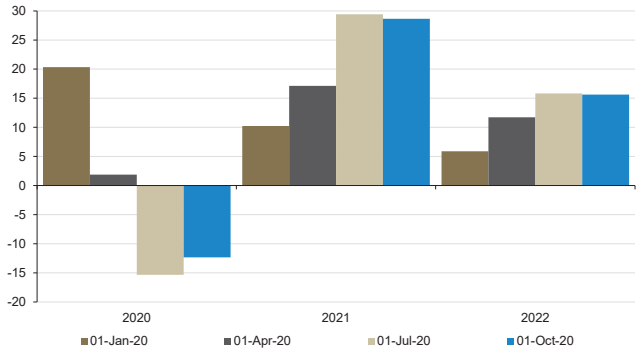
Of course, this valuation metric focuses on the near-term (current market prices are taken relative to earnings forecasts for the coming 12 months), and while the baseline assumption is that growth continues, it is expected to be constrained as COVID-19 related restrictions on activity remain in place.

As such, it is arguable that more and more investors are looking beyond the coming year to a time when pandemic-era social distancing protocols are removed and life returns to something more "normal".

On this score, while consensus earnings expectations have collapsed for the current year (though, they have increasingly been revised higher from the lows earlier this year as analysts have backtracked against the better-than-anticipated rebound in global activity) growth expectations have broadly been revised up across the forecast horizon.

CHART 40: I HAVE TO ADMIT IT'S GETTING BETTER

MSCI World earnings per share growth forecasts
(year-over-year percent)

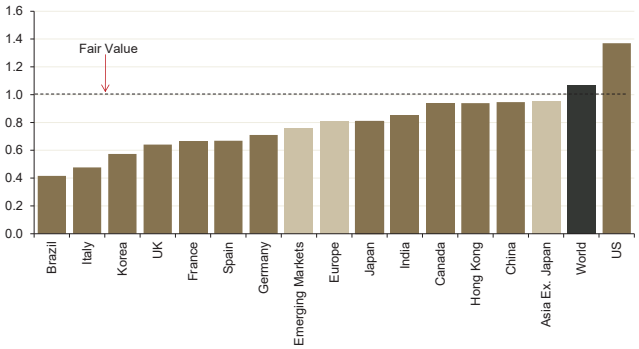


Source: Bloomberg, Guardian Capital

Scaling the P/E ratios to the forecast annual average growth rate for the coming two years — which have actually moved higher at the same time as the expectations for the current year have been culled — suggests that global equities are actually fairly reasonably priced, with those outside of the US notably somewhat undervalued.

CHART 41: ROOM TO GROW

MSCI Country Index Forward P/E to Growth* Ratio
(ratio)



**compound annualized growth rate of earnings forecasts to 2022*
As at October 21, 2020 Source: Bloomberg, Guardian Capital

Micromanagement

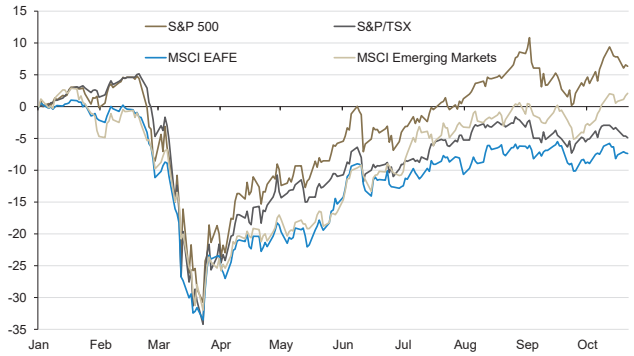
The US stock market warrants a quick discussion, given that it has continued to lead the rest of the world and the valuation gauges in the chart above suggest it has gotten ahead of itself and become disconnected from its underlying fundamentals.

The S&P 500 was up 4% year-to-date at the end of Q3 and retesting all-time highs. In contrast, the benchmarks for Europe, Australasia and the Far East (EAFE), Emerging Markets and Canada all

were down on the year and still roughly 10% to 20% away from their prior peaks.

