

2022 capital markets year in review

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2022 – Market review

Regional Equity Indices	Index Level		2022		2021
	Dec. 31, 2021	Dec. 31, 2022	Price Return	Total Return	Total Return
S&P/TSX	21,223	19,385	-8.7%	-5.8%	25.2%
S&P/TSX Small Cap	774	688	-11.2%	-9.0%	20.3%
Dow Jones Industrial	36,338	33,147	-8.8%	-6.9%	20.9%
S&P 500	4,766	3,840	-19.4%	-18.1%	28.7%
Russell 2000	2,245	1,761	-21.6%	-20.5%	14.8%
Nasdaq	15,645	10,466	-33.1%	-32.5%	22.2%
MSCI All Country World	755	605	-19.8%	-18.0%	19.0%
MSCI Europe	162	143	-11.9%	-9.0%	25.8%
MSCI EAFE	2,336	1,944	-16.8%	-13.9%	11.9%
MSCI Emerging Markets	1,232	956	-22.4%	-19.9%	-2.3%

Fixed Income Indices	Index Level		2022	2021
	Dec. 31, 2021	Dec. 31, 2022	Total Return	Total Return
FTSE Can. Universe Bond	1,190	1,051	-11.7%	-2.5%
FTSE Can. All Corp. Bond	1,378	1,242	-9.9%	-1.3%
Bloomberg Can. High Yield	167	159	-4.3%	-4.3%

Currencies	Dec. 31, 2021	Dec. 31, 2022	% change
CADUSD	0.791	0.738	-6.7%
CADEUR	0.695	0.689	-0.9%
EURUSD	1.137	1.071	-5.8%
GBPUSD	1.353	1.208	-10.7%
USDJPY	115.08	131.12	13.9%

Bond yields (%)	Dec. 31, 2021	Dec. 31, 2022	bps change
2-year Canada Govt.	0.95	4.05	310
2-year US Treasury	0.73	4.43	369
10-year Canada Govt.	1.43	3.30	187
10-year US Treasury	1.51	3.87	236
10-year Germany Govt.	-0.18	2.57	275
10-year Japan Govt.	0.07	0.42	35

Commodities	Dec. 31, 2021	Dec. 31, 2022	% change
Gold USD/oz.	1,829.20	1,824.02	-0.3%
Oil USD/bbl.	75.21	80.26	6.7%
German Nat. Gas EUR/MWh	65.85	74.95	14%
Copper USD/lb.	446.35	381.05	-15%

Source: Bloomberg December 30, 2022. Index returns are in local currency. *Total return is price return plus reinvestment of dividends. All figures quoted in the text are price only return, local currency, unless otherwise noted.

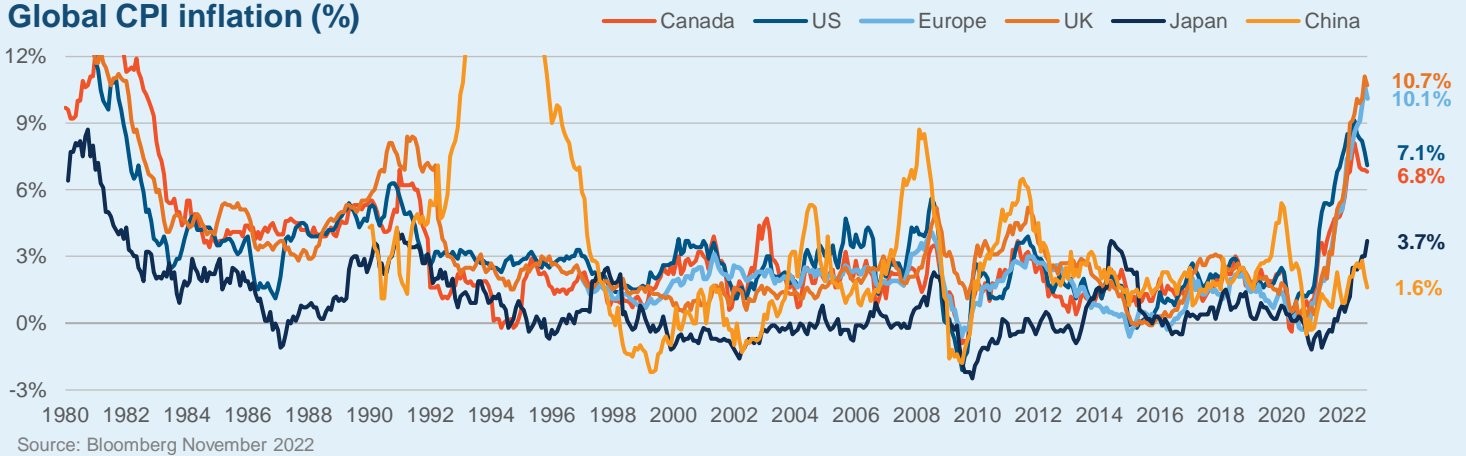
The end of the Post-Goldilocks era

This year began with the world facing the rapid spread of the Covid-19 omicron variant, renewing concerns of another pandemic-induced slowdown. Thankfully the variant proved less lethal than its predecessors, leading to some optimism around the economy reopening. Although consensus forecast that central banks tightening monetary policy would be a headwind for the economy and markets, the **path towards normalization was widely expected to be gradual**. Investors had many positives to point to that would support the global expansion. Consumer demand was expected to be supported by their war chest of excess savings accumulated over the pandemic and the strong recovery in labour markets. In turn, the earnings outlook was positive alongside above-trend global GDP growth.

However, just as the economy looked to be picking up steam, news of Russia invading Ukraine sent shockwaves around the world. **Although Russia and Ukraine make up a relatively negligible portion of global GDP, their footprint in the commodity complex was vast**. WTI crude oil surged to as high as US\$130/bbl, European natural gas prices soared as much as 475%, while agriculture futures were up across the board.

