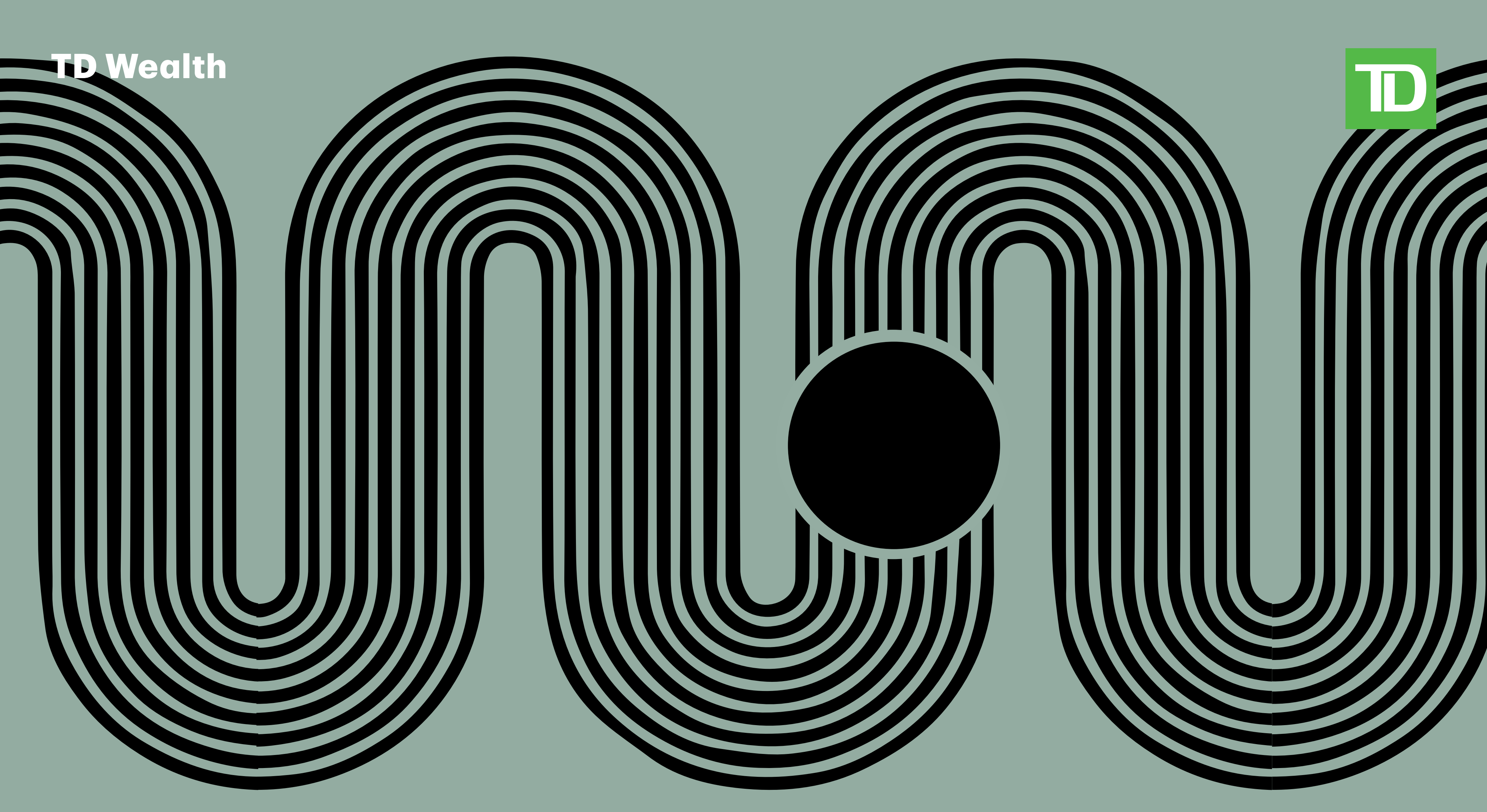
TD Wealth



Q3 | Quarterly Market Review

Everything you need to know about the quarter that was

October 4, 2022

Wealth Investment Office

QMR - Q3 22 | Highlights

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Unless otherwise indicated, performance figures are stated on a total-return basis. This document is for distribution to Canadian clients only. Please refer to Appendix A of this report for important disclosure information.

U.S. Equities

- The broad equities index climbed a “wall of worry” in the first half of Q3 only to be dragged down to reality in the second half.
- The S&P 500 fell 4.9%, the Dow Jones Industrial Average fell 6.2% and the Nasdaq Composite Index fell 3.9%.
- Only two of the 11 sectors in the S&P 500 produced a positive return. Consumer discretionary and energy outperformed, with returns of 4.4% and 2.2% Telecommunications was the worst-performing sector, falling 12.7%.
- Small-cap stocks outperformed large-caps in Q3; growth stocks outperformed value.

Canadian Equities

- Canadian equity markets tracked their American peers in Q3, although trading north of the border was held in a tighter range due to a number of crosswinds: on the one hand, a severe energy slump; on the other, superior economic performance.
- The S&P/TSX Composite Index ended the quarter down 1.4%, with only four sub-indices posting positive returns.
- Large-cap stocks outperformed small-caps in Q3; growth stocks outperformed value.

