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AUTORITÉ
DES MARCHÉS
FINANCIERS

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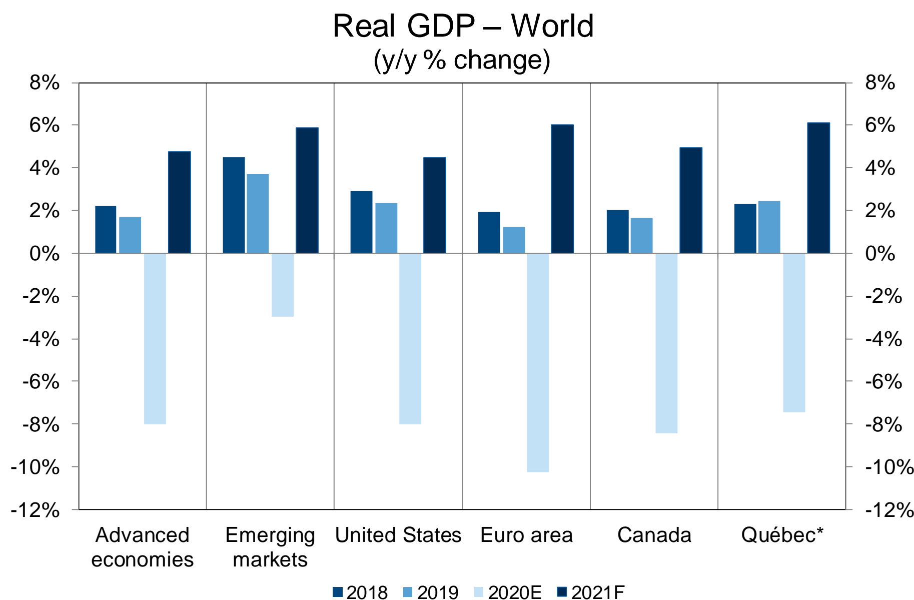
HIGHLIGHTS

- After being forced to shut down, the global economy rebounded significantly in the summer. However, the future remains uncertain, and the latest economic indicators show that the recovery is already losing momentum.
- U.S. GDP shrank an annualized 31.7% in the second quarter, down more than 10% from its pre-pandemic high. The Federal Reserve indicated that it had no plans to raise interest rates before 2023.
- After declining 8.2% in the first quarter, Canada's GDP fell an annualized 38.7% in the second quarter. The Canadian economy was dealt a double blow: lockdown measures, which impacted employment and production, and collapsing oil prices.
- Québec's GDP dropped close to 40% on an annualized basis, slightly further than Canada's overall GDP. The lockdown measures in Québec were stricter, and some were instituted more quickly, than elsewhere in Canada.
- After very strong second-quarter gains, most of the major stock market indexes posted moderate increases in the third quarter. The U.S. stock markets, driven primarily by tech stocks, outperformed the rest by a large margin.
- Yields in the major bond markets remained extremely low in the third quarter. The pandemic-induced recession and very accommodating monetary policies caused bond yields to decline to historic lows across the yield curve.

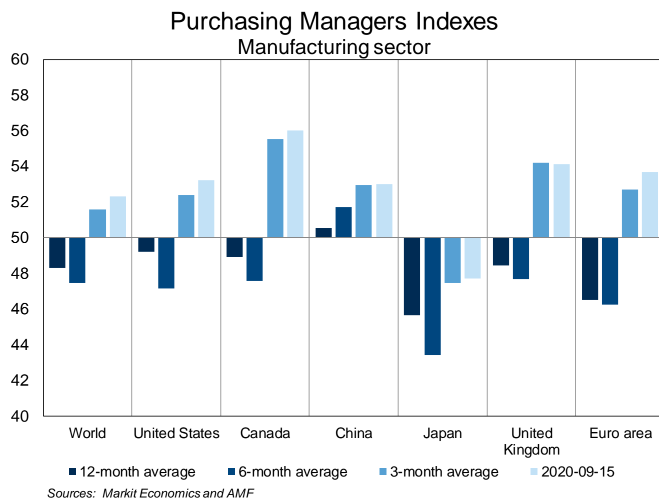


ECONOMIC CONTEXT

WORLD

After being forced to shut down, the global economy rebounded significantly in the summer, with production picking up and businesses beginning to hire again. However, it will be a very long time, possibly several years, before the situation returns back to normal. The Great Lockdown will have wiped some 7% off global GDP in 2020, caused millions of job losses and will have deep and lasting effects.

