GUARDIAN CAPITAL

## SUMMARY


- The last 18 months have been difficult and while plenty of uncertainty persists, it appears that the winds of change are finally blowing.
- The end of the pandemic appears to be on the horizon, finally, thanks to the combination of the global vaccination campaign and the development of highly effective therapeutics.
- With the resultant broader resumption of activity, the economic cycle is slated to evolve from the ‘recovery’ to the ‘expansion’ phase. While that maturation comes with a moderation in the pace of growth, the further absorption of slack over the coming year should still mean growth at stronger rates than prevailed over the decade before the pandemic hit.
- The growing indications that the trajectory of the global economy is on a positive track and inflationary pressures are building has also resulted in a shift in the approach to fiscal and monetary policy, with policymakers turning their focus from supporting an economic recovery to maintaining expansion. As such, we can anticipate crisis-era stimulus to fade in the months ahead.
- Monetary policy is, however, set to remain on the ‘easy’ side of the dial for the foreseeable future as the unwind is likely to be gradual. That said, the broad trend for market interest rates is likely to be higher from their still historically depressed levels.
- Against this backdrop, bonds appear unattractive while the generally constructive, albeit still challenging, outlook favours exposure to risk assets that can continue to benefit from an environment of strong growth and ample liquidity.

## Shifting gears

The past year and a half have largely felt like an exercise in repetition. The restrictions on activity and constant uncertainty brought about by the pandemic have kept daily life seemingly on an unvarying loop, not unlike the 1993 comedy classic *Groundhog Day*.

From an economic and market standpoint, this has meant that the underlying fundamental themes and risks to the outlook have not changed much since COVID-19 entered the lexicon, which has made regular commentaries such as these sound somewhat stuck on repeat.

With that in mind, it is a welcome change of pace to be able to note that the winds of change appear to finally be blowing, causing some significant shifts in the backdrop as 2021 enters its home stretch and the New Year starts to peek out over the horizon.

And while it is often the case that change can be difficult and uncomfortable, there is plenty to look forward to in the months ahead as the world appears to be edging closer to a post-pandemic era.

### A shot across the bow

Without a doubt the single biggest driver of change is progress with respect to the pandemic.

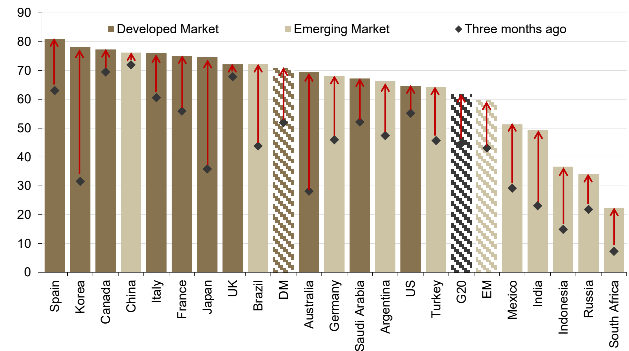
The global vaccination campaign has been a key factor in not just mitigating contagion but also keeping those infected out of hospital, and limiting the severity of cases requiring acute medical attention. The continued development of highly effective therapeutics has also undeniably played a big role in improving the ultimate prognosis of patients.

Vaccination rates worldwide have increased sharply over the last three months as doses have become more widely available, particularly among the Emerging Market (EM) economies.

As it currently stands, more than 60% of the population across the G20—and 70% of those in Developed Markets (DM)—has now received at least one jab. Those tallies are likely to increase rapidly in the coming months as approvals for inoculations for those under 12 appear imminent.

**CHART 1: TAKING MY SHOT**

**Population with at least one COVID-19 vaccine dose, G20**
(percent of total population)

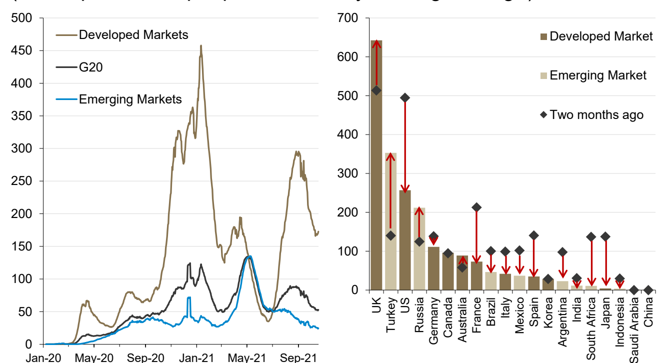



*Data as at October 19, 2021*
*Source: Our World in Data, Guardian Capital*

Not uncoincidentally, the latest wave of infection (that was largely of the highly infectious Delta variant) crested at lower highs and has since ebbed sharply with few exceptions across the world—the UK, where vaccination efforts began early and stringency measures have been unwound to the greatest extent among DM, being the biggest outlier.

**CHART 2: GETTING THIS OFF MY CREST**

**New confirmed cases of COVID-19, G20**
(cases per million people; seven-day moving average)

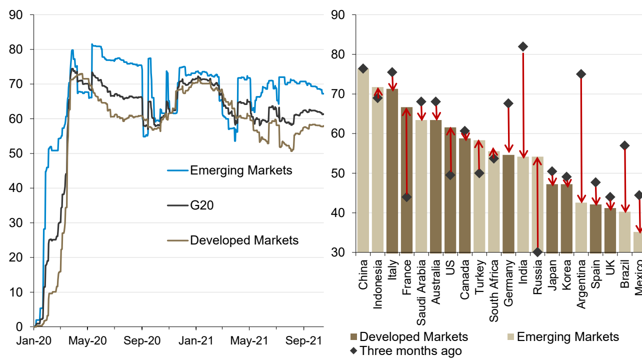



*(L) Data to October 19, 2021; (R) data as at October 19, 2021*
*Source: Our World in Data, Bloomberg, Guardian Capital*

The falling case counts combined with the better management of the virus and reduced stress on healthcare systems have given governments more comfort in moving forward with reopening plans that had been put on hold over the summer—though many regions have made proof of vaccination a requirement for enjoying the easing of social distancing protocols.

**CHART 3: EASING THE RESTRAINTS**

**Government Response Stringency Index[1], G20**
(index; higher indicates more stringent measures in place)



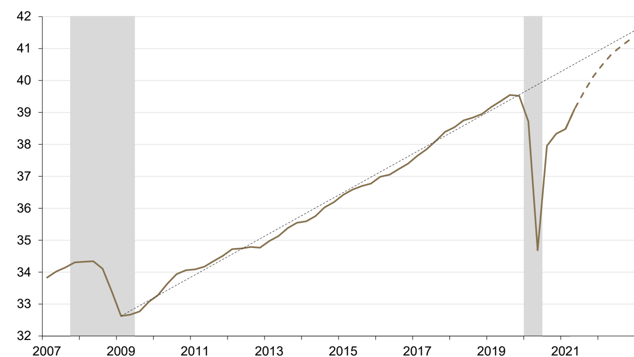

*(L) Data to October 19, 2021; (R) data as at October 19, 2021*
*Source: Oxford COVID-19 Government Response Tracker, Guardian Capital*

The easing restrictions and resultant resumption of activity in a large swath of the global economy that had been effectively idled—particularly in the higher contact service sector where public health measures have made operations difficult—means that the recovery from the unprecedented shock experienced last year remains on track despite the ebb and flow of COVID-19 case totals.

Indeed, current forecasts—which represent modest near-term downgrades due to the impact of the latest wave of infection—imply that all lost ground is expected to be fully recovered across the G7 (Canada, France, Germany, Italy, Japan, the UK and US, which, combined account for one-third of total global gross domestic product) by year-end, and the pre-crisis trend for global output could be re-established next year.