Canadian & U.S. Fixed Income

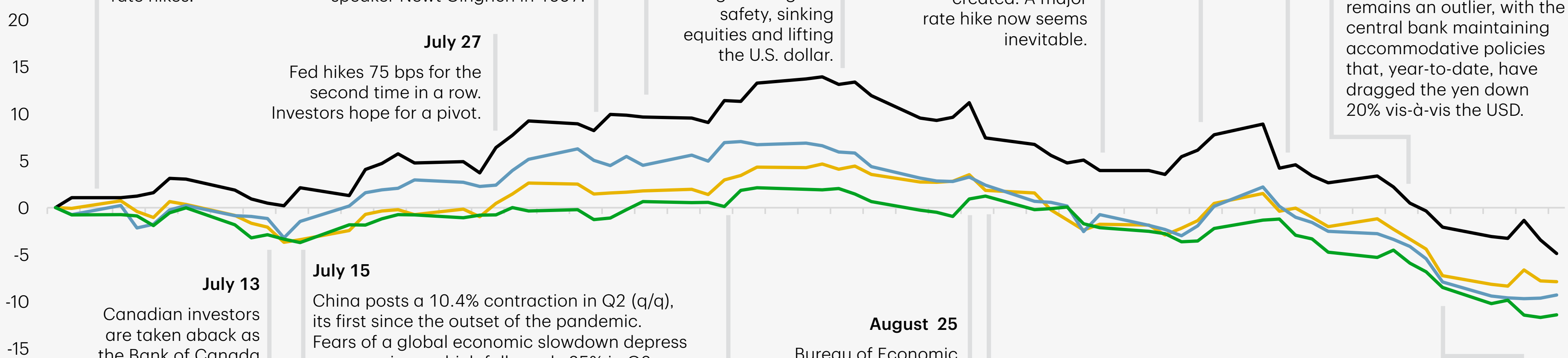
- The Canadian government bond index rose 0.6% in Q3; the U.S. government bond index fell 4.6%.
- Canadian and U.S. investment-grade corporate bond indices registered returns of 0.2% and -5.4%, respectively.
- U.S. investment-grade corporate spreads widened modestly by 3 bps over the quarter, while high-yield spreads tightened by 18 bps.

International Equities

- International developed markets performed in line with their American peers in Q3, led by Japanese markets.
- The MSCI Emerging Markets Index, in local currency terms, fell 8% in Q3, dragged down by Chinese economic weakness.
- The Chinese economy contracted (q/q) for only the second time in modern history, due to Covid lockdowns and the ongoing property finance crisis.
- Indian shares bucked the trend, as investors moved from China into the ostensibly safer emerging market.

Market Movers

Equities in Review



Early July

Economists estimate that U.S. inflation has already peaked, after the CPI report shows year-over-year price increases of 9.1% for the month of June. Investors pin their hopes on rapidly falling prices and less aggressive rate hikes.

July 13

Canadian investors are taken aback as the Bank of Canada hikes 100 bps.

July 15

China posts a 10.4% contraction in Q2 (q/q), its first since the outset of the pandemic. Fears of a global economic slowdown depress energy prices, which fall nearly 25% in Q3. Equity investors, however, are buoyed by the Chinese government's commitment to economic stimulus.

July 27

Fed hikes 75 bps for the second time in a row. Investors hope for a pivot.

August 2

Sino-American relations take a hit as U.S. House Speaker Nancy Pelosi visits Taiwan. She is the highest-ranking American official to visit since former house speaker Newt Gingrich in 1997.

August 5

Jobs report in the U.S. blows the roof off estimates, with 528,000 positions created in July, well above the consensus forecast of 250,000. Rate hikes have clearly yet to cool the U.S. labour market.

August 10

CPI report shows inflation coming down in July, from 9.1% to 8.5%. Stripping out food and energy prices, core inflation holds steady at 5.9%.

August 17

Sentiment begins to sour after Fed minutes for the July meeting are released. The notes are filled with hawkish commentary, with central bankers finding "little evidence" that inflation pressures are easing. The comments prompt a global flight to safety, sinking equities and lifting the U.S. dollar.

August 25

Bureau of Economic Analysis confirms, with its second estimate, that the U.S. economy suffered its second consecutive quarterly contraction in Q2, meeting the definition of a "technical" recession (although most other indicators point to economic strength).

August 26

Fears intensify after the Fed Chair's speech at Jackson Hole, where Powell admitted that monetary policy would remain tight "for some time" and businesses and households were bound to experience "some pain."

September 2

Payrolls report records another blowout performance, with 315,000 U.S. jobs created. A major rate hike now seems inevitable.

September 8

Hawks fly in Europe as the ECB issues an unprecedented 75-bp rate hike. This day also marks the death of Queen Elizabeth II.

September 13

The "peak inflation" theory is officially discarded as wage inflation feed into stubborn price increases. The August CPI report shows core inflation rising to 6.3%.

September 21

As expected, Fed hikes rate by 75 bps, spurring a wave of central-bank hikes across the developed world. Japan, however, remains an outlier, with the central bank maintaining accommodative policies that, year-to-date, have dragged the yen down 20% vis-à-vis the USD.

September 23

UK's new prime minister, Liz Truss, spooks the UK government bond market with a "mini-budget" that would borrow 45 billion pounds to slash taxes. Rating agencies swiftly downgrade the UK's credit outlook, and the Bank of England is forced to intervene as gilts plunge.