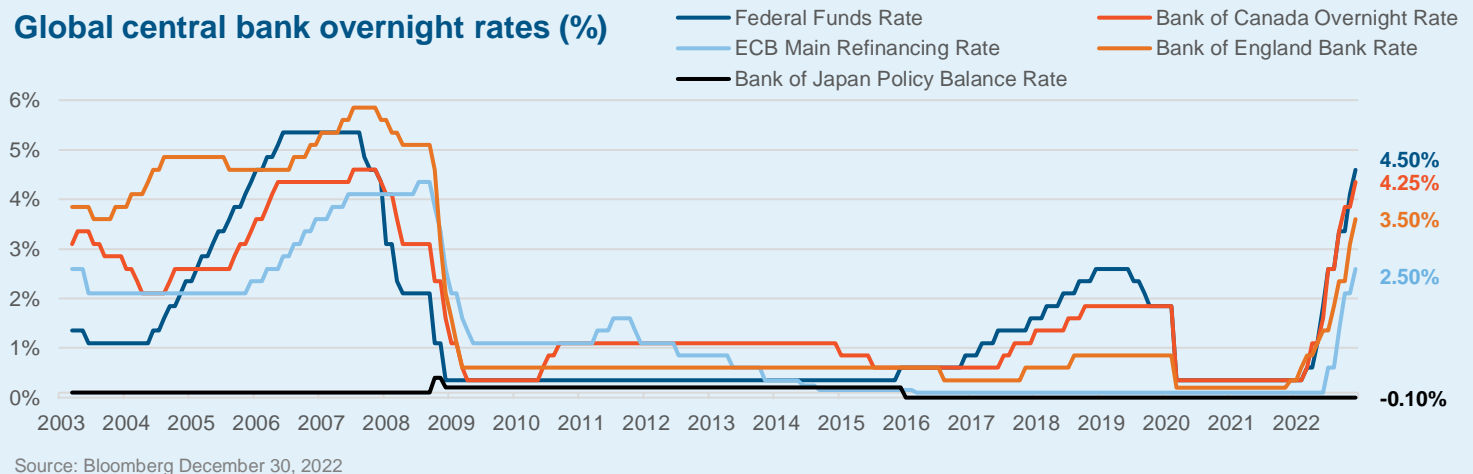
A lethal concoction of surging energy prices, another wave of pent-up demand from economies reopening, tight labour markets and ongoing supply chain pressures **boosted inflation to multi-decade highs globally**. Just as many investors feared, **inflation was indeed not transitory and central banks were caught well behind the curve on inflation**.

Global CPI inflation (%)



Now that inflation was unhinged well above their 2% targets, **central bankers were forced to raise interest rates at a historic pace to squash demand**. In addition, many central banks began reducing their swollen balance sheets via their quantitative tightening programs to reduce the excess liquidity still sloshing through the financial system.

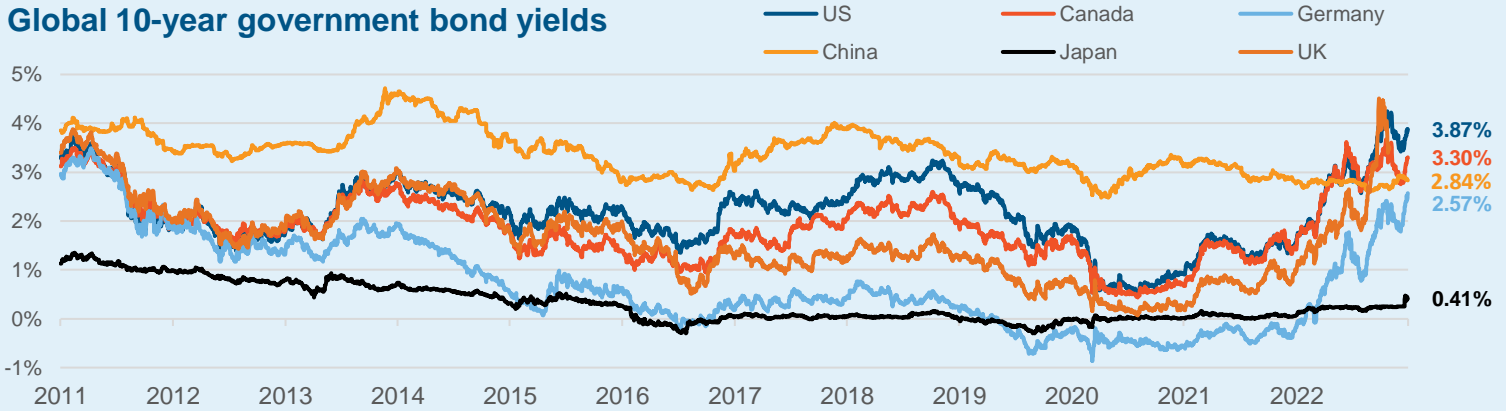
Global central bank overnight rates (%)



The ripple effects of soaring inflation led to a sharp sell off in fixed-income, with Canadian and global bonds recording their worst

year on record. **Bond yields spiked higher across the yield curve. In addition, with inflation proving stickier than expected, investors somberly waved goodbye to the zero-interest-rate policy (ZIRP) that had backstopped capital markets since the 2008 Global Financial Crisis (GFC). 2022 will be remembered as the end of the Goldilocks era, where investors enjoyed above-trend risk asset returns in the not-too-hot, not-too-cold environment of easy financial conditions and subdued inflation. Now, risk assets are being asked to stand on their own two feet for the first time in over a decade.**