**CHART 4: GETTING BACK ON TRACK**

**Real gross domestic product, G7**
(trillions of 2015 US dollars)



*Data to Q2 2021; dashed line represents Bloomberg consensus forecasts as at October 19, 2021; shaded regions represent periods of US recession*
*Source: OECD, IMF, Bloomberg, Guardian Capital*

## On to the next phase

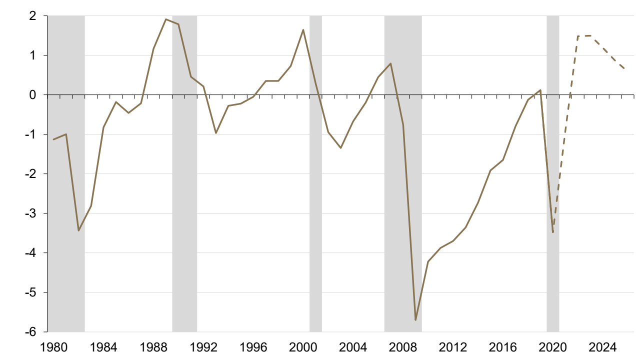
The expected evolution of the economic cycle from 'recovery' to 'expansion' represents a shift in the global growth backdrop.

At the onset of a crisis or general economic downswing, abundant excess capacity is created as demand collapses. As demand recovers, growth rebounds as this slack is readily absorbed but eventually, the pace is again constrained by structural factors that serve as a speed limit on the economy—namely, the growth of productive capacity, which is determined by technological innovation, capital and labour force growth.

Recent forecasts from the International Monetary Fund (IMF) suggest that output gaps (estimates of excess capacity in an economy) across the G7 are not expected to close until next year, but much of the low-hanging fruit has already been picked, meaning that the positive cyclical forces are increasingly being replaced more structural ones.

**CHART 5:MIND THE GAP**

**Output gap, G7**
(percent of potential gross domestic product)



*Forecast data as per IMF World Economic Outlook (October 2021); shaded regions represent periods of US recession*
*Source: IMF, Guardian Capital*

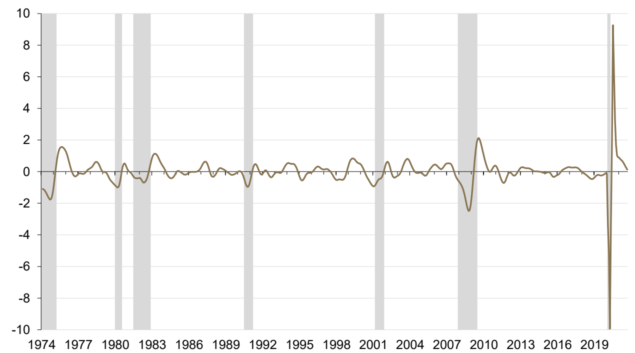
It is undeniable that indicators of forward momentum have been flagging more moderate growth in the months ahead than the robust rate of expansion recorded over the last year. For example, the pace of increase in the composite leading economic

[1] Government Response Stringency Index is a composite measure calculated as the simple additive score of seven indicators measured on an ordinal scale, rescaled to vary from 0-100; the indicators are school closings, workplace closings, public event cancellations, public transport closures, public info campaigns, restrictions on internal movement, and international travel controls.

indicator for the 36 industrialized economies of the Organisation for Economic Co-operation and Development (OECD) and six other major EM (OECD+) has slowed markedly from its earlier record highs.

**CHART 6: LEADING THE WAY FORWARD**

**Composite leading economic indicator, OECD+[2]**
(three-month percent change)




*Data to September 2021; shaded regions represent periods of US recession*
*Source: OECD, Guardian Capital*

With that said, it is important to make a distinction between "slowing" and "slow".

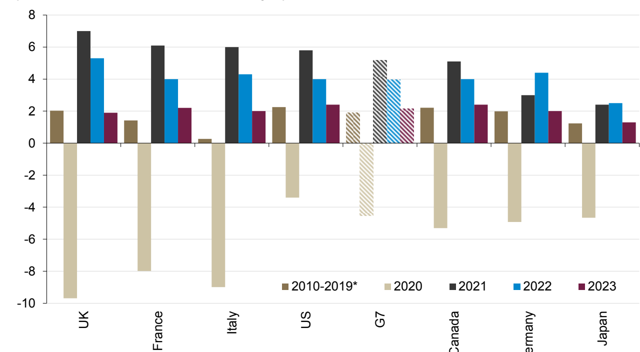
The data are indicating that the pace of increase is *slowing* from what have been historically elevated rates, not that growth can be characterized as *slow*.

The absolute rate of growth remains fairly robust, especially compared with the trend rates that prevailed prior to the crisis.

Current consensus forecasts suggest real output growth across the major G7 economies in 2021 will be the fastest at least since 1980 (2020 marked the biggest one-year decline over that period). That rate is expected to slow in 2022, but remain more than double pre-crisis trends—rates are anticipated to converge with (though still hold above) those of potential (i.e. full capacity) thereafter.

**CHART 7: SLOWER, NOT SLOW**

**Growth in real gross domestic product, G7**
(annualized percent change)




**Compound annualized growth rate; data for 2021, 2022 and 2023 are Bloomberg consensus forecasts as at October 19, 2021*
*Source: OECD, IMF, Bloomberg, Guardian Capital*

In other words, instead of being on the verge of a period of economic stagnation with outright slow-to-negligible growth, above-trend gains are expected to continue over the forecast horizon as the economic upswing, while maturing, is still fairly nascent.

## Consumer clout

The COVID-management-permitted reopening of economic activity and the overall health of global consumers are primary reasons underlying expectations of sustained fundamental economic strength in the months ahead.

Consumers have been the driver of the recovery to this point and, instead of being exhausted, there remains plenty scope for households to continue to act as the global growth engine.

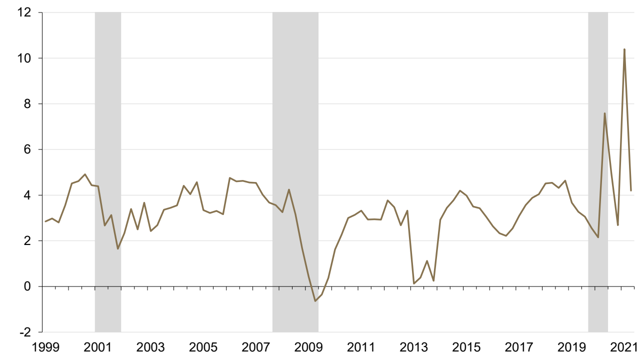
Despite the many negative impacts of the pandemic on day-to-day life, this period has actually resulted in households, on average, being in historically good financial shape.

Though job loss was substantial and has yet to be fully recovered across the G7, aggregate personal disposable income growth has been strong thanks in large part to governments (especially those in the US and Canada) filling the void to keep households afloat.

[2] OECD+ is an aggregate including the 36 OECD economies and six major non-member economies (Brazil, China, India, Indonesia, Russia and South Africa).

**CHART 8: INCOME SUPPLEMENTED**

**Personal disposable income, G7**
(year-over-year percentage change)

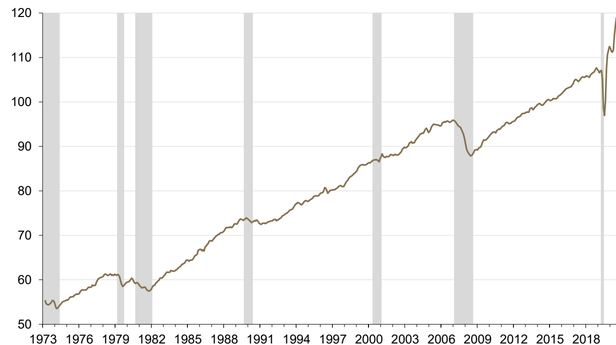



*Data to at Q2 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, IMF, OECD, Guardian Capital*

The strength of cash flows has undoubtedly provided a support to consumer spending, with overall retail sales volumes across the G7 surging to record high levels.