After the steep losses experienced by most economies in the second quarter, economic indicators initially rebounded in the summer. In almost all parts of the world, manufacturing purchasing managers indexes moved back into growth territory above the 50 level, which marks the boundary between economic expansion and economic contraction.



However, the future remains uncertain, and the recovery is already showing signs of losing momentum. The pandemic has caused over one million deaths worldwide and the number of infections continues to rise unabated, with some variation from one area of the world to the next. With winter approaching, the signs are quite worrying. Infections have begun to rise again in many parts of the globe that had experienced a lull, including Canada and Europe. Moreover, infections remain very high in the United States, Latin America and India, the world's most hard-hit regions.

A global economic recovery will depend on the course of the pandemic and the virus containment and government support measures that are put in place. Many countries do not want to go through another large-scale lockdown like the one in the spring and are planning to use targeted measures, instead.

Stimulus packages are still in place and actions are being taken to extend them, enhance them and tailor them to a crisis that could last for some time to come. Globally, budgetary measures to support households and businesses are estimated at more than US$12 trillion to date, while central banks are continuing to inject liquidity into the financial system and have indicated that their policy rates could remain close to 0% for years to come.

In the United States, with November's presidential election approaching and with anti-racist social movements in the background, society is more polarized than ever. Moreover, the pandemic has accelerated the deterioration of U.S.-Chinese relations. The points of contention are many and include the source and China's initial handling of the coronavirus crisis, Chinese trade practices, the erosion of civil liberties in Hong Kong, Chinese claims to the South China Sea, and the use of Chinese technological products for spying.

China has escaped relatively unscathed, however, by quickly bringing the health crisis under control and providing massive government support. After falling sharply in the first quarter, China's GDP rebounded in the second quarter, and the country could well be one of the rare G-20 members to end the year in positive territory.

In Europe, the transition period to give the United Kingdom and the European Union breathing space to negotiate a new trade deal will expire at the end of 2020. Negotiations are proving difficult and a no-deal Brexit cannot be ruled out. A British bill allowing the U.K. to unilaterally rewrite the European Union withdrawal treaty, in breach of international law, is

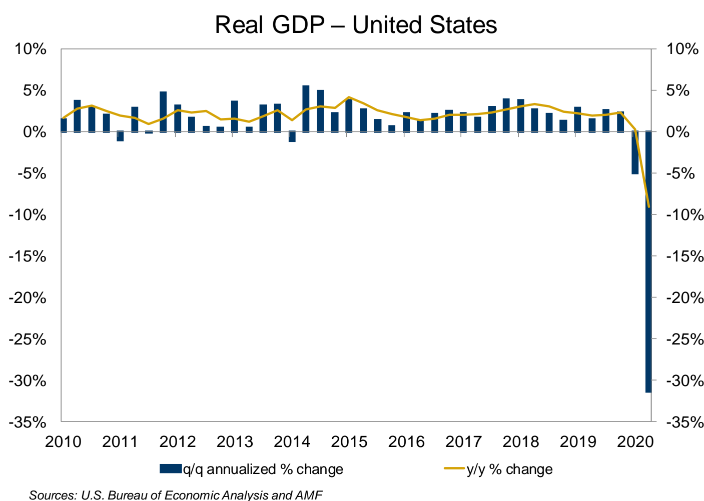
further undermining European trust in the United Kingdom.

Despite some volatility, the major stock markets have been on a strong upward trend since the low in mid-March, at the height of the pandemic. The U.S. markets have regained almost all the ground they had lost, while the European markets are also rising, albeit more slowly.

Oil prices are holding steady at around US$40 a barrel, with the recovery in global demand remaining moderate owing to public health measures that are still in place, particularly travel restrictions.

UNITED STATES

The pandemic brought a large part of the U.S. economy to a halt in the spring. Tens of millions of U.S. workers lost their jobs as businesses closed temporarily, reducing staff to the bare minimum. As a result, U.S. GDP fell an annualized 31.7% during the second quarter, down more than 10% from its pre-pandemic high.



The reopening of the economy led to a rebound in demand and production during the summer months, despite fears of a resurgence in COVID-19 cases. Fuelled by historically low interest rates, home and vehicle sales were robust, while overall manufacturing activity increased significantly. However, the pace has slowed somewhat since then

The labour market is struggling to recover from the Great Lockdown. In September, employment grew by 661,000 jobs, while the jobless rate fell to 7.9%, down from its peak of 14.7% in April. However, only half of the job losses have been recovered so far.