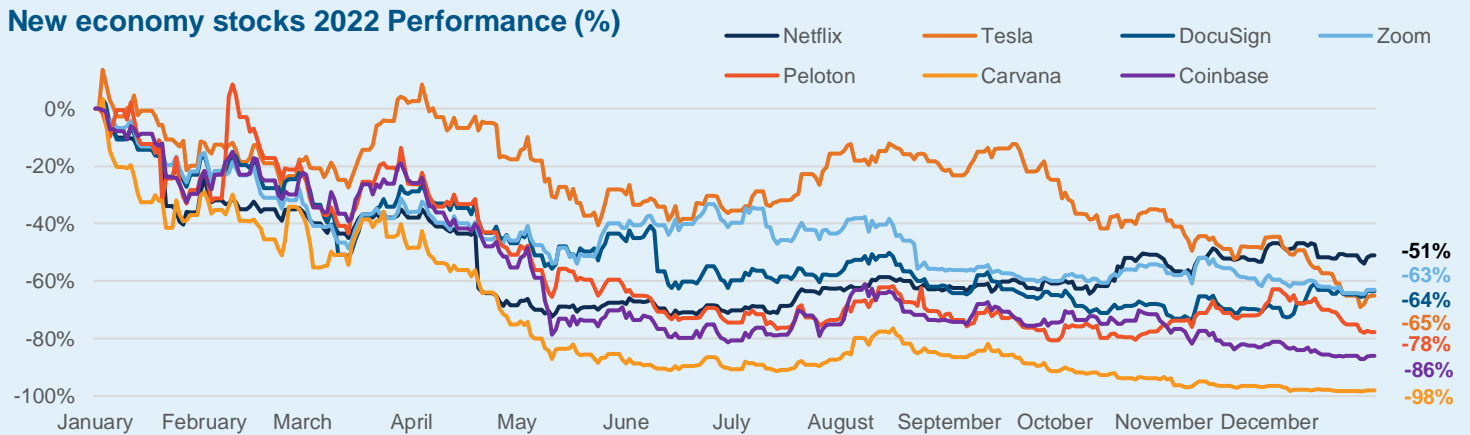
Global 10-year government bond yields



Source: Bloomberg December 30, 2022

The compression in equity valuations in reaction to sharply higher yields was solely to blame for the decline in equity prices. Stocks that largely benefitted from the ZIRP policy were hurt the most. Many of them were the new-economy, technology stocks that were often unprofitable at this stage but saw their valuations balloon over the pandemic. As a result, the normalization in interest rates have decimated their stock prices.

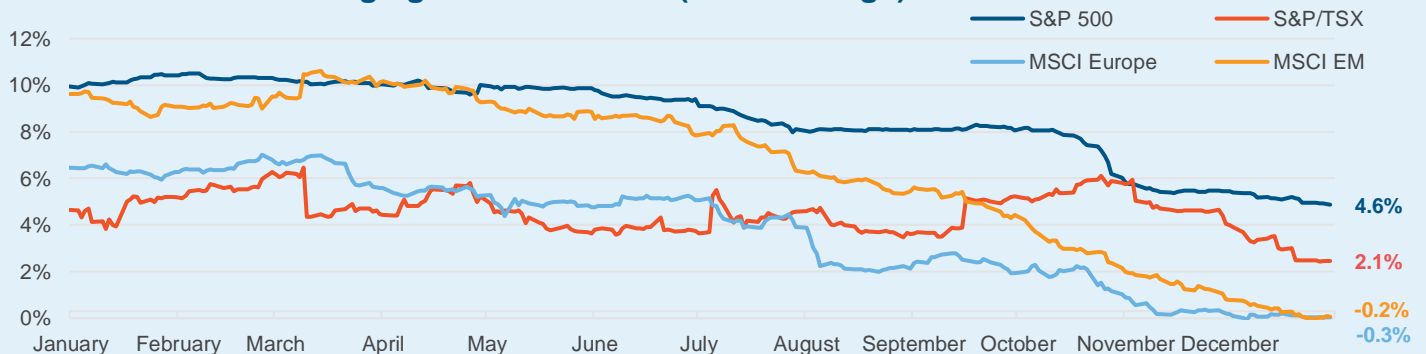
New economy stocks 2022 Performance (%)



Source: Bloomberg December 30, 2022

Fortunately for equities, corporate earnings, the other side of the stock price equation, have held up much better than anticipated in 2022. However, earnings estimates are beginning to see meaningful downward revisions.

2023 consensus earnings growth estimates (Y/Y % change)



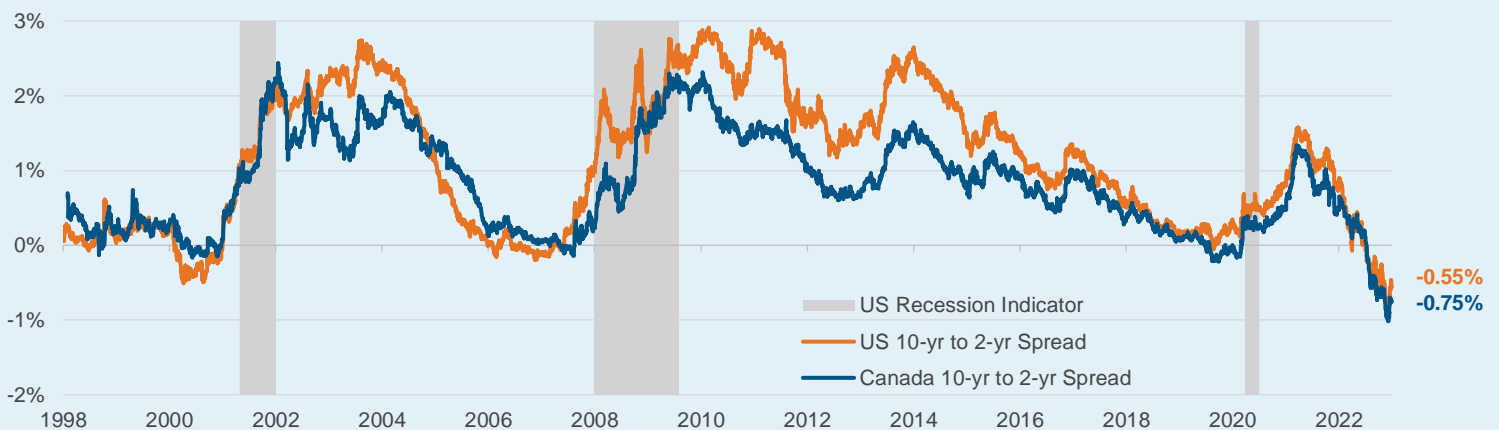
Source: Bloomberg December 30, 2022

As we turn the page on a tumultuous 2022 with central banks shifting monetary policy deep into restrictive territory, and signs of inflation abating, the focus for markets is swiftly shifting from inflation to growth. Due to the ongoing war in Ukraine and the lingering uncertainty surrounding China’s reopening, the global economic backdrop has deteriorated significantly. The global economy is only expected to grow by 2.1% in 2023, with US real GDP forecasted to expand by just 0.3%.

Forward-looking indicators, such as Purchasing Manager Indices, have fallen into contractionary territory. In addition, Q3 finally saw corporate earnings show some signs of weakness, prompting companies to lower their forward guidance for next year. 2023 consensus earnings forecasts have been revised lower, but there is likely some further downward pressure to come in 2023.