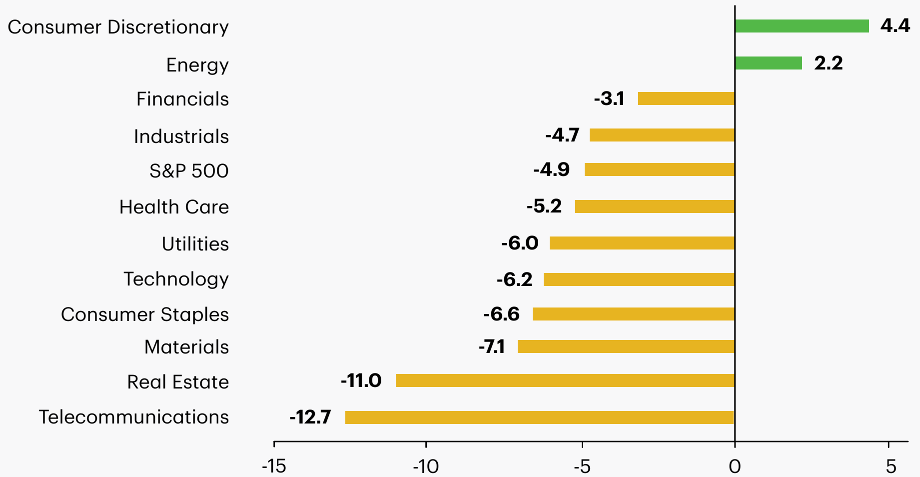
Source: TD Wealth, Reuters, Bloomberg Finance L.P. as of September 30, 2022. Note: Indices are tracked in U.S. dollars.

U.S. Equities

Indices	Q3 Return (%)	Q3 Return (%, C$)	YTD Return (%)	YTD Return (%, C$)
Dow Jones Industrial Average Index	-6.17	0.49	-19.72	-12.51
S&P 500 Index	-4.88	1.86	-23.87	-17.03
S&P 400 Index	-2.46	4.45	-21.52	-14.48
NASDAQ Composite Index	-3.91	2.90	-32.00	-25.89
Russell 2000 Index	-2.19	4.75	-25.10	-18.38

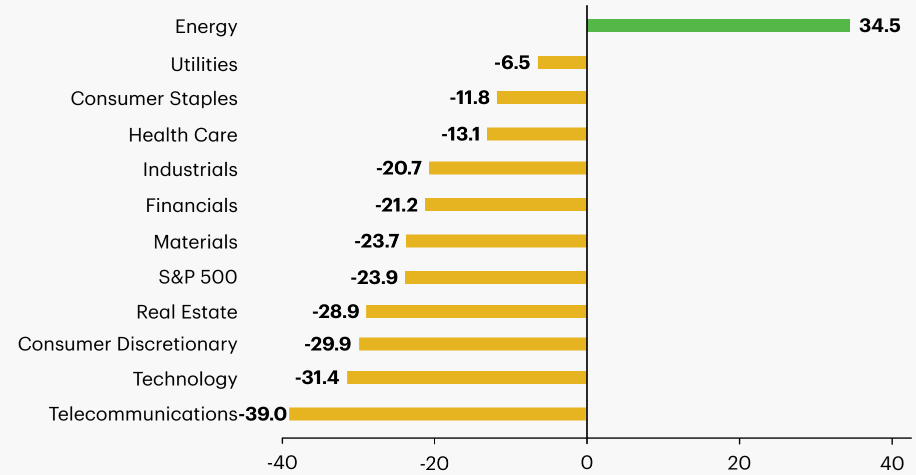
Source: Bloomberg Finance L.P. as of September 30, 2022. Total index values and returns. Index returns calculated in local currency and C$.

Q3/22 S&P 500 Sector Returns



Source: Bloomberg Finance L.P. as of September 30, 2022.

YTD S&P 500 Sector Returns



Source: Bloomberg Finance L.P. as of September 30, 2022.

The broad U.S. equities index climbed a "wall of worry" in the first half of Q3 only to be dragged down to reality in the second half. Stocks were up 14% by the middle of August on the theory that "peak inflation" in June would lead the Fed to tap the brakes on its unprecedented pace of rate hikes. This theory proved only partially true; data in early August did show that overall inflation had slowed in July, but only marginally and mostly due to falling gasoline prices. Stripping out energy and food prices, core inflation held steady in July.

The real turning point came in mid-August, though, when minutes from the Fed's policy meeting were released. Investors who had been struggling with Fedspeak were taken aback by comments that revealed a far more hawkish stance than had been anticipated. Fed officials noted that they saw "little evidence" that inflation pressures were easing — a position that was reinforced at the Jackson Hole Economic Symposium in Wyoming a week later. In his speech, Fed Chair Jay Powell admitted that monetary policy would have to stay tight "for some time" and that households and businesses would inevitably experience “some pain” as a result. Stocks tumbled and, for investors at least, “pain” was the operative word for the remainder of the quarter.

For the three months ended September 30, 2022, the S&P 500 fell 4.9%, the Dow Jones Industrial Average fell 6.2% and the Nasdaq Composite Index fell 3.9%. Only two of the 11 sectors in the S&P 500 produced a positive return. Consumer discretionary and energy outperformed, with returns of 4.4% and 2.2% Telecommunications was the worst-performing sector, falling 12.7%. Small-cap growth stocks outperformed during the quarter. Large-cap stocks (S&P 500) rose by 1.9%, underperforming small-cap stocks (Russell 2000), which returned 4.8% in the third quarter. Growth stocks (S&P 500 Growth Index) registered a total return of 3.0% during the quarter, outperforming value stocks (S&P 500 Value Index), which returned 0.9%.

By one definition, the U.S. economy is already in a recession, having reported two consecutive quarterly contractions. According to data released in late August, real GDP contracted 0.6% in Q2 (q/q annualized, -1.6% in Q1) versus a TD Economics forecast of 1.7% growth. At this point, however, most economists would agree that the U.S. economy is not yet in a recession. The National Bureau of Economic Research considers a host of other indicators that, at present, continue to point to economic growth. Domestic demand, however, has clearly decelerated. Consumer spending softened in the second quarter, rising 1.5% (3.1% in Q1), while business investment flat-lined (+9.2% in Q1) and residential investment fell off a cliff, down 16.2% (+0.4% in Q1), as real estate prices begin to fall.

