Goldilocks Optimism

Notes from the Trading Desk - Q3 2024

October 5, 2024

As we bade farewell to summer and began crossing the threshold into Fall, global markets embodied the same theme with falling inflation, and subsequently, falling rates. Overall, fixed income continues to be in vogue as we head into the end of the year with falling rates directing the flow of capital out of money markets and matured GICs and into bond funds.

Global inflation continued to ease over the third quarter, with Canada finally hitting the much longed-for 2% target in August. Weaker labour data and slowing economic growth combined with lower inflation triggered rate cuts across global central banks. Most notably, the US Federal Reserve ("the Fed") lowered rates in September for the first time since 2020.

Today, the federal funds interest rate sits at 4.75-5.00% in the US and 4.25% in Canada. Enthusiasm for a Goldilocks soft landing persists as markets had a positive reaction to slightly-better-than-expected economic data from the US following the rate cuts. The latest US jobs report, described as a "blowout," reinforced the resilience of the US economy and the possibility of a no-landing scenario and underscored the Fed's commitment to not rushing rate cuts. At this point, the market is expecting both the Fed and the Bank of Canada to continue reducing rates, pricing in ~2 rate cuts from both central banks for the remainder of 2024.

With the US presidential election only about a month away, we expect market focus will soon shift, likely reducing risk as we get closer to election day. The potential of massive tariffs from a Trump presidency is too big a risk to ignore, as is the significant fiscal stimulus that would result from a Harris presidency.

Following the UN General Assembly in New York, geopolitical headlines continue to dominate. However, despite ongoing geopolitical unrest in the Middle East and Ukraine, markets have been surprisingly nonchalant about recent developments, choosing rather to focus on Fed-driven optimism. In our view, the likelihood of escalation is too uncertain to ignore, and we look to embed modest additional downside protection to account for further equity rallies or changes in the volatility index.

On a lighter note, at home, Rogers, a top 10 position in a few of our strategies, announced the $4.7 billion acquisition of Bell's 37.5% stake in Maple Leaf Sports & Entertainment (MLSE), which owns the Toronto Maple Leafs NHL franchise and the Toronto Raptors NBA franchise among other sports teams in other leagues. Initially, the market was confused by the press release, causing spreads to widen, but our Credit Research team's analysis revealed it to be a credit-enhancing acquisition for our position. Fundamentally, we believe Rogers spreads are compelling versus global peers, and we view this transaction as neutral to modestly positive since the company is acquiring these assets without increasing leverage.

As we head into Q4, we expect another strong quarter for fixed income with $8.1 billion of inflows into high-grade bonds, supported by a diverse buyer base. While valuations may dampen, we continue to see individual opportunities within credit where we can tactically add value. We are generally moving up in credit quality and exploring opportunities to add downside protection amid the likelihood of continued volatility. While the market seems enthusiastically optimistic, our team continues to be cautiously optimistic, mindful that a number of risks could evolve over the next quarter but attuned to compelling opportunities that may spring up in this environment.

For more updates on the credit market, read our **Credit Market Themes in 5 Charts** article for this quarter.

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