Fears of a recession are most evident in the bond market. Global yield curves have inverted to levels not seen in decades, indicating the bond market’s expectation that the restrictive monetary policy will push the global economy into a recession.

Canada and US 10-year to 2-year spread (%)



Source: Bloomberg December 30, 2022

For our thoughts on investing in the “Post-Goldilocks” environment, please check out our Mackenzie Blue Book. In this report, we identify the key investment themes heading into 2023 and our asset mix recommendations that provide guidance on how to reposition portfolios in this new investing landscape.

Mackenzie’s Blue Book - 2023 Outlook

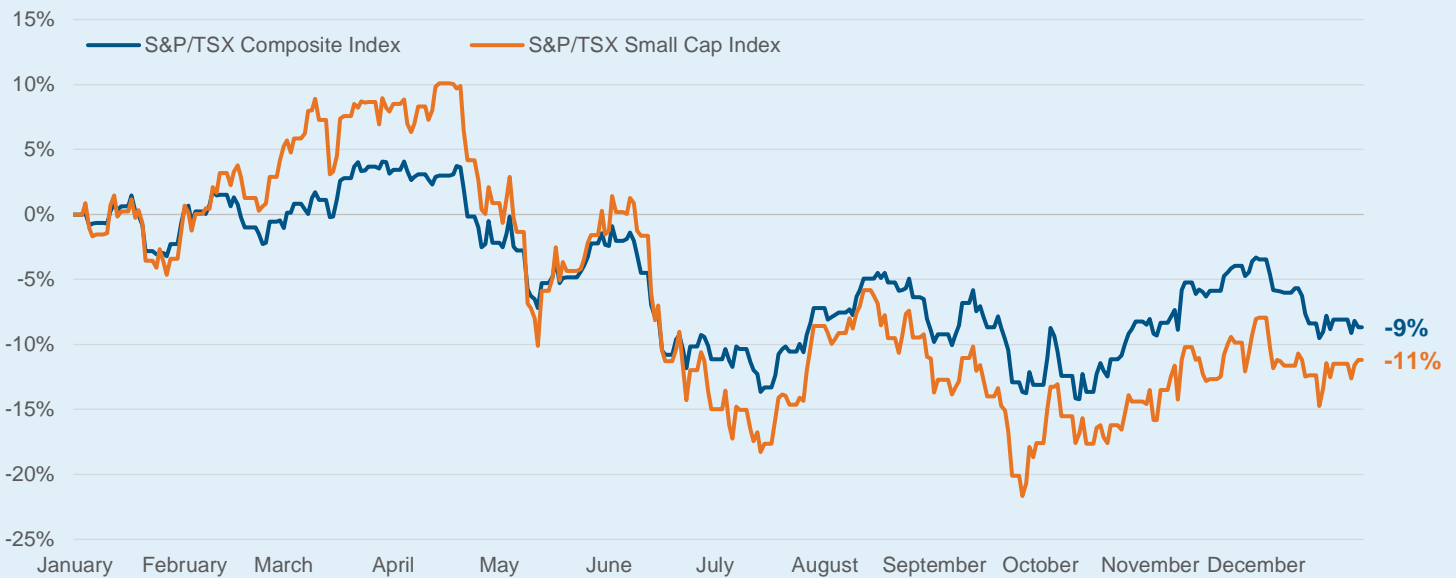
Adjusting to life after Goldilocks

[Mackenzie’s Bluebook: 2023 Blue Book - English](#) / [French](#)

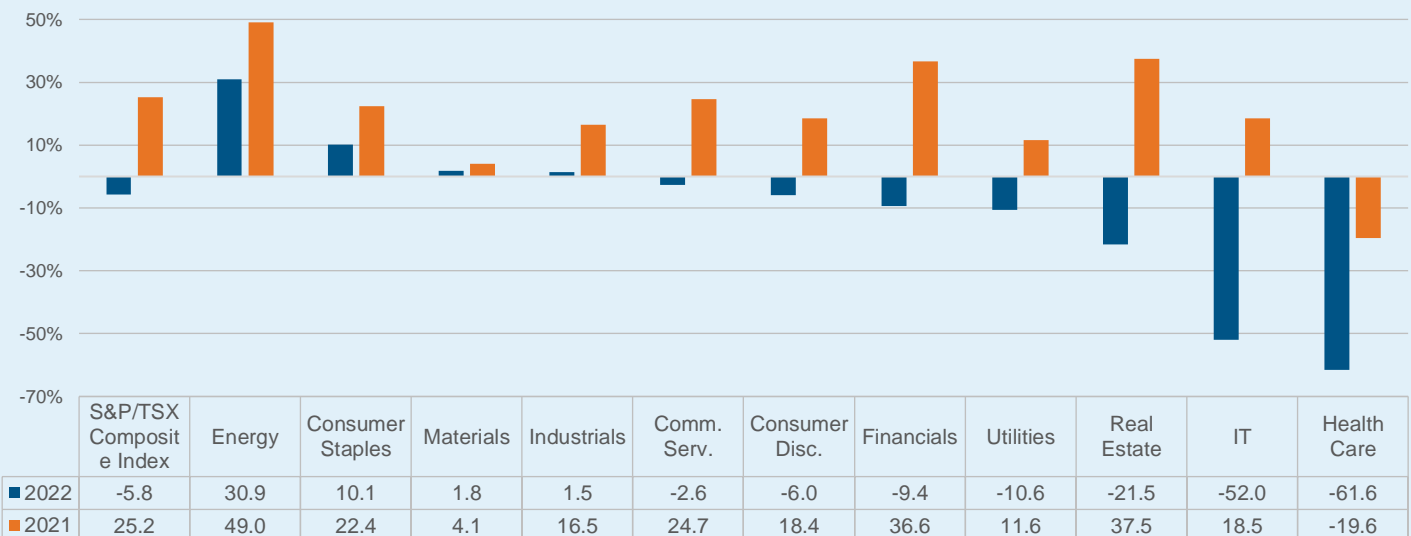
Canadian equity

Although Canadian equities could not avoid the losses seen globally, they did rank amongst the top-performing equity indices, with the S&P/TSX Composite down 5.8% on a total return basis. Energy stocks were one of the few places to hide this year. Accordingly, the index's ~17% weight helped mitigate the sizeable losses seen in virtually every other sector. The ~30% gain in the energy sector was more than offset by the double-digit losses seen in the interest-rate sensitive sectors such as information technology (-52%) and real estate (-21%). Health care (-61%) stocks were also notable underperformers, hurt by sizeable losses in cannabis stocks. Resilient profit margins helped bolster consumer staples stocks (+10%), while industrials (+1%) and materials (+1%) were the other sectors to finish in positive territory.