CHART 42: NO CONTEST

2020 Year-to-date equity market performance
(percent)



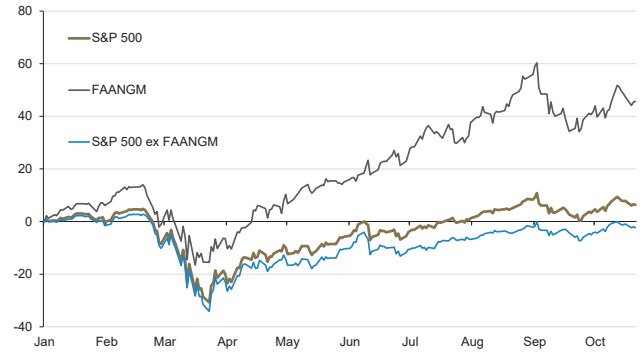
Daily data to October 21, 2020
Source: Bloomberg, Guardian Capital

Importantly, though, the story of the American stock market has not been about broad-based performance as much as it has been the strength of but a few extremely large companies.

In fact, if not for cumulative 42% year-to-date increase for Facebook, Amazon, Apple, Netflix, Google/Alphabet and Microsoft (FAANGM, which alone account for one-quarter of the market capitalization of the S&P 500) as at the end of Q3, the US stock market would actually have ended the quarter down 4%.

CHART 43: DEFANGED MARKET PERFORMANCE

S&P 500 performance year-to-date with & without FAANGM*
(percent)

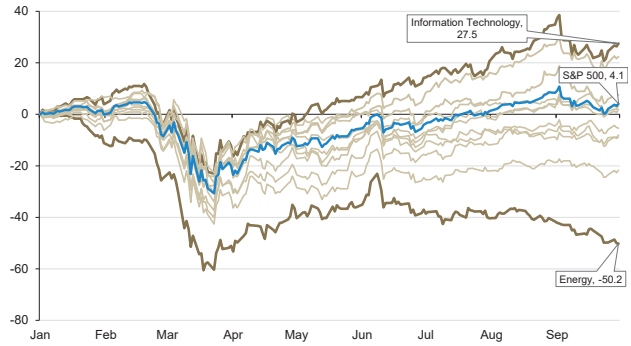


FAANGM=Facebook, Amazon, Apple, Netflix, Google and Microsoft
Daily data to October 21, 2020
Source: Bloomberg, Guardian Capital

More to this point, the equal-weighted version of the S&P 500 was down 6% year-to-date at the end of September and there has been considerable performance dispersion – there is a 77-percentage point gap between the top (Tech) and bottom (Energy) performers for the year-to-the end of September. Further, only three of 11 sectors are above the benchmark year-to-date and five sectors are in negative territory.

CHART 44: DISPERSE!

S&P 500 sector performance year-to-date
(percent)



Daily data to September 30, 2020
Source: Bloomberg, Guardian Capital

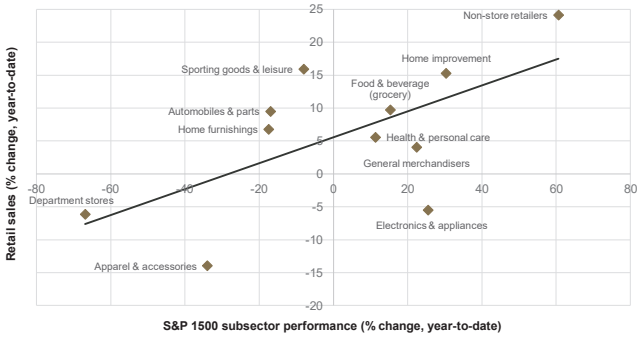
Finally, let us look at retail as a microcosm of the broader market, as further evidence that the US market performance from the lows has not been a case of a rising tide lifting all boats.

The S&P 1500's (incorporating small-, mid, and large-cap US companies) retailing sector is now up 41% year-to-date and 80% from its lows, but the performance has been far from uniformly positive.

Instead, there has been a strong correlation this year between the areas of American retail spending and the performance of the S&P 1500 subsectors (the categories from the US retail sales data compiled by the US Census Bureau has been matched to its closest corresponding equity subsector). At one of end the spectrum, you have the non-store retailers (e-commerce) that have understandably thrived in this environment, while department stores have struggled, in terms of actual sales activity and stock performance.

CHART 45: IMITATION GAME

US retail sales and S&P 1500 subsector performance



Based on monthly data to September 2020
Source: Bloomberg, Guardian Capital

In other words, the market is clearly separating the wheat from the chaff. The connection between what is happening with stocks is not out of whack with the broader macro backdrop.

The indications that broad equity markets — not just the US — are not, in fact, "priced for perfection" leaves room for further performance. As such, continued growth and low interest rates should continue to provide a supportive backdrop for equities to continue to generate positive returns, though the gains are likely to be more moderate than the outsized increases registered over the last six months.