**CHART 9: ROBUST RETAIL**

**Retail trade volumes, G7**
(index, 2015=100; three-month moving average)




*Data to July 2021; shaded regions represent periods of US recession*
*Source: OECD, Bloomberg, Guardian Capital*

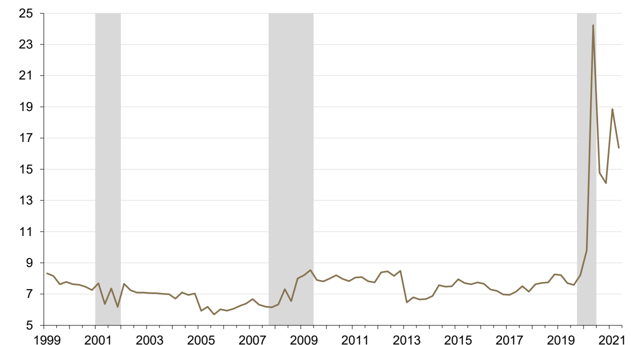
Retail sales, however, typically only reflect tangible goods (for which in-store has been readily replaced by home delivery), rather than consumer services (which tend to require person-to-person contact and are not easily substituted).

COVID-19-induced restrictions have disproportionately impacted spending on services, which traditionally account for two-thirds of household outlays, resulting in overall levels of spending being restrained and kept from maintaining their relationship with rising incomes.

As such, households have found themselves with an excess of savings on hand—personal savings rates across the G7 are triple their pre-pandemic levels with estimates suggesting US$3 trillion more than normal has been socked away.

**CHART 10: TAKING IT TO EXCESS**

**Personal savings rate, G7**
(savings as a percentage of disposable income)




*Data to Q2 2021; shaded regions represent periods of US recession*
*Source: OECD, Bloomberg, Guardian Capital*

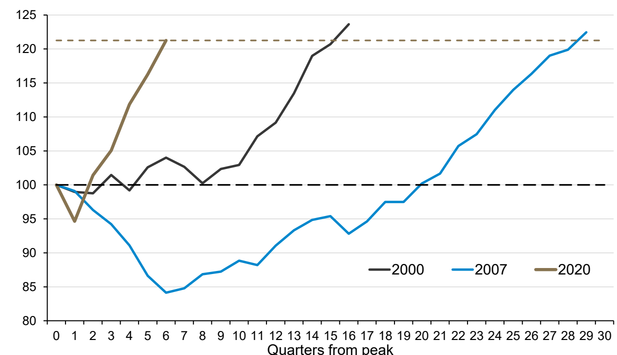
This represents a stark contrast to normal recovery periods where household spending is constrained by the need to replenish savings that were drawn upon during the downswing.

Furthermore, consumers have not had to concern themselves with the typical long-lasting blow to net worth that comes with weakening financial and real estate market conditions that typically coincide with significant recessions.

At the turn of the millennium, it took US households two quarters to recoup the hit to net worth, while the recovery from the 2007-2008 global financial crisis took a full five years. Households recovered the aggregate lost net worth from this latest crisis in a single quarter.

**CHART 11: A WEALTH OF EXPERIENCE**

**US household net worth**
(index; pre-recession/crisis peak = 100)




*2000 peak = Q3 2000; 2007 peak = Q3 2007; 2020 peak = Q4 2019*
*Source: US Federal Reserve Board, Bloomberg, Guardian Capital*

In the 12-months that have since followed, net worth has now expanded by another 20%—American households were not at this relative level of wealth until four years after the 2000 highs and seven years after the 2007 peak.

While consumers tend not to spend all wealth gains (estimates suggest that just 4% of each dollar increase in net worth is spent within a year), the rise in net worth combined with excess savings—not to mention the expected further employment gains as re-openings continue—points to consumers having ample scope to underpin the demand side of the equation over the forecast horizon.

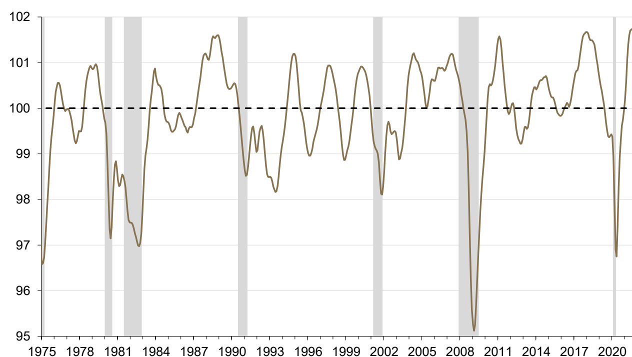
## Supply shocked

A base of ready, willing and (financially, if not yet fully permitted to be, restriction wise) able customers is clearly a boon for businesses and their outlooks.

The gauge of business sentiment for the aggregated OECD member economies has continued to climb and established another all-time high in September.

**CHART 12: BUSINESS (SENTIMENT) IS BOOMING**

**OECD Business Confidence Index**[3]
(index; 100 = long-term average)




*Data to at September 2021; shaded regions represent periods of US recession*
*Source: OECD, Guardian Capital*

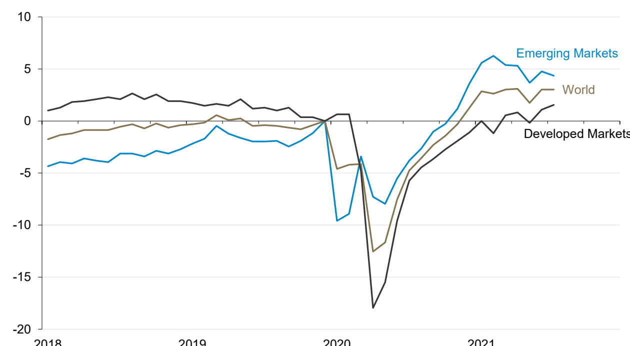
As great as a strong demand for goods and services is, however, it appears that it is, perhaps, too much of a good thing at the moment.

Businesses are facing growing pressures in meeting customer demand as earlier COVID-19-driven stoppages in production and logistical constraints are still being felt throughout supply chains.

Industrial production has ramped up globally, particularly benefiting EM in their role as supplier of inputs to production and finished goods to DM.

**CHART 13: FACTORIES FIRED UP**

**Industrial production**
(percentage change versus December 2019)

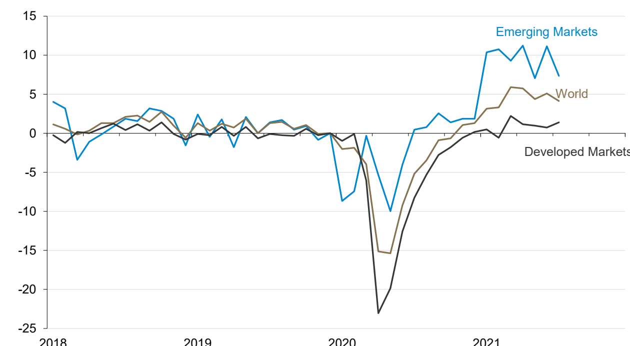



*Data to July 2021*
*Source: Netherlands' Centraal Planbureau, Bloomberg, Guardian Capital*

This in turn has driven a renewed upswing in international trade following largely stagnant flows over the previous half decade due to the backdrop of heightened tensions and rising barriers—with the EM also benefitting from this development as well.

**CHART 14: TRADING PLACES**

**International trade/export volumes**
(percentage change versus December 2019)




*Data to July 2021*
*Source: Netherlands' Centraal Planbureau, Bloomberg, Guardian Capital*

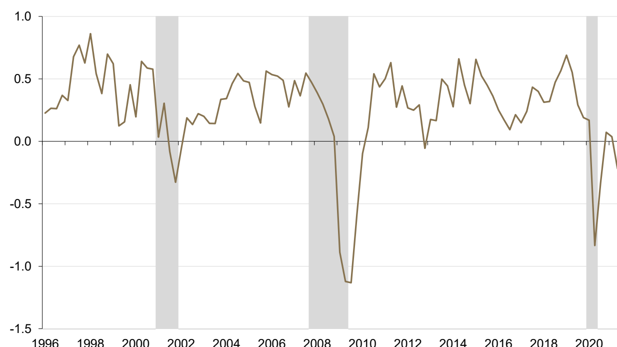
The increased domestic and foreign production, however, has not been sufficient to meet demand, particularly for consumer products. As such, firms globally have had to draw down stockpiles to fill orders. G7 economies have seen inventories pared by a significant degree, something that negatively factors

3 The OECD Business Confidence Index is a composite measure for the 38 OECD member countries that provides information on future developments, based upon opinion surveys on developments in production, orders and stocks of finished goods in the industry sector.

into the gross domestic product calculations.