Consequently, consumer confidence has fallen to its lowest level in six years. Concerns about the job and income recovery are growing, while Congress and the White House have been unable to agree on a new stimulus package. The weekly unemployment benefit supplement expired at the end of July and has not been replaced by other measures.

A survey conducted by the National Federation of Independent Business in August found that one in five small businesses will have to close their doors if current economic and business conditions do not improve sufficiently over the next six months.

The Federal Reserve's Federal Open Market Committee (FOMC) held its last monetary policy meeting before the U.S. election in November. At the conclusion of the meeting, the FOMC indicated that it did not plan to raise interest rates before 2023 and that it was committed to providing more support to the U.S. economy in the midst of a slow, uneven recovery.

The Federal Reserve clarified the terms of its new, inflation-tolerant monetary policy. It is abandoning its preemptive tightening of monetary policy and will now wait until maximum employment and average inflation at the rate of 2% are achieved over a certain period of time, which will allow inflation to run temporarily above 2%.

The economic recovery will depend in large part on the course of the pandemic and on economic policy support. With a second stimulus package delayed, many observers are saying that a premature withdrawal of fiscal support could jeopardize the U.S. economy.

CANADA

After declining 8.2% in the first quarter, Canada's GDP fell an annualized 38.7% in the second quarter—the largest drop in GDP on record. It should be recalled that economic activity across Canada squealed to an almost complete halt in April as a result of government-imposed lockdown measures.

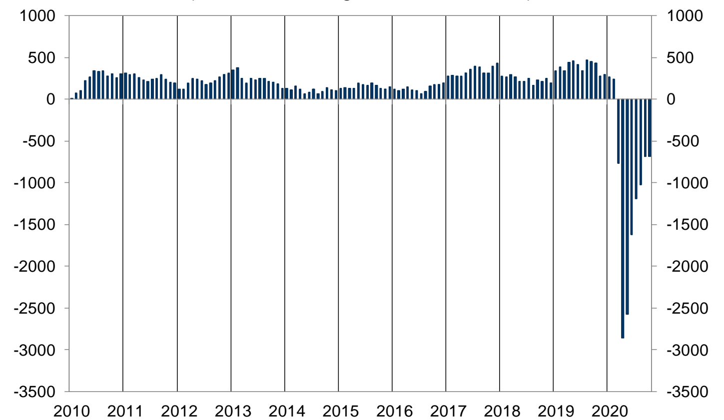
All components of demand declined substantially, but consumption contributed significantly to the plunge in GDP, with household spending falling an annualized 43%.

Business investment and residential investment declined 56.7% and 47.6%, respectively. Moreover, with temporary border closures in place, foreign trade collapsed even further than domestic demand.

The Canadian economy was dealt a double blow: lockdown measures, which impacted employment and production, and collapsing oil prices. The decline in global demand resulting from the economic lockdown and the inability of oil producing countries to agree on production cuts sent oil prices tumbling to record lows in April.

The rebound in oil prices has been very gradual, and the short-term outlook remains subdued. The economic recovery could extend over several quarters or be brought to a halt by a deteriorating health situation and the reintroduction of stricter lockdown measures. This could cause lasting damage to Canada's oil sector, which is already grappling with issues related to limited distribution capacity.

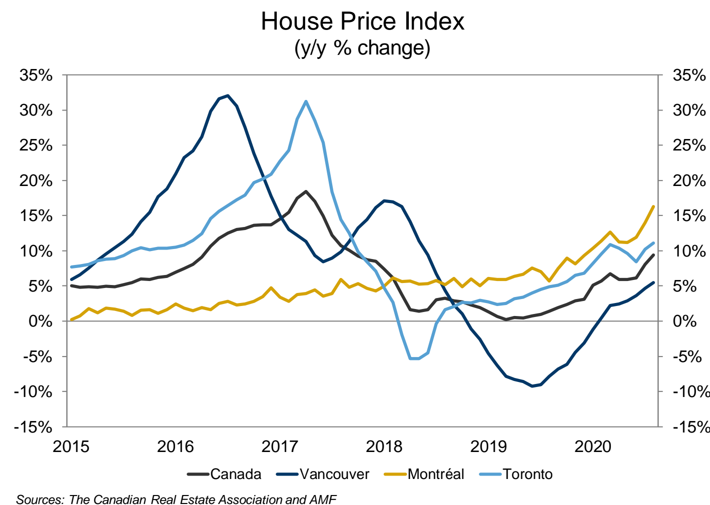
The labour market, particularly employment in the services sector, was hit especially hard by lockdown measures in the spring. At the height of the crisis, 5.5 million jobs were affected, i.e., 3 million people lost their jobs, and 2.5 million people were working less than half their usual hours.