Commodity complexities

After a very eventful first half of 2020, the commodity complex took a welcome summer break.

Oil prices, for example, exchanged extreme volatility for very tight trading range as the impact of the better-than-expected recovery to this point has been offset by a still considerable inventory overhang.

CHART 46: CONTRACTS SETTLED DOWN

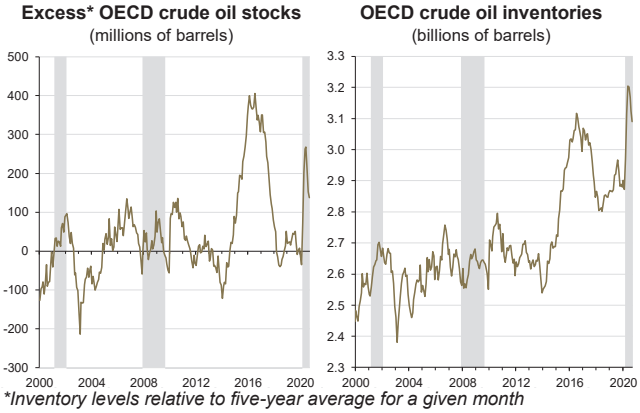
Benchmark Crude Oil Price

(US dollars per barrel)

Daily data to October 21, 2020 Shaded region represents period of US recession Source: Bloomberg, Guardian Capital

The Organization of Petroleum Exporting Countries (OPEC) and Russia have committed to curbing production through the end of the year, however, global stockpiles of crude and related products remain historically elevated on both a relative and absolute basis, which means much more progress is still need to bring the market into balance.

CHART 47: PIPELINE PRESSURES



**Inventory levels relative to five-year average for a given month*
Monthly data to September 2020 Shaded regions represent periods of US recession Source: US Department of Energy, Guardian Capital

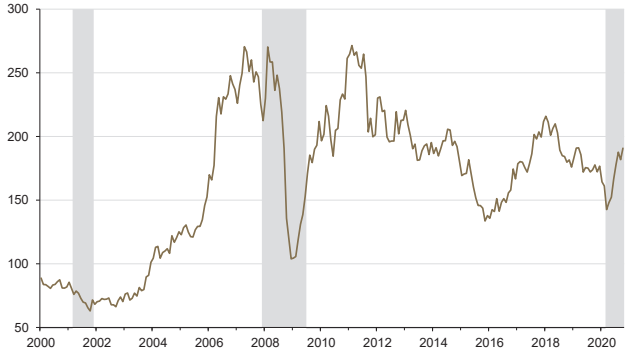
As such, there is little reason to anticipate that oil prices will break out of their recent ranges in the near future.

Base metals, in contrast, underwent a protracted market rebalancing that left stockpiles at more than decade lows. As such, the industrial commodities' prices have strongly benefited from the recovering of production across the global supply chain — the Bloomberg Base Metals Index hit its highest level in a year-and-a-half and stands to record further gains

should the global inventory cycle pickup in earnest.

CHART 48: PEDAL TO THE METAL

Bloomberg base metals spot price index
(index)



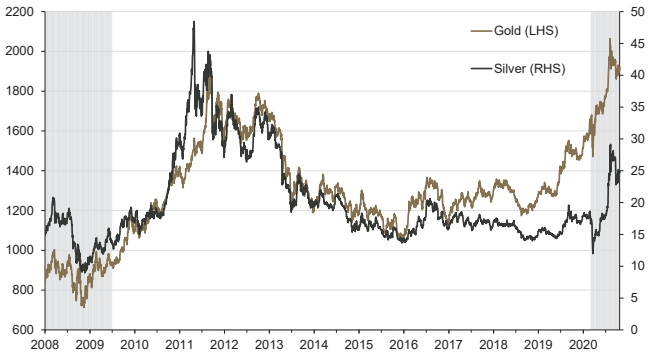
Monthly data to October 2020 (October 21, 2020 used) Shaded regions represent periods of US recession Source: Bloomberg, Guardian Capital

Precious metals have performed even better against the backdrop of elevated volatility, low interest rates, central bank balance sheet expansion and deteriorating fiscal positions that represent the idyll environment for the ages-old dollar hedge and safe haven investment.

Prices for the gold, in particular, have soared to record-high levels and the expected persistence of the market forces that brought them to this point means that they could continue to stay bid.