**CHART 15: DRAINING STOCKPILES**

**Change in inventories, G7**
(percent of gross domestic product)




*Data to Q2 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, OECD, IMF, Guardian Capital*

Even without increases in sales to end customers (which is not the base case), depleted inventory levels create a large need for businesses to restock, creating additional demand and further compounding bottlenecks.

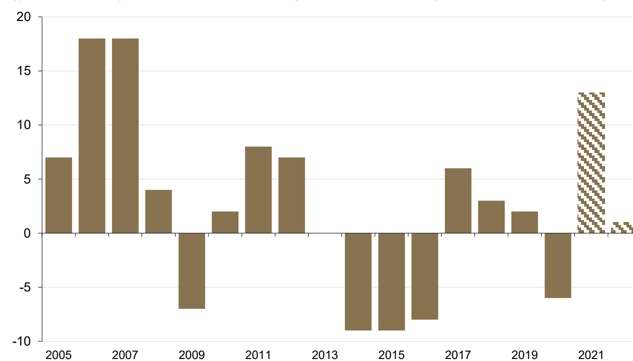
Moreover, given the recent experiences with difficulties maintaining supply channels, firms are expected to target higher precautionary inventory levels than were standard pre-pandemic.

There is a clear need for increased capacity against the strong demand at all stages of the production pipeline, and buoyant business sentiment, low costs of capital and improved clarity on the outlook, as the latest COVID wave ebbs, are resulting in surging expectations for capital expenditure.

A recent global survey indicated that business investment is slated to rise materially across all regions and sectors—with semiconductors, retail, software and transportation seeing the biggest rise in spending intentions, while the commodity space is expected to stabilize after significant weakness.

**CHART 16: PLANT GROWTH**

**Nonfinancial capital expenditure**
(year-over-year percent change; inflation-adjusted US dollars)




*Based on S&P Global Capex 2000; shaded bars are forecasts as of July 2021*
*Source: S&P Global Market Intelligence, S&P Global Ratings*

## Feeling the pressure

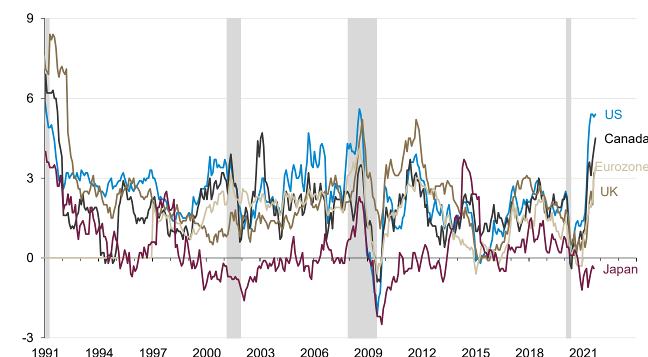
Increases in productivity-enhancing investments are definitely welcome and should help to ease supply constraints—not to mention support the long-term prospects for the global economy.

The benefits, however, will not be felt immediately. Most estimates suggest that it could be well into next year before supply pressures ease, meaning supply bottlenecks are likely to persist near-term and continue to put pressure on prices for a growing variety of goods across the world.

Measures of consumer price inflation have jumped sharply in recent months, and while much of the multi-decade-high headline rates can be attributed to the impact of last year's weakness (the 'base effects' that will fade in the coming months), they are not the sole driver of the sticker-shock readings.

**CHART 17: PRICING PRESSURES**

**Consumer price inflation**
(year-over-year percentage change)




*Data to September 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, Guardian Capital*

Raw material prices—particularly those on energy products—have increased sharply of late, with aggregate commodity price indexes hitting levels not seen since before oil prices collapsed in 2014.

**CHART 18: MATERIAL INCREASES**

**S&P GSCI commodity price index**
(index)

*Data to October 15 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, Guardian Capital*

Diminished commodity inventories and limited new production in the pipeline after years of slumping prices, led to significantly curtailed investment in natural resource sectors— Energy has also been hurt by many countries shifting away from traditional and less environmentally friendly products—would suggest that gains are not soon to be reversed.

This is echoed by the corresponding surge in the Baltic Dry Index (a gauge of shipping costs for raw materials seen as a bellwether for the natural resource sector) that points to there being some staying power in recent price increases.

**CHART 19: NO FREE SHIPPING**

**Baltic Dry Index***
(index; US dollar basis)

**Baltic Dry Index is a composite of the dry bulk timecharter averages of Capesize, Panamax and Supramax ships; data to October 15, 2021*
*Source: Bloomberg, Guardian Capital*

As well, despite still-elevated unemployment, there is a growing shortage of labour for the plethora of available positions. As of August, there were more job openings than unemployed Americans.

**CHART 20: HELP WANTED**

**Ratio of job openings to unemployment, US**
(ratio)

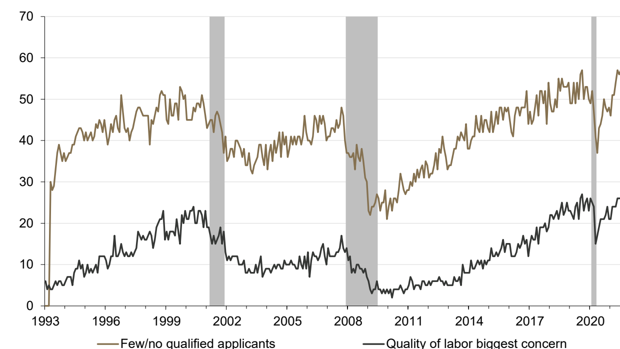
*Data to August 2021; shaded regions represent periods of US recession*
*Source: US Bureau of Labor Statistics, Bloomberg, Guardian Capital*

And that says nothing of the dearth of available workers with the requisite skills for the positions.

Nearly two-thirds of American small businesses reported “few or no” qualified applicants for openings—and one-quarter of firms cited “quality of labour” as the single biggest issue facing their business, an unprecedented share.

**CHART 21: A DEARTH OF QUALITY**

**NFIB small business optimism survey**
(percent of survey respondents)




*Data to September 2021; shaded regions represent periods of US recession*
*Source: National Federation of Independent Business, Guardian Capital*

As with other inputs, these supply and demand imbalances in the job market are pushing costs higher—though, pressures here could soon be somewhat alleviated as COVID-19 risks ebb and

income supports fade, encouraging more people to be willing to return to the workforce.

Taken together, however, the data indicate that costs of production are rising more and more broadly than was previously expected.

## A change in policy

The anticipated eventual easing of bottlenecks, combined with the reopening-related price increases and base effects fading from the calculation, provide scope for the secular disinflationary trends of the last cycle (such as demographics and the spread of technology-driven declines in the cost of production) returning to the fore. All of these factors would suggest that inflation is likely to moderate in the months ahead.

With that said, the risk to consumer purchasing power should these up-trends continue—and inflation expectations have been increasing—is putting impetus on monetary policymakers to shift their stances in order to keeping a lid on price pressures.

Of course, while central banks hold a lot of sway, there is little they can do to address supply-side constraints—no amount of tweaking of interest rates or asset purchases can get more semiconductors off of the assembly line.