Although the situation has improved since April, the pace of job creation has slowed in recent months. As at September, the labour market has recovered 2.3 million jobs, or over three quarters of all job losses, and the unemployment rate is 9%. However, some 700,000 jobs have yet to be recouped, and considerable uncertainty remains about the strength of the economic recovery.

The real estate market appears to have weathered the crisis, with home sales reaching new highs in late summer. Sales for the first eight months of the year are up nearly 1% from the same period last year, despite the lockdown in the spring.

The sales to new listings ratio is high, creating upward pressure on prices. The MLS home price index rose 9.4% in August on a year-over-year basis, the most significant increase since 2017.



Sources: The Canadian Real Estate Association and AMF

The impact on the real estate market, however, may be delayed, with households having benefitted from payment deferrals and federal government income support. The CMHC is expecting a resurgence in payment defaults this fall, when the payment deferrals granted by financial institutions expire. In the worst-case scenario for the real estate market, the wave of payment defaults could lead to a surge in homes being repossessed and resold in the early months of 2021, potentially resulting in a surplus of sellers, which would drive down selling prices.

In the fall, household income will be impacted by the end of the Canada Emergency Response Benefit (CERB) and the transition to the new employment insurance (EI) benefits announced by the federal government. As EI pays less than the CERB, households may have to limit their spending or defer major purchases.

With inflation holding steady at under 2% and significant remaining uncertainty about how the health situation will evolve, the Bank of Canada has indicated that interest rates would be kept at the effective lower bound until economic slack is absorbed, which will likely take several quarters.

Although the economy rebounded quickly this past summer, the road to recovery could be long and bumpy. Canada will likely have to deal with structural challenges in the coming quarters, with the crisis having potentially caused permanent damage to the economy.

Québec

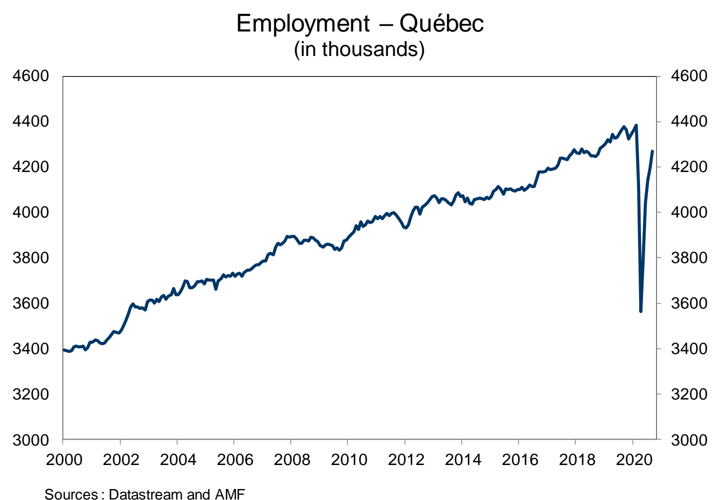
Québec's GDP, like that of Canada as a whole, posted its steepest decline on record. It dropped nearly 40% on an annualized basis, slightly more than Canada's total GDP for the same period, reflecting the fact that the lockdown measures imposed by the Québec government were stricter, and some were instituted more quickly, than elsewhere in Canada.

Québec domestic demand also saw its largest decline on record, with household consumption falling an annualized 43.5% and business investment plunging 58.1%.

Foreign trade also dropped sharply. The recovery in exports could be limited owing, in particular, to difficulties in the aviation sector, with aerospace accounting for a large share of Québec's exports.

Québec's GDP in the second quarter was nearly 15% below pre-pandemic levels.

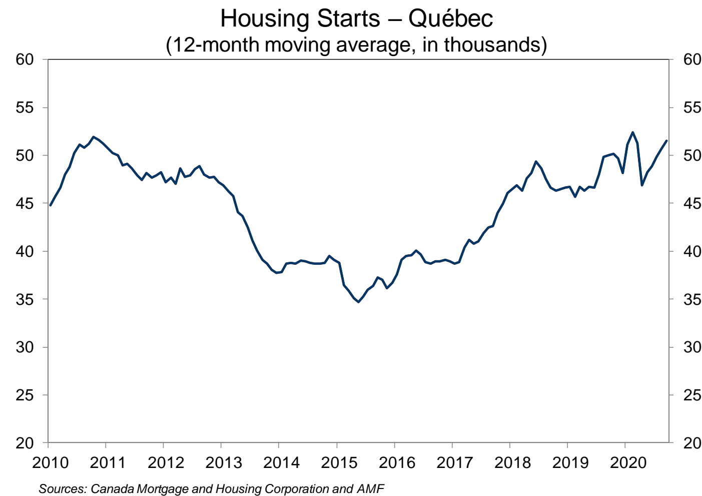
The crisis also had an unprecedented impact on the labour market. More than 820,000 people lost their jobs in March and April, driving the unemployment rate up to 17%. Things have gradually improved since then, and the labour market had recouped more than 85% of the job losses as at September 2020. Nevertheless, more than 100,000 jobs have yet to be recovered.