Neither are prospects likely to improve anytime soon. Measures of both consumer and business sentiment have turned lower in recent months. The Institute of Supply Management’s purchasing managers index (PMI) for manufacturers, for instance, fell to 52.8 in August from 56.1 in May. (Readings above 50 denote economic expansion.) The PMI for services did manage to rise slightly, to 56.9 in August from 55.9 in May, but growth on the service side has more to do with the residual aftereffects of excess savings and post-pandemic store reopenings — neither of which are sustainable tailwinds. Nevertheless, TDE expects a rebound in consumer spending and business investment in Q3, with real GDP forecasted to rise 1.1%. The abysmal performance in Q2, however, has led the bank to cut its projection for 2022 economic growth, from 2.2% to 1.6%.

With storm clouds on the horizon, there’s a growing risk that the Fed may make a mistake, hiking too quickly and dragging the economy into recession. On the other hand, the job market remains as tight as it’s ever been and the central bank is determined to prevent a dangerous “wage-inflation spiral” — where the fear of higher prices leads workers to demand higher wages, which in turn forces companies to raise prices. In the third quarter, the job market defied expectations of a slowdown, beating consensus estimates three months in a row (and seven of the past eight months) to generate 267,000 jobs in June, 526,000 in July and 315,000 in August. Hourly earnings for the month held steady around 5.2% year-over-year. The unemployment rate did rise ever so slightly in August, to 3.7% from 3.6% in May, but this had more to do with increased labour force participation than any sign of weakness in the jobs market.

It’s clear that wages have already contributed to the difficult inflationary environment. Investors were betting that markets would rise once “peak inflation” had been met and inflation began to fall, as it did in July (8.5% versus 9.1% in June). Unfortunately, the problem that Americans had been facing with energy and food prices seems to have been replaced by a more one: wage inflation, which ultimately hurts the U.S. economy by making it less competitive. Core inflation, which includes wages but not food or energy, had declined gradually from March to May (6.5% to 6.0%). It held steady at 5.9% in June and July, but then actually increased in August to 6.3%.

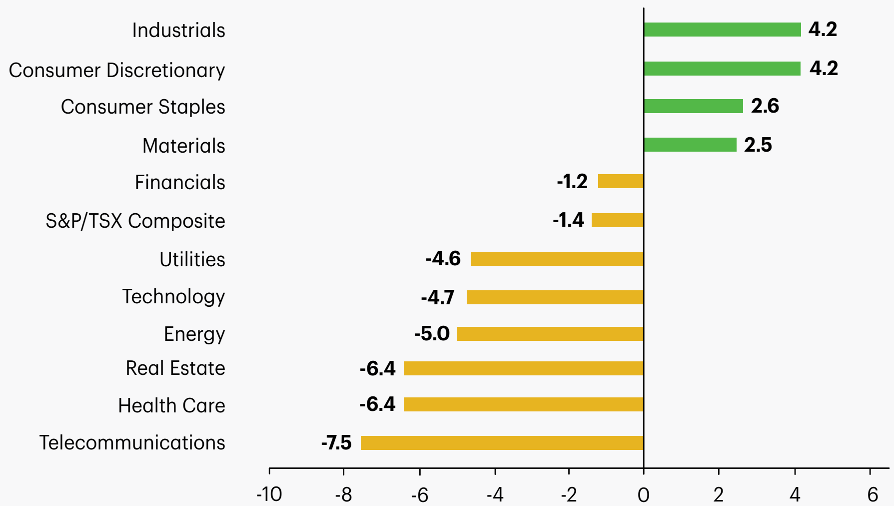
The Fed has responded to stubbornly high core inflation by implementing the fastest rate-hiking schedule in its history. In September, it issued its third consecutive 75-bp rate hike, raising the upper bound of the federal funds target range to 3.25%. The Fed survey of board members (the “dot plot”) now shows the policy rate rising to 4.5% by the end of the year (from 1.75% the year prior) to a peak of 4.75% sometime in 2023. TD Economics, for its part, thinks that the threat of recession will force the Fed to blink much sooner than that; TDE expects the U.S. policy rate to peak at 4.00% by end of year.

Canadian Equities

Indices	Q3 Return (%)	YTD Return (%)
S&P/TSX Composite Index	-1.41	-11.14
S&P/TSX 60 Index	-1.73	-11.18
S&P/TSX Completion Index	-0.11	-11.03
S&P/TSX Cdn SmallCap Index	-2.48	-16.30
S&P/TSX Preferred Share Index	-7.30	-15.34

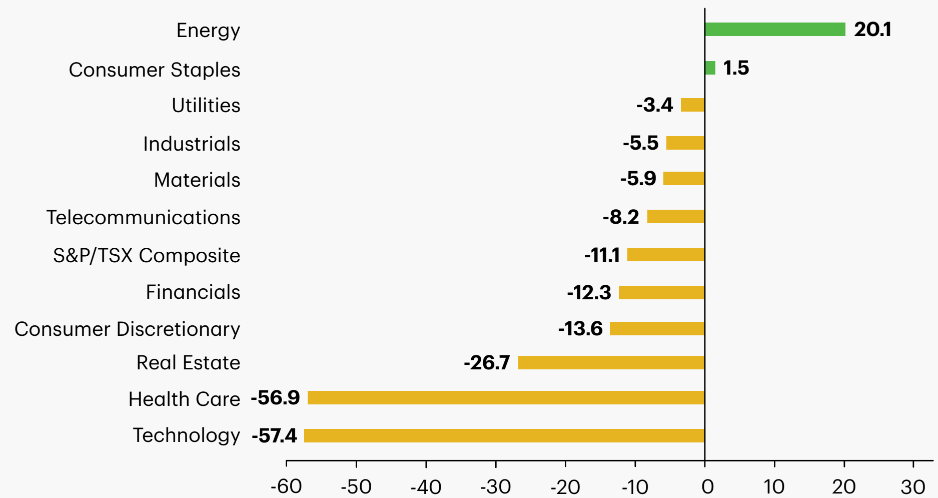
Source: Bloomberg Finance L.P. as of September 30, 2022. Total index values and returns, except the S&P/TSX Preferred Share Index which is reported on a price-return basis.