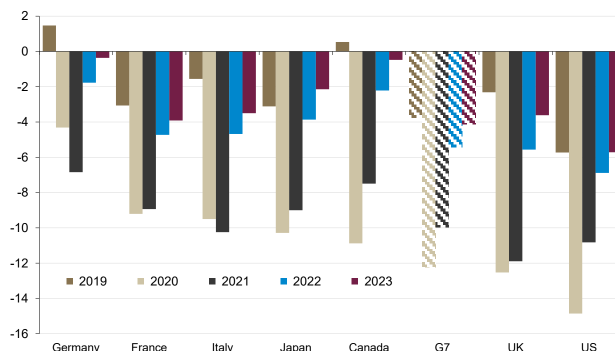
What policymakers can do is help temper demand by removing liquidity from the system and raising costs of capital.

The challenge—and something that central banks have historically struggled to accomplish—is to calibrate monetary policy in such a way that financial conditions do not tighten too much, too quickly, ultimately making the cure for inflation worse than the disease, by abruptly ending the expansion.

In other words, the nature of the inflationary pressures, not to mention the uncertainties surrounding the outlook, mean the potential for a mistake is large; which speaks to the likely gradual nature of shifting the direction of policy—and this is especially the case given that emergency fiscal policy supports are fading and focus shifts to reining in gaping deficits.

**CHART 22: FISCALLY DRAINED**

**General government fiscal balance**
(percent of gross domestic product; <0 denotes deficit)



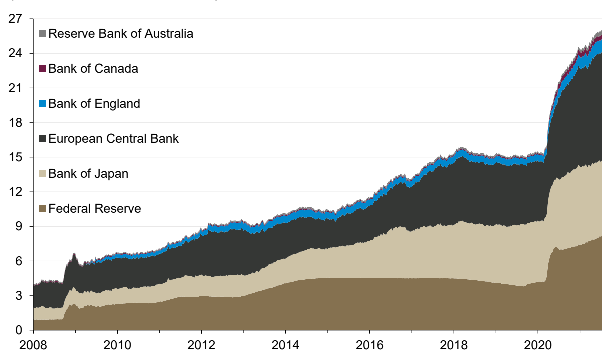

*Forecast data as per IMF's October 2021 World Economic Outlook*
*Source: IMF, Guardian Capital*

Before even contemplating the removal of stimulus, however, central banks need to stop adding more of it to the system first. To that end, policymakers have started taking steps toward winding up the crisis-era asset purchase programs.

Since March 2020, major central banks have expanded their balance sheets by more than US$10 trillion dollars—the still-growing kitty now stands at US$27 trillion, or the equivalent of nearly 40% of the market value of the global bond market.

**CHART 23: STILL SUBSTANTIAL, ON BALANCE**

**Central bank asset holdings**
(trillions of US dollars)




*Data to October 15, 2021*
*Source: Bloomberg, Guardian Capital*

In recent months, the Reserve Bank of Australia (RBA) and Bank of Canada (BOC) have reduced their pace of asset purchases—but they are still ongoing, meaning there is additional stimulus being pumped into the system, just to a lesser degree.

The US Federal Reserve (Fed) is expected to follow suit in November, while the European Central Bank (ECB) will evaluate the future of its bond buying later this year.

Any tapering of purchases is likely to be done gradually and on a clearly defined path so as to not upset markets—for example, Fed Governor Powell has already indicated a preference to fully wind up the program by the middle of next year.

After that, balance sheets are expected to remain substantially above their pre-crisis levels for the foreseeable future as central banks will find it difficult to fully extricate themselves from the market.

That suggests that the abundant supply liquidity is also going to persist for the foreseeable future.

The transition of focus from supporting the recovery to maintaining stability in the expansion, however, means that the more traditional levers of monetary policy are going to return to centerstage.

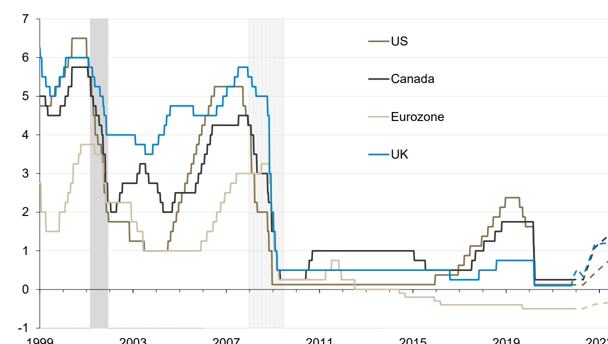
The next phase of the exit strategy will be raising rates from their effective lower bounds—and the belief here remains that the hiking cycle will be a reasonably protracted affair.

For sure, the combination of greater conviction over the outlook and rising inflationary pressures have already driven many EM (such as Brazil, Mexico, South Korea, and Russia) and a handful in DM (including Norway and New Zealand) to make their first volleys, but major central banks are likely to lag.

Even with the recent shift in market expectations for the path of policy rates—which is arguably more aggressive that policymakers have in mind—liftoff is not anticipated to begin in earnest until the second half of 2022, and rates are expected to remain below pre-crisis levels for at least the next two years.

**CHART 24: GOING UP… EVENTUALLY…**

**Central bank policy rates** (basis points)




*Data to October 19, 2021; dashed lines represent overnight index swap-implied policy rates as at October 19, 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, Guardian Capital*

## Looking for an income fix

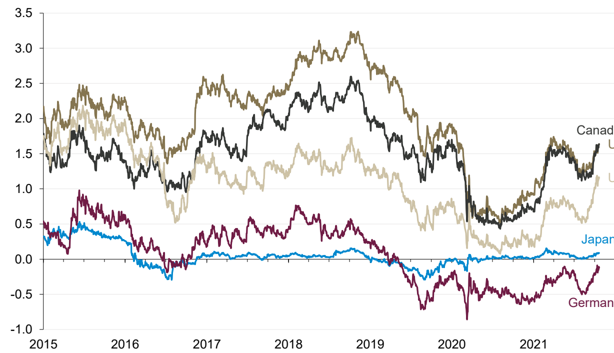
While monetary policy is set to remain on the 'easy' side of the dial, the shift in focus toward maintaining stability means that the broad trend for market interest rates is likely to be higher from their still historically depressed levels—notwithstanding the potential for rates (especially those at the front-end of the yield curve), to see some near-term volatility as market expectations ebb and flow.

Benchmark government bond yields have marched steadily higher in recent weeks and are retesting their earlier post-crisis highs—the yield curve has steepened, as well as longer-term rates have increased more than those for shorter maturities.

But if pre-crisis levels are to be any sort of guide, there is still plenty of potential for further upside moves should generally positive baseline forecasts materialize and the cycle enter its next stage.

**CHART 25: BREAKING THE RANGE**

**10-year government bond yields**
(percent)



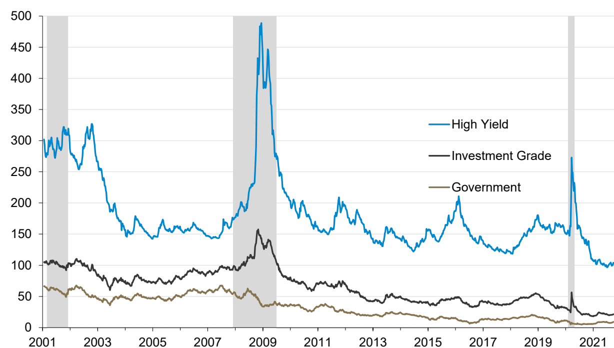

*Data to October 19, 2021*
*Source: Bloomberg, Guardian Capital*

Rising rates are inherently bad for fixed income given that prices move inversely to yields, but the still-low level of yields on offer on government debt make the risk/reward trade-off even less compelling in the current environment. The meagre coupon provides a limited cushion for even a modest further increase in rates while, even if yields hold steady, investors are locking in negative real returns.

Corporate credit continues to offer an alternative in the fixed income space, with these yield-bearing assets offering higher coupons than government bonds with shorter average durations, resulting in greater protection from any moves in rates.