Sources : Datastream and AMF

Income support measures implemented by the federal government, however, offset the effect of job losses, and household disposable income even increased in the second quarter. Furthermore, reduced consumer spending and increased disposable income combined to lift the household savings rate, which currently stands at 34.5%.

Following the complete shutdown of Québec's construction sector in April, the real estate market rebounded and housing starts picked up again. Property sales have risen steadily since the start of the summer, and new listings are not sufficient to meet demand.



The weighted average price of residential properties in Québec climbed 18% in September. Interprovincial comparative figures show that Montréal once again recorded the highest price appreciation among Canada's major cities (+16.3% year-over-year). Montréal has been the price gain leader for over a year now.

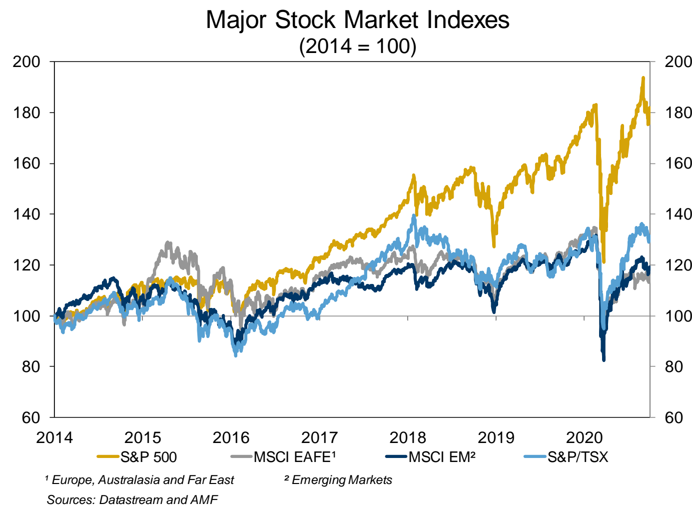
Although Québec's economy has rebounded since last spring, the lockdown measures that were reintroduced in October in certain areas of the province will dampen the economic recovery. Despite financial support announced by the provincial government, some businesses may not survive a second forced closure, and some industries could incur permanent damage.

Moreover, the marked deterioration in the public health situation in the fall could lead to closures in other sectors of the economy, and previously announced measures could be extended. The continued economic recovery will likely be gradual.

Financial markets

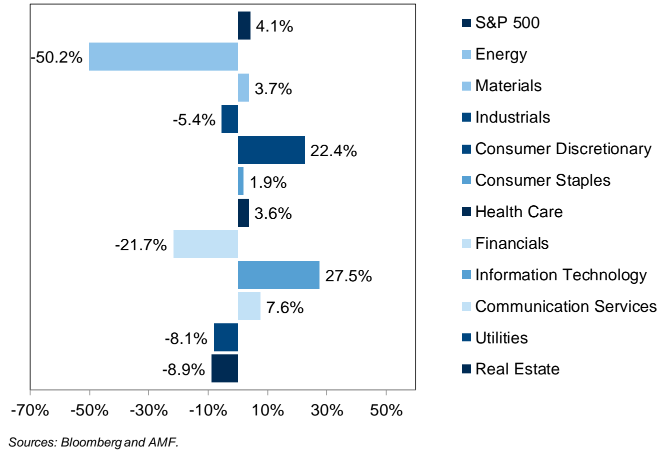
Stock markets

Despite some declines in September, after very strong second-quarter gains, most of the major stock market indexes posted moderate increases in the third quarter. Since soon after the correction in March 2020, stock markets have seen an almost uninterrupted rally, bolstered by the unprecedented actions of governments and central banks. Although volatility increased slightly late in the quarter, it remains well below the levels reached at the height of the crisis.