S&P/TSX Composite and S&P/TSX Small Cap - 2022 performance



S&P/TSX sector total returns (%)



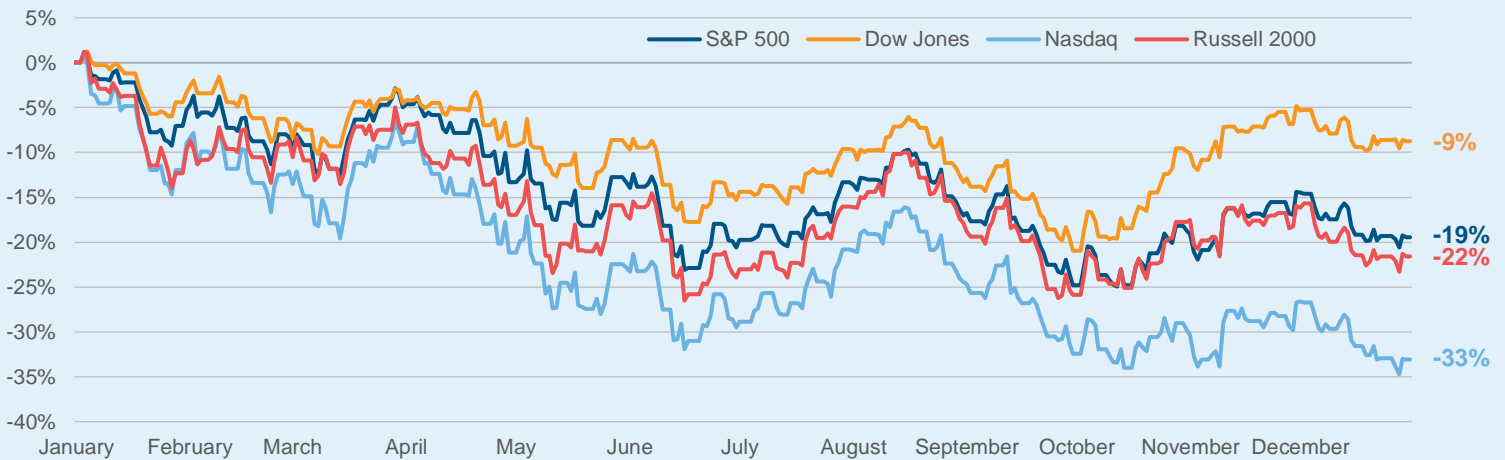
Source: Bloomberg December 30, 2022

US Equity

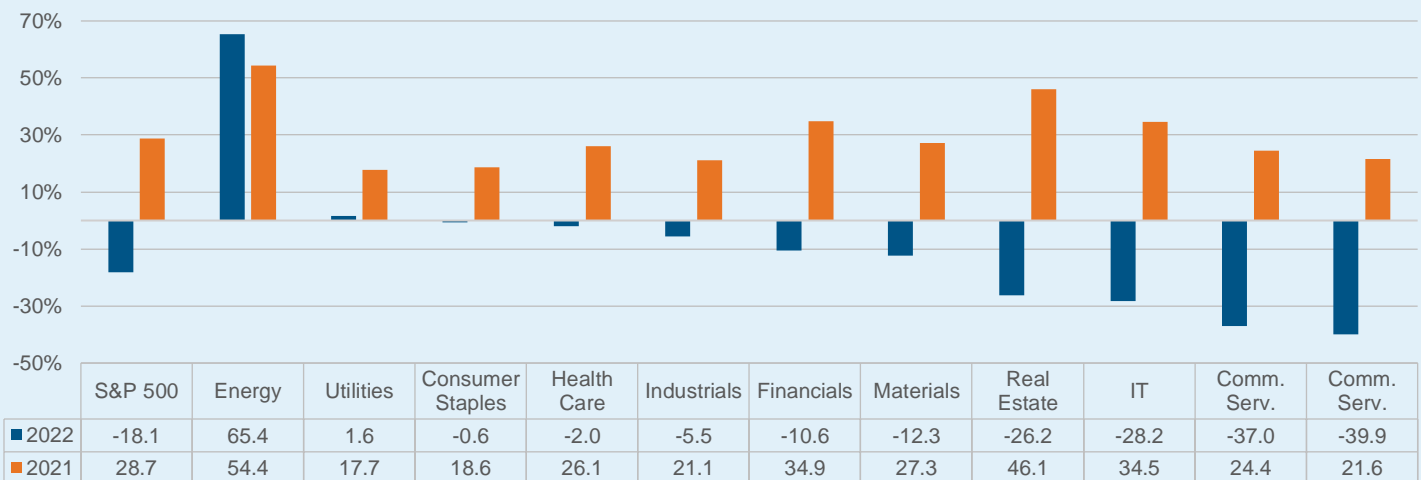
Rising interest rates took a massive bite out of US equities this year. US stocks were among the worst performing compared to major global equity indices, ending their dominance in recent years. Excluding the Dow Jones, all major large and small-cap US equity benchmarks recorded double-digit losses (S&P 500, NASDAQ and Russell 2000). The S&P 500 recorded its worst calendar year since the 2008 GFC, declining 19% from its all-time-high. The tech-heavy NASDAQ Composite fared even worse, plunging more than 30%. Sharply rising bond yields dragged equity valuations back down to earth, with the S&P 500 forward P/E ratio falling from 22.7x at the beginning of the year to 17.5x, slightly above the 10-year historical average of ~17x.

Nine of the eleven sectors in the S&P 500 finished in negative territory. The heavily-weighted information technology (IT) sector was the largest detractor amid the spike in bond yields. The consumer discretionary sector saw heavy losses (-37%), with Tesla (-65%) and Amazon (-50%) weighing heavily. The communication services sector (-40%) was hauled down by massive losses in Meta (-64%), Alphabet (-39%) and Netflix (-50%). The energy sector was the standout positive performer, bolstered by higher commodity prices and soaring profit margins, as the Ukraine war and lockdowns in China worsened the ongoing commodity supply shock.