**CHART 26: ADDED PADDING**

**Global bond yield-to-duration**
(basis points)



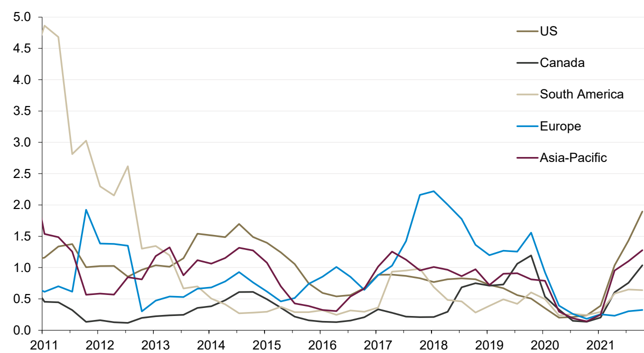

*Data to October 19, 2021; rise in yields required to erase 1-year total return*
*Source: Bloomberg, Guardian Capital*

Further, credit fundamentals continue to improve in conjunction with the economic growth and earnings.

As a result, default rates have fallen sharply and the ratio of credit rating upgrades-to-downgrades has improved further across all regions globally.

**CHART 27: (UP)GRADING ON A SCALE**

**Ratio of S&P credit rating upgrades-to-downgrades**
(ratio; 12-month moving average)

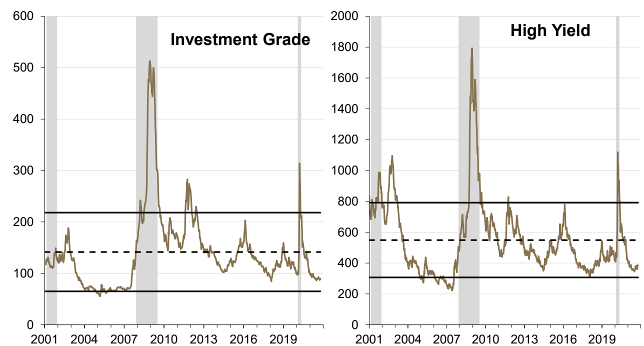



*Data to October 19, 2021*
*Source: Bloomberg, Guardian Capital*

The outlook and ample liquidity suggest defaults should remain limited and keep pressure on credit risk premia. That said, there is limited compensation for assuming credit risk as it stands, given the level of credit spreads—a particular concern in the more speculative end of the corporate bond market, where investors' hunt for yield has compressed the coupon premium above high-quality debt issues to historical lows.

**CHART 28: SPREAD THIN**

**Global option-adjusted bond yield spreads**
(basis points)




*Data to October 19, 2021; shaded regions represent periods of US recession; dashed line is average; black lines are +/-1 standard deviation*
*Source: Bloomberg, Guardian Capital*

## Taking stock

The negligible risk premium in credit markets is not echoing in equity markets. For example, the forward earnings yield for the MSCI All-Country World Index (ACWI) remains materially above government bond yields at the moment. This proxy for the 'equity risk premium' suggests that there is scope for stock market valuations to increase further (and for the

premium to decline) given where interest rates currently sit.

**CHART 29: IT'S ALL RELATIVE**

**MSCI ACWI[4] equity risk premium***

(basis points)

**MSCI ACWI forward earnings yield less 10-year US Treasury note yield*
*Data to October 20, 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, Guardian Capital*

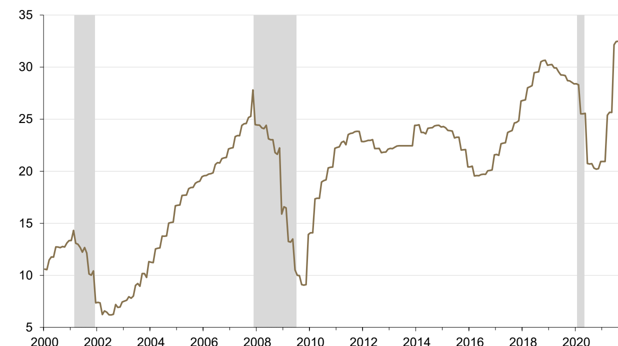
Such a comment may seem surprising given that all-time highs are back within arms' reach, but it is important to acknowledge that equities have not been rising for no reason.

Indeed, the recovery of corporate earnings, of which equities give shareholders a claim, amid a pandemic has been nothing short of spectacular.

Trailing earnings globally have surged by more than 30% from year-ago levels and have fully recaptured their pre-crisis heights—something that took nearly a decade in the aftermath of the financial crisis.

**CHART 30: BACK FROM WHENCE WE CAME**

**MSCI ACWI Index trailing 12-month earnings per share**
(US dollars)




*Data to September 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, Guardian Capital*

These gains have managed to outpace the strong price performance of global stock markets, resulting in the price-to-earnings ratio actually compressing sharply from last year's highs. In other words, earnings have so far kept the promise of strength implied by the post-crisis market rally.

**CHART 31: FEELING COMPRESSED**

**MSCI ACWI Index trailing price-to-earnings ratio**
(ratio)

*Data to October 15 2021; shaded regions represent periods of US recession*
*Source: Bloomberg, Guardian Capital*

Giving that earnings have been driving equity performance, a key consideration with respect to future return prospects is whether the strength in corporate profits can be sustained.

This question is even more pertinent given that rising input costs, higher costs of capital, and a larger commitment to working capital (given expectations that firms will aim to maintain higher inventory levels going forward), would have to seem to suggest companies will face growing pressure on profit margins.

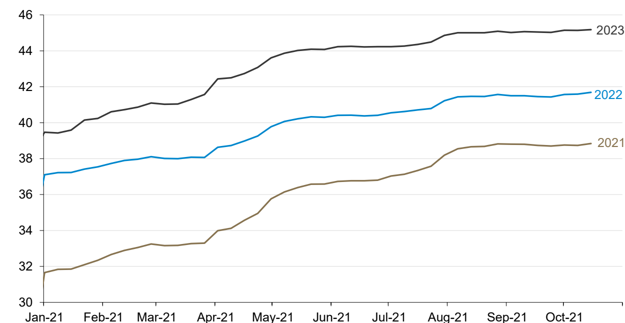
At the moment, however, it seems that these earnings headwinds are expected to be more than offset by the pricing power afforded by the excess demand environment combined with the constructive economic outlook.

Consensus forecasts for earnings have continued to be ratcheted not only for the current year but for next year and the year after as well.

[4] The MSCI ACWI is a market capitalization weighted index of equities in both Developed and Emerging Markets.

**CHART 32: THINGS ARE LOOKING UP**

**Consensus earnings per share forecasts, MSCI ACWI**
(US dollars)

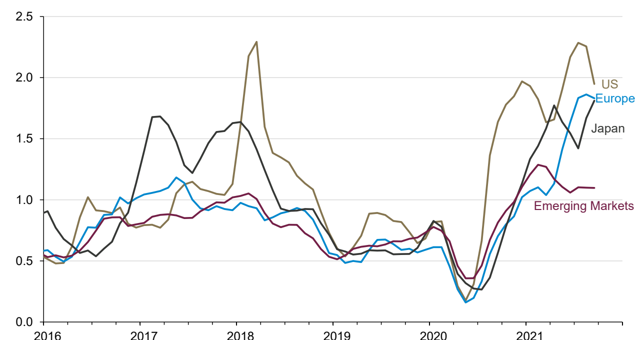



*Data to October 15, 2021*
*Source: Bloomberg, Guardian Capital*

Moreover, earnings revisions have been biased to the upside across all regions, with all geographies expected to generate strong profit growth in the month ahead.