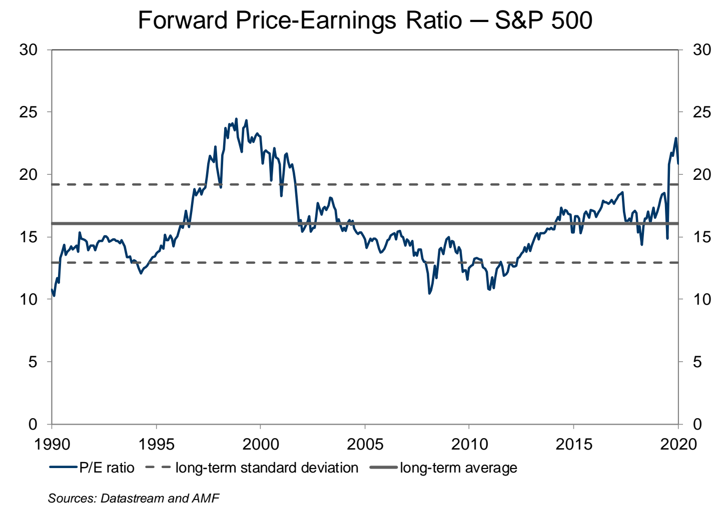


The U.S. stock markets posted the best performances by far of all the major markets. The S&P 500 index bounced back a spectacular 50% from its March 23 low, ending the third quarter at more or less its pre-crisis high.

The U.S. indexes continued to be propelled by the information technology sector and major technology firms in other sectors. The heavily technology-weighted Nasdaq has posted a 63% rebound since its March low and a 24% increase since the beginning of the year. The five Internet giants, which lead the S&P 500 in market capitalization, currently account for almost a quarter of the index's total capitalization, which is historically very high.



The U.S. stock market index gains were also due in large part to expanding valuation multiples. The S&P 500 is currently trading at around 21 times forward earnings, far above its long-term average. The drastic decline of interest rates is making future corporate earnings expressed in present value terms more appealing. Although corporate earnings are down significantly because of the pandemic, earnings are expected to rebound as of next year, according to analysts' consensus estimates.

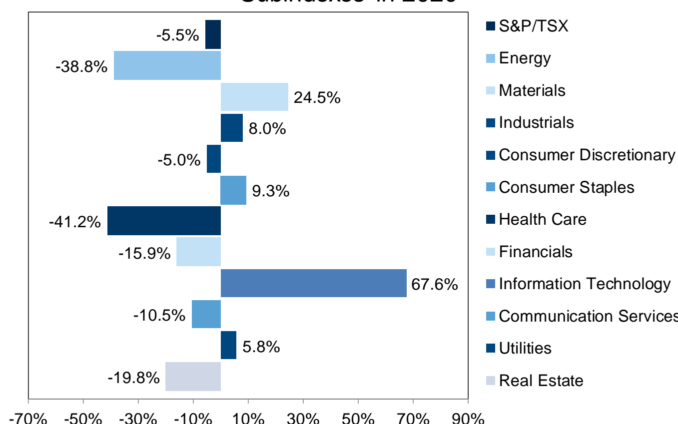


In Canada, the S&P/TSX slightly underperformed the U.S. indexes but still returned a very enviable 44% from its March low and -6% from the start of the year. The energy sector was hard hit by the pandemic. Although

oil prices have stabilized in recent months owing to a significant scaling back of production, questions remain about the robustness of global demand. Demand will continue to be hampered by the effects of the pandemic over the short- and medium-term and will be tempered somewhat over the long term by a gradual transition to a less oil-dependent economy.

The S&P/TSX Financials also declined from the beginning of the year. As elsewhere in the world, Canadian bank stocks dropped sharply in the wake of the pandemic. Increased loan loss provisions, in particular, dragged down earnings. However, Canadian bank stocks have fallen far less significantly than their peers in major jurisdictions, including the United States and Europe.

Performance of the Main S&P/TSX Subindexes in 2020



Sources: Bloomberg and AMF.

Since the start of the year, TSX-listed companies headquartered in Québec have underperformed S&P/TSX-listed companies as a whole. According to the Morningstar National Bank Québec Index, Québec companies have returned -12% since the start of the year, compared with -6% for the S&P/TSX. Industrials, the largest sector of the Québec index (approximately one quarter of market capitalization), has been pummeled since the start of the pandemic, particularly companies in aviation- and aerospace-related sectors.