Q3/22 S&P/TSX Sector Returns



Source: Bloomberg Finance as of September 30, 2022. Index total returns.

YTD S&P/TSX Sector Returns



Source: Bloomberg Finance as of September 30, 2022. Index total returns.

Canadian equity markets tracked their American peers in Q3, although trading north of the border was held in a tighter range due to a number of crosswinds: on the one hand, a severe energy slump; on the other, superior economic performance. While the Bank of Canada has hiked rates as quickly as the Fed, the Canadian dollar dropped 7.7% against the greenback in Q3 due to a general flight to safety as well as tumbling oil prices, which were depressed by weaker demand as investors fretted about global economic growth (particularly in China). With perhaps some irony, though, the depreciation of the Canadian dollar has helped to keep its economy humming, with exports rising in domestic-currency terms.

Similar to its southern neighbour, stocks in Canada climbed steadily through mid-August on the theory that, once U.S. inflation had peaked, as it did in June, the Fed would pause its hiking and usher in a powerful tailwind for equities. U.S. inflation did slow marginally in July, but this was mainly due to falling energy prices. Core inflation (which excludes energy and food) held steady in July before rising unexpectedly in August. The growing threat of inflation has prompted increasingly hawkish comments from central bankers and a slew of rate hikes across the developed world.

The S&P/TSX Composite Index ended the quarter down 1.4%, with only four sub-indices posting positive returns. Large-cap growth stocks outperformed in the third quarter. Small-cap stocks (S&P/TSX Canadian Small Cap Index) declined by 2.5%, underperforming large-cap stocks (S&P/TSX 60 Index), which declined by 1.7%. Growth stocks (MSCI Canada Growth Index) increased 1.0% over the quarter, outperforming value stocks (MSCI Canada Value Index), which ended the quarter at -4.3%.

West Texas Intermediate finished the quarter at US$79.49, down a striking 24.8% from the $105.76 close on June 30, 2022. Intra-quarter volatility saw WTI reach an intraday peak of US$111.45 in early July, and an intraday low of US$76.25 in late September as fears emerged that a slowing Chinese economy, coupled with rate hikes, could drag the global economy into recession, which would severely impair energy demand. Canadian financials were down 1.24% on a total-return basis during Q3. Weakness in the banks' capital markets business has been partially offset by strength in the lending business, but earnings in fiscal Q3 declined 3.4% y/y, with the surprise ranging between -4% (for Royal Bank, RY) and 2% (for TD). The spot price of gold, meanwhile, ended the quarter at US$1672.00, a decline of 7.5% from the June 30 close of $1,807.30. Gold spiked to an intra-day high of US$1824.60 in mid-August before sinking to an intra-day low of $1,622.20 in late September.

The Canadian economy continued to outperform its G7 peers in Q2, recording a solid expansion of 3.3% (0.8% in Q1). That figure came in below consensus estimates as well as a TD Economics forecast of 4.4%, but it nonetheless demonstrates Canada's enviable position as an exporter of wheat, minerals and energy as the war rages between Ukraine and Russia. In the second quarter, however, growth was driven primarily on the domestic side, with consumer spending up an impressive 9.7% in Q2 (q/q), with consumption in services up 16.4%. This reflected strength in the reopening of the economy and the pivot away from spending on goods towards services.

Also bolstering growth was investment in non-residential structures (+11.1%), as well as machinery and equipment (+19.3%). This was powered by the expansion of oil and gas companies in western provinces, which are capitalizing on higher energy prices. On the flip side, growth in residential structures pulled back significantly (-27.6%), reflecting the impact of the Bank of Canada's aggressive rate-hiking cycle. TD Economics is forecasting a slowdown in Q3 (lowering its forecast to 1.6% from 3.0%), but it is also expecting the Canadian economy to remain out of recession for the remainder of the year, raising its 2022 forecast to 3.3% from 3.0%.

On the labour front, meanwhile, we've begun to see the pendulum swing back from an unsustainably tight market. In June, July and August, the Canadian economy lost 114,000 jobs (43,000, 30,600 and 40,000, respectively). Unemployment, meanwhile, rose to 5.4%, from the all-time low of 4.9% recorded in June. While the loosening job market is likely to get some people worried, it's worth noting that a slowdown in job creation is exactly what the Bank of Canada needs to ensure that the high-inflation environment does not become entrenched. The labour market is coming from levels of extreme tightness and has been due for some giveback, and this is exactly what's happening.

We're also seeing a deterioration of household finances, with stocks, bonds and real estate prices all falling simultaneously. Net worth fell by 6.1% in the second quarter, marking the first decline since the outset of the pandemic and the steepest quarterly drop since tracking began in 1990. Residential valuations fell by 5% (+3.9% in Q1) while investments fell 5.7% (-1% in Q1). Healthy wage growth (+2%) is keeping consumers spending, but rising rates are now starting to eat into disposable income. The debt-servicing ratio is still low but ticked upwards to 13.6% in Q2 (13.5% in Q1, 15% pre-pandemic), while disposable income rose a negligible 1% in Q2 (3.3% in Q1). By the end of next year, total debt-servicing costs are projected to be 30% higher than the first quarter of 2022, with the average borrower spending an extra $2,500 per year on debt.