CHART 49: MY PRECIOUS

Precious metal spot price
(US dollars per troy ounce)



Daily data to October 21, 2020 Shaded region represents period of US recession Source: Bloomberg, Guardian Capital

Where to next?

It has now been more than six months since the initial wave of COVID-19 caused the world to go on lockdown. Significant progress has been made in terms of an economic recovery but there remains much more lost ground to be made up.

The obvious questions are: where do we go from here and what is likely to guide the market and macro narrative as we (thankfully) enter the home stretch of this tumultuous calendar year?

Clearly, the most important driver of what happens next is what happens with COVID-19.

As it stands right now, it is arguable that the restart of business activity in much of the world has reached its limits under the current stages of pandemic restriction rollbacks, which stands to constrain any future gains.

Absent the continued unwinding of restrictions on all activity (especially those that face larger issues implementing social distancing mandates), there is limited scope for the overall economy to achieve pre-COVID-19 levels soon.

Moreover, there is rising risk that these supply-side constraints are going to get worse before they get better, given the resurgence of contagion following lulls over the summer has paused reopening plans and, in several cases, resulted in a reversal of some easing of restrictions.

Against this backdrop, expectations are for future growth to be much more moderate than the torrid pace recorded over the last few months — and the likelihood is that the road to recovery will be bumpier than the recent experience.

That trajectory, combined with the still ample monetary and fiscal stimulus, should continue to be constructive for financial markets and supports a continued tilt toward exposure to risk assets. These, however, are likely to find themselves much more susceptible to shocks that result from headlines over the coming months.

Headlines will undoubtedly be abundant with the impending US Election providing a fertile source of material for news media over the next month as the rhetoric is likely to heat up as November 3 approaches.

Political uncertainty is never well-received by markets, however, some solace can be taken by investors in the fact that history shows that whoever actually holds Office does not carry much impact in the near-term for the economy or markets. After all, the causal flows tends to be that the market and macro backdrop influences the election, rather than the other way around, as recessionary conditions and associated market weakness tend to be a catalyst for a change in political regimes.

As such, knee-jerk reactions to happenings on this front, sharp as they may be, tend to be short-lived.

Therefore, developments on the COVID-19 front will continue to be paramount.

The risks of another round of lockdowns (though there is limited political appetite, aggressive and uncontrolled spread could force governments' hands) represent a clear downside, but there is an obvious source of upside risk to expectations: ending or mitigating the ongoing pandemic.

There appears to be high conviction that a vaccine will be developed sooner rather than later, though the production of enough doses and dispensing them to all corners of the world will undoubtedly take time and likely makes this a 2021 story.

For the nearer future, further inroads on therapeutics that can help limit the potential worst outcomes from COVID-19 would also help reduce concerns about the negative implications of opening back up in full.

Even more, development of rapid and frequent testing capabilities would help to better monitor and control outbreaks, providing greater confidence in pushing forward with the easing of restrictions on business activity.

Until these measures are in place to really help global growth move into the express lane and push the growth pedal to the floor, the recovery will likely remain on its current trajectory and abide by posted speed limits — and markets will likely tread more carefully until there is more clarity on what comes next.

Equities	+	**Fixed Income**	—
Canadian Equity	+	Government Bonds	—
US Equity	+	Investment-Grade Credit	+
EAFE Equity	+	High-Yield Credit	+
Emerging Markets	+		

Source: Guardian Capital

Market Returns at September 30, 2020 All returns in CDN $

CANADIAN EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P/TSX Composite	-2.1	4.7	-3.1	0.0	7.2	5.8
S&P/TSX 60	-2.0	4.4	-2.1	0.3	7.6	6.2
S&P/TSX Completion	-2.2	6.1	-6.4	-1.1	5.7	4.5
S&P/TSX SmallCap	-4.6	6.6	-8.6	-2.9	4.5	0.8
S&P/TSX Composite High Dividend	-3.1	3.6	-18.5	-15.2	4.2	4.8
S&P/TSX Composite Dividend	-1.7	5.1	-6.8	-4.6	7.1	N/A

S&P/TSX SECTOR RETURNS (%)