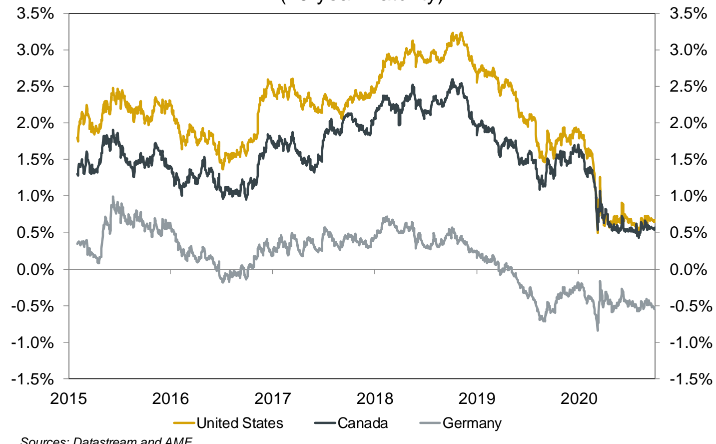
In short, stock markets have bounced back convincingly, owing, in particular, to the sustained actions of the authorities and to more positive-than-expected developments in economic conditions. Valuations have also significantly increased, particularly in the United States. Market performance over the coming months will continue to depend on the course of the pandemic and economic recovery.

Bond markets

Yields in the major bond markets remained extremely low in the third quarter. The pandemic-induced recession and the implementation of very accommodating monetary policies, including large-scale asset purchase programs, caused bond yields to decline to historic lows across the yield curve.

This very low-yield environment should persist for several quarters—years even. After the initial rebound, the economic recovery is expected to be very gradual and inflationary pressures should remain very moderate, all of which will help maintain extremely flexible monetary policies.

Government Bond Yields
(10-year maturity)



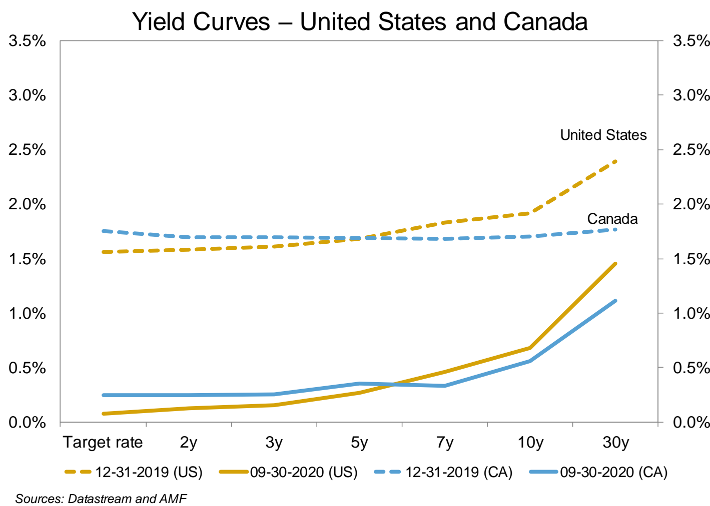
Sources: Datastream and AMF

In the United States, U.S. government 10-year yields were around 0.7% at the end of the quarter, compared with 1.9% at the start of the year. In real terms, the entire yield curve is in negative territory. Based on real return 10-year bonds, inflation expectations are at around 1.6%.

Everything seems to indicate that the U.S. Federal Reserve will keep its foot on the gas for several years to come in order to support the recovery. According to U.S. central bank officials, the federal funds rate should remain at the effective lower bound until at least 2023.

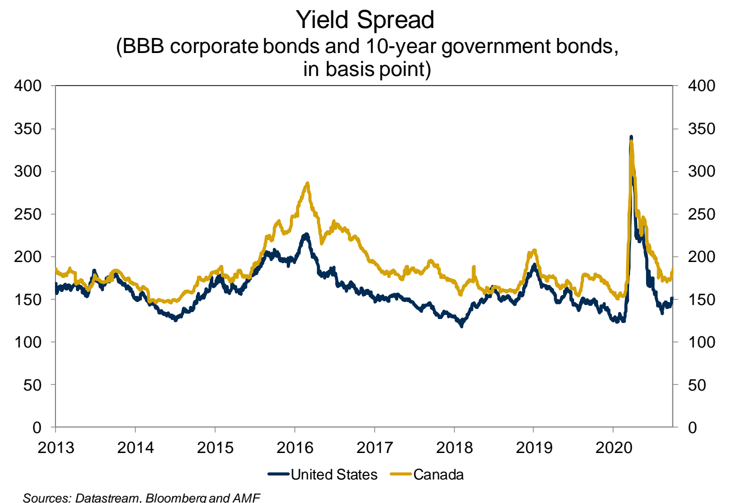
Moreover, the Fed's new policy explicitly allows inflation above 2% to be tolerated for a certain amount of time after a period of weak inflation. This change in policy reinforces expectations that the central bank will stay on the sidelines for a long time to come, even if there is a potential resurgence of inflationary pressures. The Fed is also expected to continue its asset purchases at the current pace for the next several months.