Deteriorating household finances and cooling labour markets will not, however, be enough to stop the Bank of Canada from hiking rates — not so long as inflation remains stubbornly high. From May through August, core inflation (CPI-Common) rose from 3.9% to 5.7%, in large part due to the surging price of airfare and other travel-related services. Meanwhile, the more volatile consumer price index (which includes energy and food prices) recorded an annual increase of 7.0% in August (down from a peak of 8.1% in June). Until weakness in the labour market and household finances translates into significantly lower inflation, the Bank will be unlikely to press pause on rate hikes.

There is some hope, however, that hikes for the remainder of the year will be smaller than they have been. In July, the Bank surprised markets with a “jumbo” 100-bp rate hike, surpassing even the Fed’s hawkishness. It then followed up in September with a 75-bp hike, with Governor Tiff Macklem cautioning that “short-term inflation expectations remain high [and] the longer this continues, the greater the risk that elevated inflation becomes entrenched.” TD Economics now expects the policy rate to rise by another 75 bps for the remainder of the year — which would represent an enormous 3.75-percentage-point increase over the course of 12 months.

Preferred Shares

Canadian preferred shares had one of their worst quarters in history, as investor concern over macroeconomic uncertainty and geopolitical risk overshadowed the promise of rising interest rates and a shrinking investable universe. The S&P/TSX Preferred Share Index declined 7.30% in Q3/22, while the five-year government of Canada yield increased 22 bps, with the latter fuelled by persistent inflation and hawkish signalling by central banks. On a total-return basis, the index is down 15.34% year-to-date, underperforming Canadian equities (-11.14%) and corporate bonds (-10.58%). Investor defensiveness can be observed through credit-spread movements and outflows of preferred-share ETFs. Canadian corporate bond spreads increased 7 bps during the quarter, closing at the highest level in 27 months. Outflows from the five largest preferred-share ETFs were $323 million, slightly lower than the $428 million that was taken out in Q2/22. Outflows so far this year amounted to $983 billion.

According to a ruling by the Office of the Superintendent of Financial Institutions (OSFI), there are limitations for limited-recourse capital-notes issuance by depository institutions, which is driving banks to issue preferred shares to institutional investors. TD, BMO and CIBC came to the market with $1.9 billion, priced at an average spread of 422 bps and a dividend rate of 7.32%, which added to the pressure on prices. Market conditions have changed drastically over the past 12 months, as rising interest rates and deteriorating investor sentiment pushed the cost of capital higher. To put things into perspective, in October 2021 Royal Bank issued a preferred share at 4.20% and TD’s issue was priced at 5.75% in March 2022.

Redemptions continued, but the pace slowed to $1.3 billion from $2.35 billion in the second quarter, as the cost of refinancing has gone up drastically. Issues that reset during the third quarter are currently yielding around 6.8%.

The average yield on investment-grade fixed rate-resets increased to 5.4% from 5.0% at the end of the previous quarter. The yield on investment-grade perpetuals increased to 6.3% from 6.0% in Q2/22, which is equivalent to a bond yield of 8.2% after accounting for the tax advantage of Canadian dividends.

Canadian & U.S. Fixed Income

Government Bond Yield	Canada			United States		
	Current (%)	Q/Q Change (pp)	YTD Change (pp)	Current (%)	Q/Q Change (pp)	YTD Change (pp)
91-Day Treasury Bill	3.78	1.68	3.61	3.25	1.62	3.22
2-Year Government Bonds	3.79	0.70	2.84	4.28	1.33	3.55
5-Year Government Bonds	3.33	0.22	2.07	4.09	1.05	2.83
10-Year Government Bonds	3.17	-0.05	1.75	3.83	0.82	2.32
30-Year Government Bonds	3.09	-0.04	1.42	3.78	0.59	1.87

Source: Bloomberg Finance L.P. as of September 30, 2022. Index returns are reported on a total-return basis; pp (percentage point).

Global Fixed income markets continued their relentless and painful repricing over the third quarter. Price pressures broadened, and most developed-market central banks escalated the hawkish rhetoric and delivered substantial policy rate hikes. This resulted in upward market repricing of government bond yields. Only shorter-maturity government bonds were impacted in the Canadian universe, while the entire curve was impacted for the U.S., leading to significant outperformance for Canada. In the Canadian fixed income universe, higher yields for shorter-maturity debt, with modestly wider credit spreads, were mostly offset by modestly lower yields for medium- to long-term maturities, leading the FTSE Canada Universe Bond Index to post 0.5%, while the Bloomberg U.S. Aggregate Bond Index (CAD-hedged) posted -5.0%.

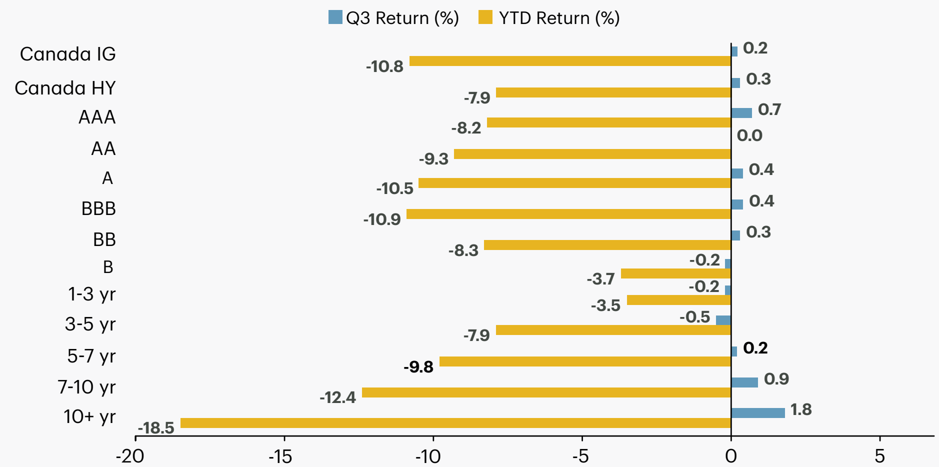
In the U.S., the Fed hiked twice over the quarter, with hikes of 0.75% both in July and September. Fed Chair Powell predictably cited continued strong core CPI and labour-market data as a motivation for the committee to go with a third consecutive outsized rate hike. The latest statement of economic projections suggests a terminal policy-rate target range of 4.50% to 4.75% in 2023. The projections for the fed funds rate (the "dot plot") suggests an aggressive tightening in policy rates, with the median for the fed funds rate reaching 4.4% by year-end and a terminal target rate of 4.625% in 2023.