Communication Services	-0.4	2.0	-7.1	-6.3	6.1	10.0
Consumer Discretionary	1.9	8.4	-3.3	-5.5	3.8	9.8
Consumer Staples	7.7	9.1	10.5	6.2	8.5	15.6
Energy	-11.0	-8.1	-36.0	-31.4	-4.6	-3.8
Financials	-3.5	4.0	-12.9	-12.1	6.5	8.4
Health Care	-8.5	-14.3	-40.8	-44.3	-39.5	-6.5
Industrials	3.1	13.6	9.3	14.9	14.2	14.0
Information Technology	-2.5	3.6	67.9	86.0	33.5	15.7
Materials	-2.9	9.1	25.8	35.7	17.4	0.0
Real Estate	0.8	4.1	-16.7	-18.8	5.2	8.8
Utilities	6.4	11.0	9.2	11.4	11.9	8.3

U.S. EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
S&P 500	-1.4	6.8	8.7	16.2	14.1	16.7
Dow Jones Industrial Average	0.3	6.1	2.1	6.6	14.0	15.7
NASDAQ	-2.8	8.9	28.2	40.8	19.2	19.9
Russell 1000	-1.2	7.4	9.6	17.0	14.0	16.8
Russell 2000	-0.9	2.9	-5.9	1.3	7.9	12.7
Russell 3000	-1.2	7.1	8.6	16.0	13.6	16.5
Russell 1000 Growth	-2.3	11.0	28.1	38.8	20.0	20.3
Russell 1000 Value	0.0	3.6	-8.9	-4.2	7.6	12.8

S&P 500 SECTOR RETURNS (%)

Communication Services	-4.1	6.8	11.9	19.4	10.5	12.3
Consumer Discretionary	-1.2	12.8	27.1	30.0	17.0	21.3
Consumer Staples	1.0	8.3	7.3	8.7	9.3	14.7
Energy	-12.4	-21.3	-46.5	-44.8	-9.7	-0.6
Financials	-1.1	2.4	-17.8	-11.1	7.8	12.6
Health Care	0.3	3.8	8.2	21.2	11.8	18.4
Industrials	1.7	10.3	-1.1	2.2	10.8	14.5
Information Technology	-3.0	9.8	32.6	48.5	27.1	23.7
Materials	3.9	11.1	8.6	13.2	12.1	12.3
Real Estate	0.4	0.0	-4.0	-6.5	N/A	N/A
Utilities	3.7	4.1	-2.8	-4.1	10.3	13.6

INTERNATIONAL EQUITIES

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
MSCI World Index (Net, C$)	-1.0	5.8	4.8	11.4	10.4	12.3
MSCI EAFE Index (Net, C$)	-0.1	2.8	-4.3	1.4	5.2	7.4
MSCI ACWI (C$)	-0.8	6.0	4.4	11.4	10.2	11.4
MSCI France (C$)	-2.2	0.8	-10.9	-5.3	5.4	6.8
MSCI Germany (C$)	-0.6	6.2	3.1	10.9	5.8	8.1
MSCI Japan (C$)	3.5	4.9	2.3	7.9	7.5	9.0
MSCI U.K. (C$)	-2.6	-2.2	-21.1	-15.1	-0.5	4.7
S&P/IFC Investable (Emerging Markets)	0.8	7.0	0.9	10.1	9.1	5.8
MSCI EAFE Growth (Gross, C$)	1.9	6.4	8.1	14.8	9.6	10.2
MSCI EAFE Value (Gross, C$)	-2.1	-0.7	-15.4	-10.7	1.7	5.4

INTERNATIONAL EQUITIES

MSCI EAFE SECTOR RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Communication Services	-0.1	2.0	-0.3	2.3	1.3	6.4
Consumer Discretionary	1.7	7.6	-2.6	4.3	5.1	9.2
Consumer Staples	1.4	2.4	1.9	1.6	5.8	9.9
Energy	-11.5	-15.0	-43.1	-42.1	-3.1	-1.0
Financials	-5.6	-3.2	-21.1	-16.2	-1.2	3.6
Health Care	2.2	0.9	10.3	21.5	7.7	12.8
Industrials	1.8	8.2	-1.4	6.3	8.5	8.8
Information Technology	2.0	6.0	13.1	24.8	15.2	12.0
Materials	1.1	8.7	3.4	11.9	11.3	5.7
Real Estate	-1.7	0.9	-16.5	-14.8	N/A	N/A
Utilities	-0.3	1.0	3.6	6.8	6.8	5.5

Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson Financial

Market Returns at September 30, 2020 All returns in CDN $

CANADIAN FIXED INCOME – CA$

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE Canada 91 Day TBill	0.0	0.1	0.8	1.3	1.0	1.0
FTSE Canada Short Term Overall Bond	0.2	0.7	4.8	4.9	2.3	2.5
FTSE Canada Mid Term Overall Bond	0.4	1.1	9.4	8.2	4.1	4.7
FTSE Canada Long Term Overall Bond	0.4	-0.3	11.0	8.9	6.9	6.8
FTSE Canada Universe Bond	0.3	0.4	8.0	7.1	4.3	4.4
FTSE Canada High Yield Overall Bond	0.8	4.6	2.5	3.9	7.3	5.8
FTSE Canada Real Return Bond Overall	0.0	4.4	11.0	8.8	4.6	4.5
SECTOR RETURNS (%)						
FTSE Canada Federal Bond	0.4	0.0	7.5	6.4	2.9	3.2
FTSE Canada Provincial Bond	0.4	0.1	9.2	7.8	5.3	5.3
FTSE Canada All Corporate Bond	0.0	1.3	6.8	6.9	4.7	4.8

GLOBAL FIXED INCOME

INDEX RETURNS (%)	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
FTSE World Government Bond	2.3	1.0	10.4	7.7	3.9	4.5

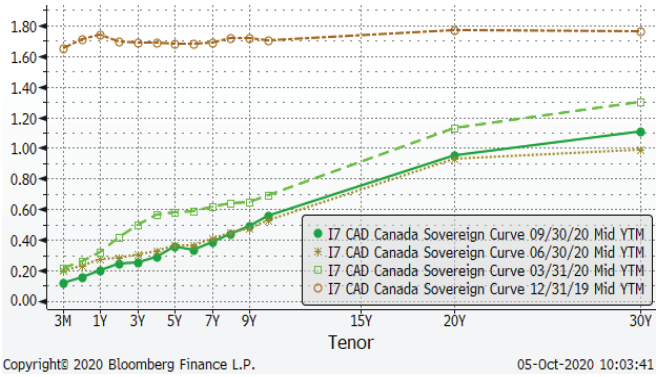
COMMODITY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Bloomberg WTI Cushing Crude Oil Spot Price	-3.2	0.4	-32.1	-25.0	-2.3	-4.2
Bloomberg European Dated Brent BFOE Price	-5.4	-1.8	-36.5	-31.0	-2.8	-4.2
Edmonton Crude Oil Syncrude Sweet Blend FOB Spot	-3.7	7.5	-35.1	-28.2	-3.5	-4.7
S&P GSCI Nat Gas Index Spot	-1.5	41.5	18.9	9.4	0.0	-1.7
S&P GSCI Copper Index Spot	2.6	8.9	11.5	17.8	5.2	0.8
S&P GSCI Gold Index Spot	-1.8	3.2	28.2	29.8	11.1	6.5

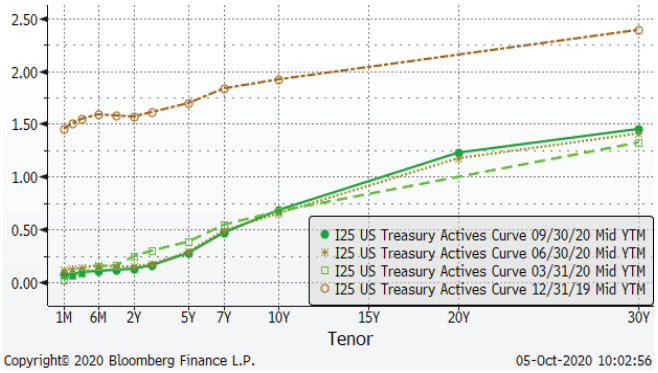
CURRENCY

	1 Mo	3 Mos	YTD	1 Yr	5 Yrs	10 Yrs
Canadian $/U.S. $ (% chg)	2.5	-1.9	3.0	0.9	-0.1	2.6
Canadian $/Yen (% chg)	3.0	0.3	6.1	3.3	2.5	0.3
Canadian $/GBP (% chg)	-1.0	2.6	0.5	5.8	-3.1	0.6
Canadian $/Euro (% chg)	0.5	2.4	7.6	8.5	0.9	1.1

GOVERNMENT OF CANADA YIELD CURVE



U.S. TREASURY YIELD CURVE



Sources: Bloomberg Finance L.P., FTSE Bond Analytics, TD Securities, Thomson

Date Published: October 26, 2020