In Canada, bond yields also continue to be extremely low. Yields on Government of Canada 10-year bonds ended the quarter at 0.6%, compared with 1.6% at the beginning of the year. Like the Fed, the Bank of Canada clearly signalled that it would hold its policy interest rate at the effective lower bound until economic slack is absorbed and the inflation target is achieved for a sustained period.



Sources: Datastream and AMF

Corporate bond yields also remained within a narrow corridor in the third quarter. At the start of the crisis, yield spreads between corporate bonds and government bonds had widened as a result of heightened refinancing and payment default risks, particularly in the economic sectors most affected by the pandemic, such as the energy sector. The rapid implementation of an array of government support programs for the private sector and central bank asset purchase and liquidity support programs helped to quickly stabilize bond markets.



Sources: Datastream, Bloomberg and AMF

In general, corporate bond yields are now lower than before the crisis. The low yields have led companies to make greater use of the bond markets for their financing needs, with corporate debt issues reaching record highs in certain markets. These additional inflows should allow many companies to better weather the crisis but, in some cases, are weakening their balance sheets.

In addition, the low yield spreads suggest that investors are relatively unconcerned by the credit risk associated with corporate bonds. Yield spreads on riskier, high-yield bonds are relatively low from a historical perspective. Given the very low or even negative yields on government debt, some of the low spreads on corporate debt probably reflect investors' search for yield.

Market Performance

Stock Markets

	Level	% change							Last 12 months	
	2020-09-30	1 month	3 months	6 months	9 months	1 year	3 years[2]	5 years[2]	Min.	Max.
MSCI All Country World Index	657	-3.2	6.5	24.7	-0.1	7.2	5.5	8.1	460	688
MSCI EAFE[1]	1,057	-1.5	0.6	13.0	-11.5	-6.9	-2.1	2.0	842	1,219
MSCI Emerging Markets	61,978	-3.5	7.8	27.3	0.4	10.0	2.4	7.1	44,713	64,322
S&P 500	3,363	-4.1	8.5	28.0	4.4	13.0	10.1	11.9	2,237	3,581
S&P/TSX	16,121	-3.5	3.9	23.6	-5.7	-3.2	1.0	3.9	11,228	17,944
Morningstar National Bank Québec Index	286	-1.3	7.5	22.6	-12.4	-7.6	1.8	5.1	201	337

Bond Markets

		Level								Last 12 months	
		2020-09-30	-1 month	-3 months	-6 months	-9 months	-1 year	-3 years	-5 years	Min.	Max.
Québec	10-year	1.3	1.3	1.3	1.9	2.2	2.0	2.8	2.5	1.2	2.3
Ontario	10-year	1.3	1.4	1.3	2.0	2.2	2.0	2.7	2.4	1.2	2.3
Canada	10-year	0.6	0.6	0.5	0.8	1.6	1.4	2.1	1.4	0.4	1.7
United States	10-year	0.7	0.7	0.7	0.7	1.9	1.7	2.3	2.0	0.5	1.9
United Kingdom	10-year	0.2	0.3	0.2	0.3	0.9	0.5	1.4	1.8	0.1	0.9
Germany	10-year	-0.5	-0.4	-0.5	-0.5	-0.2	-0.6	0.5	0.6	-0.9	-0.2
Canada	AA Corp. (10-year)	1.7	1.6	1.7	2.5	2.6	2.4	3.3	2.9	1.4	2.8
	BBB Corp. (10-year)	2.4	2.4	2.6	3.9	3.2	3.1	4.0	3.8	2.3	4.2
	BBB - 10-year Gov. spread	1.9	1.7	2.1	3.2	1.6	1.8	1.9	2.4	1.5	3.3
United States	AA Corp. (10-year)	1.5	1.5	1.6	2.2	2.5	2.4	3.1	3.1	1.2	3.3
	BBB Corp. (10-year)	2.2	2.2	2.4	3.5	3.1	3.1	3.7	4.1	1.9	4.2
	BBB - 10-year Gov. spread	1.5	1.5	1.7	2.8	1.3	1.5	1.4	2.1	1.2	3.4

[1]Europe, Australasia and Far East [2]Annualized returns

Sources: Datastream, Bloomberg and AMF

NOTE

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