US equity indices - 2022 performance



S&P 500 sector 2022 total returns (%)



Source: Bloomberg December 30, 2022

International Equities

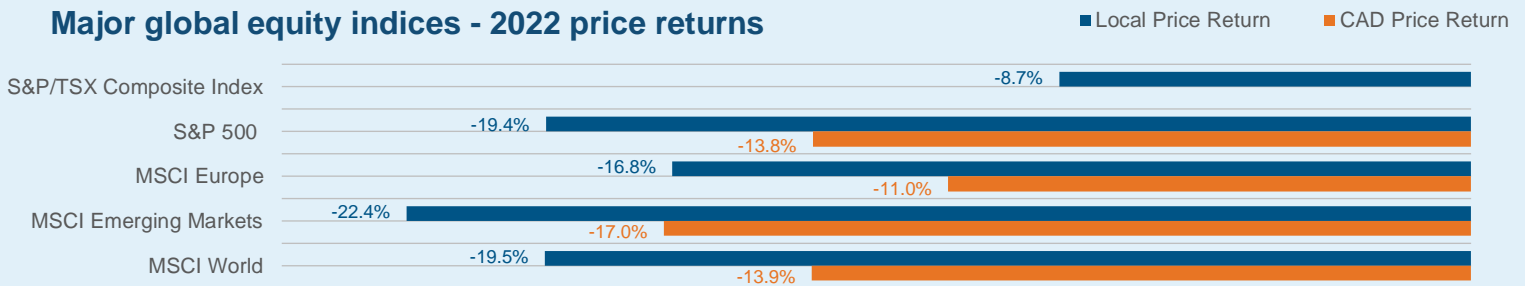
International equities were also weak, with the MSCI EAFE Index seeing a -14.5% loss (total return). Europe was acutely vulnerable to the situation in Ukraine, given the region’s reliance on Russia to source nearly half of its natural gas needs prior to the war. In retaliation, Western nations placed heavy sanctions on Russia, the EU announced an embargo on Russian seaborne crude oil, and the G7 formalized a price cap on Russian oil at US\$60/bbl. The combined effects have led to an enormous jump in inflation across the continent – Eurozone headline CPI inflation rapidly eclipsed the 10 percent handle. Soaring inflation prints have the European Central Bank aggressively raising interest rates. However, energy costs moderated significantly towards the end of the year. A warmer than expected fall season alongside a massive acceleration in US LNG exports that filled European natural gas storages above 90% heading into winter led to the moderation noted above. This should provide some much needed relief in prices across the region.

Although the UK economy continues to struggle with its cost of living crisis (UK headline CPI accelerated to 10.7% y/y in November), the UK FTSE 100 Index managed to record a positive return of 0.9%, ranking among the best performers this year. Similar to its Canadian counterparts, a significant energy weighting in the index offset the losses in other sectors. In addition, the outsized gains in AstraZeneca (+32%), which holds an ~8% weight in the index, also helped to support the broader index.

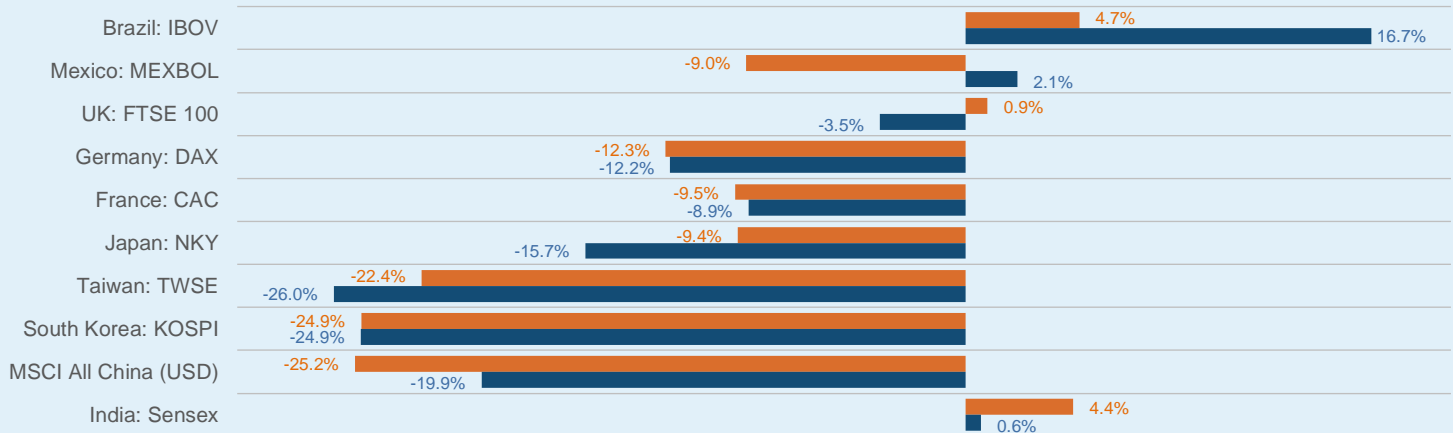
Meanwhile, Japanese stocks held up relatively well for the first eleven months of the year as the Bank of Japan (BoJ) held onto their uber-dovish policies. However, in December, the BoJ unexpectedly raised their cap on 10-year bond yields to 0.50% from 0.25%, leading to a major sell-off in Japanese equities – the Nikkei 225 Index ultimately fell 9.4% on the year.

Emerging market (EM) equities continued to struggle, with the MSCI Emerging Market Index (USD) falling -20.1% (total return). The primary detractors were Chinese, Taiwanese, South Korean, and Russian equities. EM stocks were battered by the overall risk-off environment in the first half of this year. Several factors weighed on the region. Two major headwinds were the Ukraine war and the lockdowns in China, as a spike in COVID-19 cases led to rolling lockdown measures across the country. The other headwind for EM equities was a surging US dollar (+8%), hurting capital flows and making it more strenuous for many developing countries to service their dollar-denominated debt. After President Xi secured an unprecedented third term in October, authorities strongly signalled that policy is shifting from upholding their strict zero-COVID measures to supporting economic growth. Whether China can fully reopen without setbacks will have major implications on the global growth outlook in 2023.