The Bank of Canada at its September meeting hiked by 75 bps to bring the overnight rate into restrictive territory at 3.25%. The statement itself

Fixed Income Indices	Q3 Return (%)	YTD Return (%)
FTSE Canada Universe Bond Index	0.5	-11.8
FTSE Canada Universe All Government Bond Index	0.6	-12.2
FTSE Canada All Corporate Bond Index	0.2	-10.8
FTSE Canada Real Return Bond Index	0.9	-16.7
FTSE Canada Provincial Bond Index	1.0	-14.8

Source: Bloomberg Finance L.P. as of September 30, 2022. Index returns are reported on a total-return basis.

Canadian & U.S. Fixed Income



Source: Bloomberg Finance L.P. as of September 30, 2022.

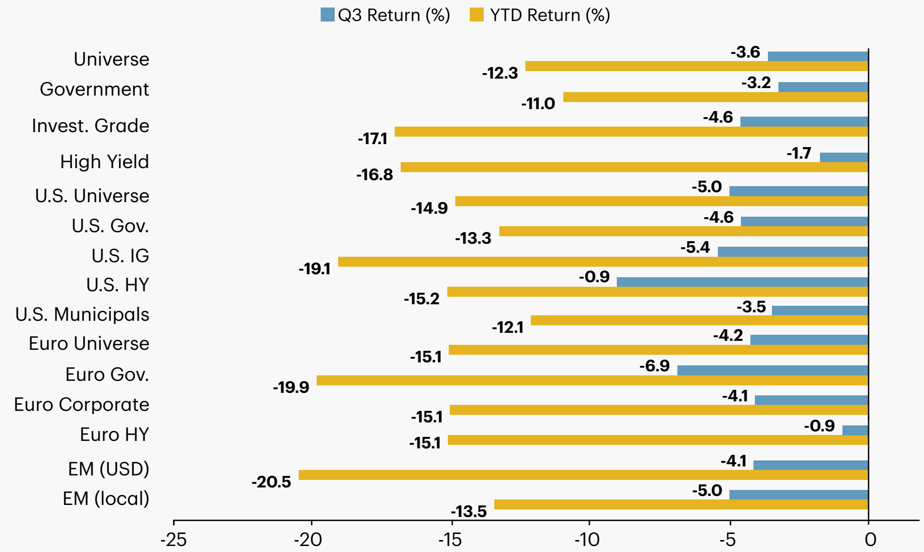
was rather concise but stuck a slightly hawkish tone, with an emphasis on broadening inflation pressures and strong domestic demand. The more intriguing part of the Bank's policy statement was the forward-looking section, which cautioned that rates would need to rise further.

Broad global fixed income, represented by the Bloomberg Global Aggregate Index (CAD-hedged), posted -3.6% over the quarter. Canadian government bonds outperformed U.S. Treasuries and the global universe, with the Canadian government bond index returning 0.6%, while the U.S. Treasury Index (CAD-hedged) returned -4.6%. The U.S. 10-year Treasury yield started the quarter at 3.01% and ended at 3.83%, while the equivalent Canadian government bond yield started at 3.22% and ended at 3.17%.

Hawkish central banks, persistently high inflation, heightened volatility in government yields, heightened recession fears — all these led to widening of credit spreads. On the Canadian side, the investment-grade spread widened by 8 bps and ended the quarter at an option-adjusted spread of 172 bps. Modestly positive performance from Canadian government bonds and higher overall yield from the corporate bonds were able to offset the loss from slightly wider spreads. The sector posted returns of 0.2%, modestly underperforming the aggregate Canadian fixed income index return of 0.5%. Diving deeper, Canadian AAA-rated corporate credit benefited the most due to stronger balance sheets and therefore less credit-spread widening, posting returns of 0.7% and outperforming lower-quality AAs, which were flat; A-rated credit at 0.4%; and BBB-rated credit at 0.3%.

Understandably, the longest-maturity corporate bonds outperformed medium- and short-maturity bonds, given that only shorter-maturity government bond yields were repriced higher and longer-maturity yields were modestly lower, though credit spreads widened across the credit maturity profile. Over the quarter, the longest-maturity cohort of 10-year-plus posted returns of 1.8%. The medium-maturity cohort of seven- to 10-year and five- to seven-year returned 0.9% and 0.2%. And the shorter-maturity cohorts of three- to five-year and one- to three-year bonds returned -0.5% and -0.2%. Higher real yields were offset by an improving inflation contribution for Canadian real-return bonds and led the sector

Global Fixed Income



Source: Bloomberg Finance as of September 30, 2022.

to post returns of 0.9%, outperforming the government bond universe at 0.6%. Canadian provincial bonds, also with higher interest-rate sensitivity and relatively stable spreads, outperformed corporate bonds over the quarter, returning 1.0%.