**CHART 33: EARNING MOMENTUM**

**Analyst three-month earnings per share revision ratios**
(ratio of upgrades to downgrades; >1 denotes more upgrades)



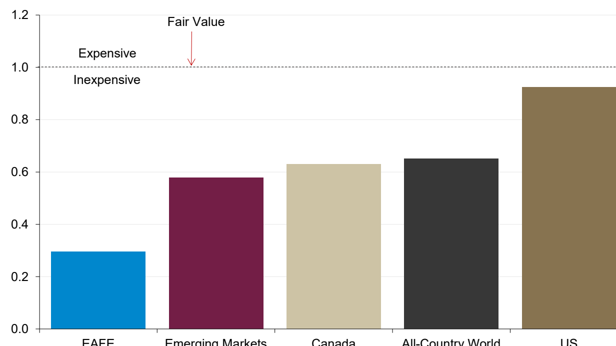

*Data to September 2021*
*Source: Bank of American Merrill Lynch, Guardian Capital*

While it would appear that the bar has been set pretty high, especially given the fact that the pandemic is still ongoing, some solace can be taken in that elevated risk premium.

A lot may be already be in the price, but not everything—when valuations are scaled to expected earnings growth over the next three years, they not only suggest there is scope for further gains, but that there is some capacity to absorb downside surprises as well.

**CHART 34: ROOM FOR GROWTH**

**Forward price-to-earnings-to growth* ratio**
(ratio)




**Annualized forecast earnings growth 2023; data as at October 20, 2021*
*Source: Bloomberg, Guardian Capital*

## China in a bull shop

The outlook appears constructive, but there are still plenty of risks and one not yet addressed is China.

While geopolitics are fraught worldwide, China arguably provides the biggest source of political risk.

For starters, though animosity between the US and China may not be as forthright now as under the last Administration, tensions do remain elevated and trade actions imposed by the previous American President largely remain in place.

Recent efforts at thawing diplomatic relations between the world's two largest economies have proven unsuccessful and ongoing sparring does not give hope that a more conciliatory tone to proceedings is imminent.

But as important as these geopolitical developments are for EM—and recent history shows investor risk appetite tends to have a negative correlation with tensions on this front—it is the recent shift in domestic policies in China that have had the greatest impact on embedded risk premium across the EM assets and the broader economic outlook.

The Chinese government has taken swift action of late to combat what it views as sources of systematic inequality that pose a threat to social stability—anti-competitiveness and areas like education and housing—as well as address concerns over financial risk and data security, while also ensuring that businesses and their leaders

uphold the Party line.

These measures have been generally consistent with the long-standing goals of the Chinese Communist Party, but that does not change the fact that they have raised the regulatory uncertainties associated with investing in the Middle Kingdom and added headwinds to domestic growth.

Party officials have tried to quell market concerns over broadening government overreach, while emphasizing the country's strong economic fundamentals and ample capacity for monetary and fiscal policy to support and protect domestic growth.

Investors understandably remain incredulous, and trying to forecast and time further efforts for market intervention is inherently difficult—which means that risk premia are likely to persist.

## Changes for the better

The last 18 months have been difficult and, while plenty of uncertainty persists, it appears that the winds of change are finally blowing.

The end of the pandemic appears to finally be on the horizon thanks to the combination of the successful global vaccination campaign and the development of highly effective therapeutics.

With the resultant broader resumption of activity, the economic cycle is slated to evolve from recovery to expansion—and, while that maturation comes with a moderation in the pace of growth, the further absorption of slack over the coming year should still mean growth at stronger rates than prevailed before the pandemic hit.

An offshoot of this is that policymakers will shift their focus from supporting an economic recovery to maintaining expansion. As such, we can anticipate crisis-era stimulus to fade in the months ahead.

The resultant bias toward upward pressure on market interest rates makes bonds appear unattractive, while the generally constructive, albeit still challenging, outlook favours exposure to risk assets that can continue to benefit from an environment of strong growth and ample liquidity.

## Balanced fund summary views

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

*Source: Guardian Capital as at October 21, 2021*

## Market Returns at September 30, 2021 All returns in CAD.

### CANADIAN EQUITIES

| INDEX RETURNS (%) | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| S&P/TSX Composite | -2.2 | 0.2 | 17.5 | 28.0 | 9.6 | 8.8 |
| S&P/TSX 60 | -2.0 | 0.2 | 18.8 | 28.2 | 10.4 | 9.4 |
| S&P/TSX Completion | -3.0 | 0.1 | 12.7 | 27.7 | 7.4 | 7.2 |
| S&P/TSX SmallCap | -0.1 | -2.5 | 16.7 | 44.1 | 5.8 | 5.3 |
| S&P/TSX Composite High Dividend | 1.0 | 0.8 | 26.7 | 43.9 | 8.5 | 8.1 |
| S&P/TSX Composite Dividend | -1.1 | 1.1 | 18.5 | 28.6 | 9.0 | 9.0 |

### S&P/TSX SECTOR RETURNS (%)

| Sector | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| Communication Services | -3.2 | 0.7 | 19.0 | 23.4 | 7.4 | 10.9 |
| Consumer Discretionary | -4.1 | -6.5 | 9.9 | 33.0 | 9.2 | 14.2 |
| Consumer Staples | -4.2 | 4.6 | 13.5 | 7.2 | 7.9 | 15.4 |
| Energy | 8.7 | 2.8 | 40.9 | 61.6 | 0.5 | 1.8 |
| Financials | -1.1 | 1.1 | 24.8 | 45.5 | 12.0 | 12.4 |
| Health Care | -10.3 | -19.4 | -1.7 | 27.9 | -11.5 | -7.8 |
| Industrials | -2.6 | 3.9 | 11.0 | 18.8 | 14.9 | 16.5 |
| Information Technology | -9.4 | -1.3 | 20.1 | 29.3 | 36.3 | 24.2 |
| Materials | -5.7 | -5.6 | -6.0 | -9.5 | 5.3 | -0.4 |
| Real Estate | -3.2 | 3.3 | 25.8 | 38.0 | 9.9 | 11.6 |
| Utilities | -2.9 | 1.0 | 6.0 | 11.9 | 11.0 | 8.4 |

### US EQUITIES

| INDEX RETURNS (%) | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| S&P 500 | -4.4 | 2.9 | 15.3 | 23.3 | 16.1 | 19.0 |
| Dow Jones Industrial Average | -4.0 | 0.8 | 11.5 | 17.7 | 14.9 | 17.0 |
| NASDAQ | -5.1 | 1.9 | 11.5 | 22.7 | 21.3 | 22.0 |
| Russell 1000 | -4.4 | 2.5 | 14.5 | 24.2 | 16.3 | 19.1 |
| Russell 2000 | -2.7 | -2.2 | 11.8 | 40.1 | 12.7 | 16.9 |
| Russell 3000 | -4.2 | 2.2 | 14.3 | 25.1 | 16.0 | 18.9 |
| Russell 1000 Growth | -5.4 | 3.5 | 13.7 | 20.8 | 22.0 | 22.1 |
| Russell 1000 Value | -3.2 | 1.5 | 15.5 | 28.0 | 10.2 | 15.8 |

### S&P 500 SECTOR RETURNS (%)

| Sector | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| Communication Services | -6.3 | 3.9 | 20.9 | 31.3 | 11.8 | 14.7 |
| Consumer Discretionary | -2.3 | 2.3 | 9.7 | 13.0 | 18.2 | 21.9 |
| Consumer Staples | -3.9 | 2.0 | 4.1 | 5.6 | 7.8 | 14.2 |
| Energy | 9.7 | 0.6 | 42.4 | 73.6 | -2.3 | 4.2 |
| Financials | -1.6 | 5.1 | 28.4 | 50.9 | 15.8 | 19.3 |
| Health Care | -5.3 | 3.8 | 12.8 | 16.2 | 13.4 | 19.4 |
| Industrials | -5.9 | -2.0 | 10.9 | 22.3 | 11.7 | 17.3 |
| Information Technology | -5.5 | 3.7 | 14.6 | 22.3 | 27.5 | 25.6 |
| Materials | -7.0 | -1.3 | 9.9 | 20.0 | 12.2 | 15.1 |
| Real Estate | -6.0 | 3.2 | 23.7 | 23.8 | 9.5 | N/A |
| Utilities | -5.9 | 4.1 | 3.6 | 5.3 | 8.3 | 12.8 |