Major global equity indices - 2022 price returns



Global equity markets - 2022 YTD price returns



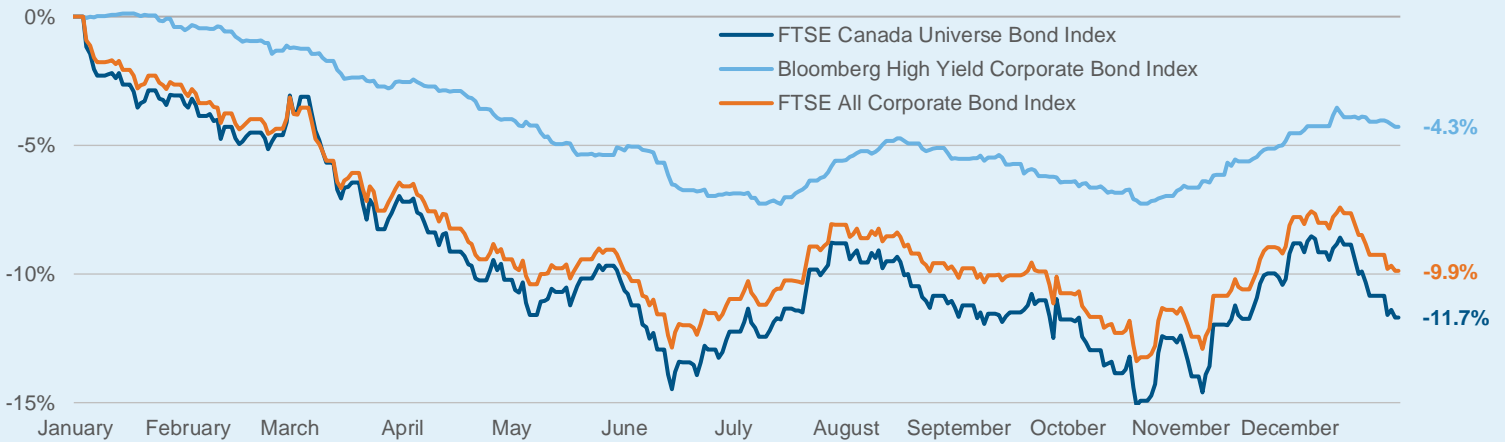
Source: Bloomberg December 30, 2022

Canadian fixed income

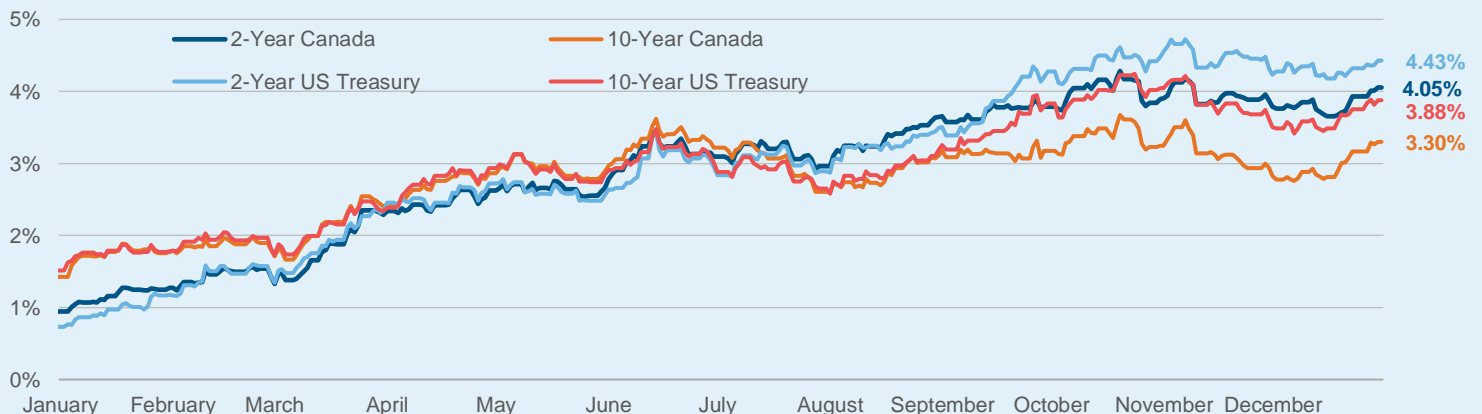
After a lacklustre 2021 Canadian fixed income investors had an even more challenging ride in 2022. The spike higher in bond yields in reaction to increasingly hawkish global central bank policy in their efforts to tame the highest inflation in nearly four decades resulted in the worst year on record for fixed income investors. The FTSE Canada Universe Bond Index fell -11.7% (total return), with the Government of Canada 10-year bond yield jolting 187 basis points (bps) higher to 3.30%, the highest level in over a decade. The overall rise in yields led to shorter-duration bonds significantly outperforming longer-term instruments. The FTSE Canada Long Term Overall Bond Index fell -21.8%, while the FTSE Canada Short Term Index was down just -4.0%.

Central bankers shifted more hawkish amid rising and persistent inflation and inflation expectations. Global central banks (excluding Japan and China) have sharply raised interest rates into restrictive territory while transitioning their quantitative easing programs to quantitative tightening. Signs of inflation peaking became more apparent towards the end of the year, indicating that the bulk of the rate increases is likely behind us. In turn, the upward pressure on bond yields eased slightly in the latter months 2022. Credit spreads widened in response to the deteriorating economic backdrop, but the additional yield pick-up in investment-grade corporate bonds helped mitigate the rise in bond yields, allowing credit to outperform government bonds. Still, government, investment-grade corporate, and high yield bonds all delivered double-digit losses. Within the government sector, federal bonds outperformed provincial and municipal bonds.