For global corporate bonds, we witnessed a high degree of variance due to the adverse action in government bond yields dwarfing any move in the spreads. U.S. investment-grade corporate spreads modestly widened by 3 bps over the quarter, while U.S. sub-investment-grade ("high-yield") corporate spreads tightened by 18 bps. The U.S. investment-grade corporate bond universe (CAD-hedged) returned -5.4%, underperforming the global investment-grade corporate universe (CAD-hedged), which returned -4.6%. Despite growing recession concerns, U.S. sub-investment-grade corporate bonds (CAD-hedged) remained resilient by posting -0.9% over the quarter, outperforming the global sub-investment-grade corporate universe (CAD-hedged) at -1.7%. USD emerging-market debt was again severely punished over the quarter, posting -4.1% due to higher yields, while local-currency debt returned -5.0%.

International Equities

Indices	Q3 Return (%)	Q3 Return (%, C$)	YTD Return (%)	YTD Return (%, C$)
FTSE 100 Index	-2.72	-4.78	-3.66	-13.67
DAX Index	-5.24	-5.22	-23.74	-28.84
CAC 40 Index	-2.46	-2.45	-17.10	-22.31
MSCI Europe (LC) Index	-4.72	-4.71	-24.00	-28.79
Nikkei 225 Stock Average	-0.83	-0.44	-8.07	-21.10
MSCI Emerging Markets Free (LC) Index	-8.02	-5.30	-20.46	-20.62

Source: Bloomberg Finance L.P. as of September 30, 2022. Total index values and returns. Index returns calculated in local currency and C$.

International developed markets performed in line with their American peers in Q3, led by Japanese markets. In the UK, the blue-chip FTSE 100 dipped 2.7% in subdued trading, despite what by all accounts can be described as historic upheaval. On July 7, former PM Boris Johnson resigned after a series of scandals. Then, in early August, inflation hit double digits (10.1%). Then, on September 8, Queen Elizabeth II died. And on September 23, incoming PM Liz Truss spooked bond markets with her plan to borrow 45 billion pounds in order to slash taxes (a plan that has since been abandoned). The FTSE 100, however, was held steady by the falling pound, which plunged 8.2% against the U.S. dollar, boosting the fortunes of multinationals with large American markets. GDP contracted 0.4% in the second quarter (q/q annualized, 3.2% in Q1) and the economy is flirting with a technical recession. The UK consumer confidence index fell to an all-time low in August (-44) and business confidence is also waning, with the August composite PMI hovering just above the 50 contractionary threshold (50.9). Against this backdrop, the Bank of England hiked rates by 50 bps twice in Q3, lifting the policy rate to 2.25%

European markets were fixated on central-bank policy last quarter, tracking their American peers closely. The MSCI European Monetary Union Index fell 4.7% in Q3. Stocks rose through mid-August on hopes that inflation had peaked. This proved excessively optimistic, as the tight labour market and rising wages fed into price increases. Europe also dealt with a growing energy crisis in late August, as the Russian government attempted to pressure Ukrainian allies by cutting the supply of natural gas. The threat of a global economic slowdown sent the euro down 6.7% against the U.S. dollar, prompting the European Central Bank to intervene twice: a 50-bp hike in July; and in September an unprecedented 75-bp hike. Data from Q2 showed the European economy accelerating to 2.8% in Q2 (2.0% in Q1) due to tightening labour markets and accumulated savings. Consumer and business sentiment have both fallen into contractionary territory in recent months, however, with the economic sentiment index falling to 93.7 in September from 103.5 in June; and the Eurozone Composite PMI falling to 48.2 in September from 51.9 n June, its worst reading since the height of the pandemic.

Japan's Nikkei 225 Stock Average was flat in the third quarter, falling 0.8% due in large part to the dovish monetary policy that has sunk the yen this year (which supports the export-dependent economy). The yen has fallen over 20% vis-à-vis the U.S. dollar this year. Japanese equities tracked Wall Street for the most part, with investors fixated on inflation and central-bank tightening. Japanese investors seem to have been done in by the same confused messaging that prompted "peak inflation" enthusiasm earlier in the quarter, only have their hopes dashed by hawkish Fed commentary in mid-August. Relatively muted inflation (3% in August) has allowed the Bank of Japan to maintain an accommodative policy stance, but the Bank was forced to intervene in September to defend the currency. Real GDP growth accelerated to 2.2% in Q2 (0.1% in Q1) due to strong consumption, but business confidence has fallen into contractionary territory as investors and business managers alike worry about a global recession. In August, the Jibun Bank Composite PMI fell to 48.9 in August from 52.3 in May.

Emerging markets underperformed due to economic weakness in China. The MSCI Emerging Markets Index, in local currency terms, fell 8% in Q3, led by an 11% drop for the Shanghai Composite. In September, a Covid lockdown was extended in the Sichuan capital, Chengdu, while the ongoing property finance crisis prompted homebuyers to boycott payments on unfinished condo developments. The Chinese economy shrunk 10.4% in Q2 (q/q, seasonally adjusted, annualized, +5.2% in Q1), its first contraction since the outset of the pandemic. In Mexico, meanwhile, the IPC Index fell 6% in Q3, although the economy performed better than expected, expanding 4% (3.6% in Q1). India and Brazil both bucked the trend in Q3, with shares on the Nifty 50 and Bovespa rising 11% and 12% respectively. In India, stocks benefited from an influx of foreign capital, as investors pulled out of China and ploughed into what they perceived to be a safer market. The Indian economy, however, contracted 5.6% in calendar Q2 (3.2% in Q1) as the rebound from Covid reopenings petered out and new global growth headwinds began to emerge. In Brazil, meanwhile, stocks rose on strong earnings from national flag-bearers Embraer and Petrobras. They also got a boost from a calmer political climate following President Jair Bolsonaro’s vow to concede if defeated politically. The Brazilian economy expanded 4.8% in Q2 (4.0% in Q1). TD Economics forecasts 2022 growth of 2.6%, 2.2%, 6.5% (fiscal year) and 2.6%, respectively, for these nations.

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