### INTERNATIONAL EQUITIES

| INDEX RETURNS (%) | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| MSCI World Index (Net, C$) | -3.9 | 2.3 | 12.4 | 22.2 | 13.0 | 14.9 |
| MSCI EAFE Index (Net, C$) | -2.7 | 1.8 | 7.7 | 19.2 | 8.1 | 10.3 |
| MSCI ACWI (C$) | -3.9 | 1.2 | 10.5 | 20.9 | 12.4 | 14.1 |
| MSCI France (C$) | -4.0 | 0.2 | 10.9 | 27.4 | 10.3 | 11.5 |
| MSCI Germany (C$) | -5.4 | -2.0 | 3.9 | 10.5 | 6.5 | 10.7 |
| MSCI Japan (C$) | 3.0 | 7.0 | 5.3 | 15.8 | 8.6 | 10.5 |
| MSCI UK (C$) | -1.8 | 2.0 | 11.6 | 24.4 | 4.1 | 7.5 |
| S&P/IFC Investable (Emerging Markets) | -3.3 | -4.9 | 0.8 | 15.5 | 9.0 | 9.1 |
| MSCI EAFE Growth (Gross, C$) | -3.6 | 2.4 | 6.6 | 15.0 | 11.0 | 12.7 |
| MSCI EAFE Value (Gross, C$) | -1.5 | 1.5 | 9.6 | 24.7 | 5.8 | 8.7 |

### INTERNATIONAL EQUITIES

| MSCI EAFE SECTOR RETURNS (%) | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| Communication Services | -1.8 | -1.9 | -0.7 | 10.2 | 2.5 | 7.6 |
| Consumer Discretionary | -1.3 | -1.4 | 7.0 | 24.9 | 9.8 | 12.5 |
| Consumer Staples | -3.3 | -1.2 | 1.4 | 3.4 | 4.2 | 10.0 |
| Energy | 11.8 | 11.2 | 22.8 | 53.7 | 3.0 | 3.6 |
| Financials | 0.0 | 4.1 | 14.6 | 37.0 | 6.6 | 9.3 |
| Health Care | -4.1 | 2.8 | 4.9 | 4.0 | 8.9 | 12.9 |
| Industrials | -3.1 | 3.6 | 10.0 | 21.5 | 10.0 | 12.0 |
| Information Technology | -4.1 | 7.4 | 15.9 | 29.2 | 17.7 | 15.8 |
| Materials | -7.6 | -3.6 | 3.6 | 18.7 | 11.2 | 8.9 |
| Real Estate | -3.7 | -0.8 | 4.1 | 14.0 | 1.9 | N/A |
| Utilities | -8.6 | -2.4 | -8.6 | -1.0 | 6.2 | 6.7 |

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

## Market Returns at September 30, 2021 All returns in CAD.

### CANADIAN FIXED INCOME

| INDEX RETURNS (%) | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| FTSE Canada 91 Day TBill | 0.0 | 0.1 | 0.1 | 0.2 | 0.9 | 0.9 |
| FTSE Canada Short Term Overall Bond | -0.4 | 0.1 | -0.4 | 0.0 | 1.9 | 2.1 |
| FTSE Canada Mid Term Overall Bond | -1.4 | 0.0 | -3.0 | -2.4 | 2.4 | 3.7 |
| FTSE Canada Long Term Overall Bond | -2.7 | -1.6 | -8.9 | -8.1 | 2.7 | 4.8 |
| FTSE Canada Universe Bond | -1.4 | -0.5 | -4.0 | -3.3 | 2.3 | 3.3 |
| FTSE Canada High Yield Overall Bond | 0.3 | 1.3 | 6.2 | 10.6 | 7.4 | 7.0 |
| FTSE Canada Real Return Bond Overall | -1.5 | -0.3 | -4.3 | -2.5 | 2.3 | 3.1 |

### SECTOR RETURNS (%)

| | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| FTSE Canada Federal Bond | -1.2 | -0.4 | -3.4 | -3.6 | 1.3 | 2.2 |
| FTSE Canada Provincial Bond | -1.8 | -0.8 | -5.5 | -5.0 | 2.5 | 4.0 |
| FTSE Canada All Corporate Bond | -1.1 | -0.1 | -2.4 | -0.6 | 3.3 | 4.1 |

### GLOBAL FIXED INCOME

| INDEX RETURNS (%) | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| FTSE World Government Bond | -2.0 | 1.0 | -6.5 | -8.3 | 0.6 | 3.1 |

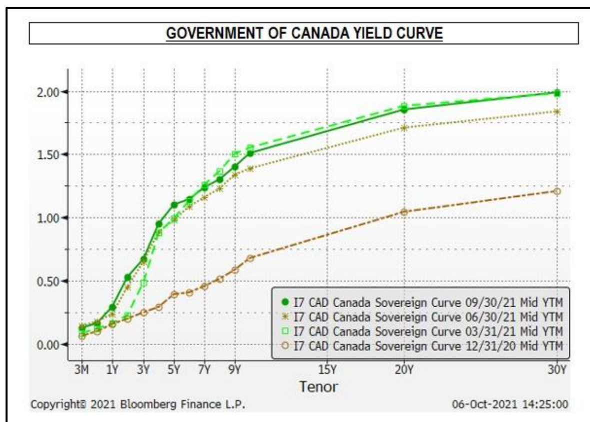
### COMMODITY

| | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| Bloomberg WTI Cushing Crude Oil Spot Price | 9.8 | 4.5 | 53.8 | 76.9 | 8.5 | 1.5 |
| Bloomberg European Dated Brent BFOE Price | 10.8 | 7.3 | 53.1 | 82.4 | 9.8 | -0.8 |
| Edmonton Crude Oil Syncrude Sweet Blend FOB Spot | 10.2 | 5.3 | 65.1 | 85.7 | 7.9 | 0.3 |
| S&P GSCI Nat Gas Index Spot | 34.4 | 64.4 | 129.8 | 120.2 | 14.3 | 6.9 |
| S&P GSCI Copper Index Spot | -5.9 | -2.4 | 14.5 | 27.0 | 12.2 | 4.5 |
| S&P GSCI Gold Index Spot | -3.1 | 1.5 | -7.8 | -12.1 | 5.2 | 2.8 |

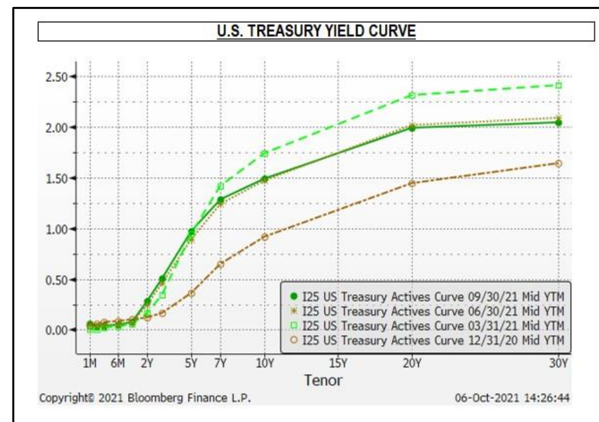
### CURRENCY

| | 1 Mo | 3 Mos | YTD | 1 Yr | 5 Yrs | 10 Yrs |
|---|---|---|---|---|---|---|
| CAD/USD (% chg) | 0.3 | 2.3 | -0.6 | -5.2 | -0.7 | 2.0 |
| CAD/Yen (% chg) | -1.3 | 1.8 | -8.0 | -10.3 | -2.7 | -1.7 |
| CAD/GBP (% chg) | -1.8 | -0.1 | -1.9 | -1.1 | 0.0 | 0.5 |
| CAD/Euro (% chg) | -1.6 | 0.0 | -5.8 | -6.3 | -0.1 | 0.5 |

### GOVERNMENT OF CANADA YIELD CURVE




### US TREASURY YIELD CURVE




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

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October 2021