Market Overview

The S&P 500 started the third quarter of 2023 (Q3) on a positive note, as investors were still riding the tailwind of the excitement surrounding artificial intelligence (AI) and the possible impact on Q2 earnings. Although Q2 earnings released in the second half of July were generally stronger than expected, the S&P 500 started to turn lower in late July. Investors were increasingly becoming concerned that rising interest rates were going to have a deleterious effect on the economy. Government bonds did not provide a safe refuge as they suffered the effects of higher interest rates. Investors were in no mode to take large risks and were attracted to money market funds and other high-yielding short-term investments. The stock market headed lower in August and September, failing to generate a convincing counter-rally. There were very few places for investors to hide, even the defensive sectors of the stock market, consumer staples, health care and utilities performed poorly in August and September.

Quarter in Review

The Canadian stock market, the S&P/TSX 60 Index, started the third quarter on a positive note and performed well in July. Like the S&P 500, the Canadian stock market moved lower in August and September. The Canadian energy sector performed well in July and August as worldwide supply continued to be restrictive with OPEC+ continuing to limit its overall production. The positive trend in the energy sector was not enough to offset the poor performance of Canadian banks. Investors were generally concerned that a slowing economy would have an impact on Canadian banks. Overall, the Canadian stock market slightly underperformed the U.S. stock market.

At the beginning of Q3, HAC held positions in gold bullion, U.S. government bonds and the healthcare sector. In the early stages of Q3, HAC entered into a position in the Canadian energy sector. HAC started to reduce its position in U.S. government bonds in August, as they were performing poorly and exited its position in early September. HAC exited its position in the healthcare sector in August as it was underperforming. In August, HAC entered into small short-sell positions in the junk bond sector, offset by U.S. government bonds, and the transportation sector offset by the S&P 500. The position in the transportation sector worked particularly well as the sector underperformed the S&P 500. HAC exited both of its short-sell positions in September. In early September, HAC entered into positions in natural gas and the uranium sector. Both of these positions performed well in September. HAC exited its positions in the energy sector and gold bullion in September as the sectors were approaching the end of their strong seasonal periods. At the end of Q3, HAC was substantially invested in short-term government Treasury Bills in the U.S. and Canada.

Outlook and Positioning

Historically, the fourth quarter (Q4) of the year tends to be seasonally positive for both the Canadian and U.S. stock markets. October can be volatile and can provide good buying opportunities. On average, over the long term, late October tends to start the favourable six-month cycle for the stock market, which lasts until early May. In late October, the cyclical sectors of the stock market tend to start their strong seasonal periods. The technology sector tends to perform well from mid-October to early December. The Canadian banking sector tends to start its strong seasonal period in mid-October. The stock market tends to perform well in November and December on a seasonal basis. It is expected that the stock market will end the fourth quarter at a higher level than where it started and end the year on a positive note.
The risk to the stock market continues to be the effects of higher interest rates. Higher interest rates have had a negative impact on most asset classes. If interest rates continue to rise this could continue to put downward pressure on the stock market. In addition, there are a number of economic indicators that are signalling the possibility of an economic slowdown ahead. Economic growth currently appears to be stable, but if economic growth slowed or the economy went into a recession, this could have a negative impact on the stock market. On balance, despite the headwinds, the stock market is expected to end Q4 on a positive note.