Canadian fixed income indices - 2022 total returns

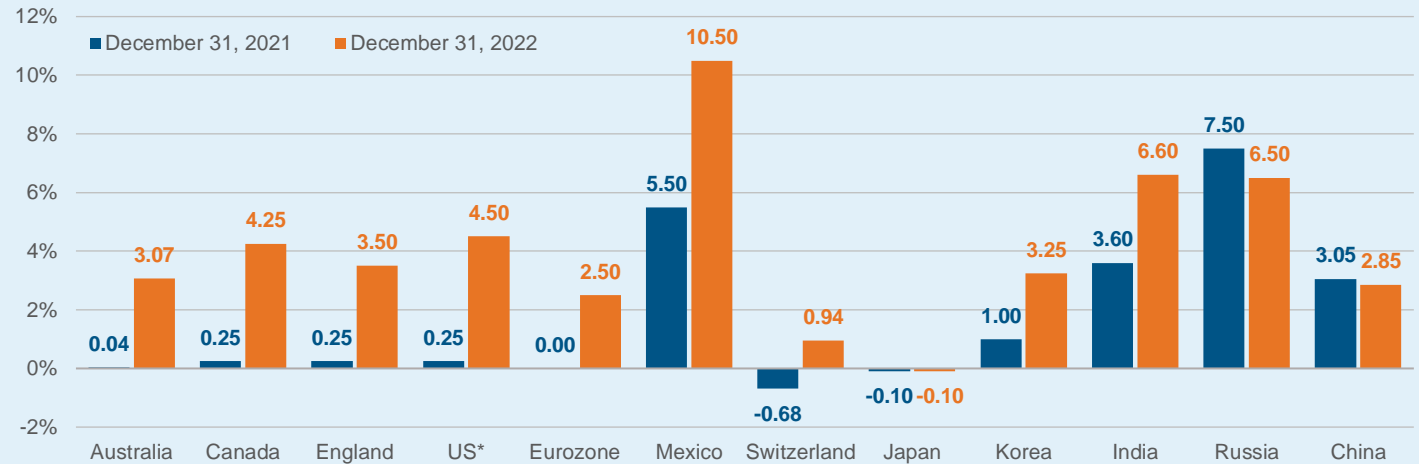


2-year and 10-year government bond yields



Source: Bloomberg December 30, 2022

Global central bank rates (%)



Source: Bloomberg December 30, 2022
*upper range

Commodities

The bulk of the sharp rise in commodity prices to start the year were given back in the latter half amid growing recession fears. In addition, persistent lockdown measures in China have weighed on the demand outlook and have kept a lid on prices. Chinese authorities have clearly signalled that they will begin easing lockdown restrictions, shifting their focus on supporting their anemic economy. After the initial spike following Russia's invasion of Ukraine, energy prices have moderated significantly. WTI and Brent crude oil have completed their year-long round-trip. Natural gas prices also eased significantly amid Europe experiencing an unusually warm fall season and US LNG exports accelerating to fill European storages ahead of winter. Despite pressures for more supply, US shale producers are showing restraint, with production still 1.2 million bbl/day lower than pre-pandemic levels. With oil prices sagging, OPEC+ delivered a significant 2 million bbl/day production cut in October, flagging their desire to keep WTI above the US\$70-80/bbl level. After surging to an all-time high last year, copper prices (a bellwether for global economic activity) have dropped sharply (-14%) due to lockdowns in China and concerns over a global economic slowdown.

Bloomberg commodity index



Source: Bloomberg December 30, 2022

WTI crude oil (US\$/bbl)



Source: Bloomberg December 30, 2022

Despite the highest inflation in decades, gold prices were essentially flat (-0.4%), ending the year at US\$1,842/oz. However, given the macro backdrop, its performance was not as strong as gold bugs expected. Gold prices are negatively correlated to real bond yields, which have risen sharply on increasingly hawkish central bank policy. After spending the last two years deep in negative territory, the US 10-year Treasury Inflation-Protected Securities (TIPS) yield skyrocketed 268 bps to 1.58%. The other headwind for gold was a strong US dollar. Gold prices in terms of other major currencies fared well: CAD (+7%), EUR (+6%), GBP (+12%), and JPY (+14%). The US Dollar Index (DXY) fell ~8% in the final two months of the year, while the rise in real yields abated. These developments sparked a 14% rally in gold prices to end the year.

Gold spot (US\$/oz)

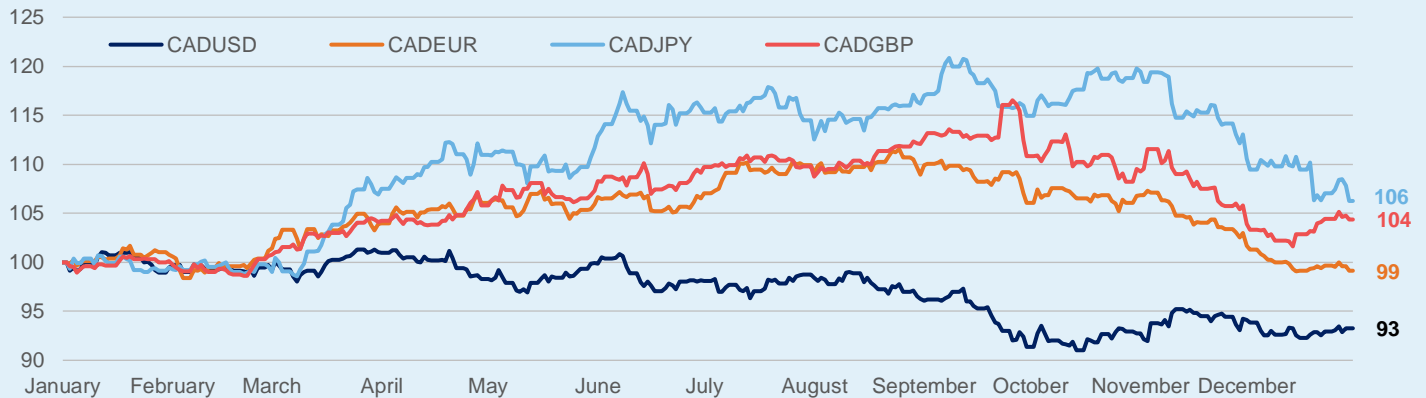


Source: Bloomberg December 30, 2022

Currencies

It was a tale of two cities for the Canadian dollar. Although the loonie depreciated against the US dollar, it strengthened against nearly every other major currency. Against the greenback, it ended the year down 7% to CADUSD \$0.73. The weakness of the CADUSD currency pair had more to do with the outright strength of the greenback, which had risen to the highest level in two decades. Conversely, the loonie fared well against the other major currencies, bolstered by stronger commodity prices and a relatively more hawkish Bank of Canada.

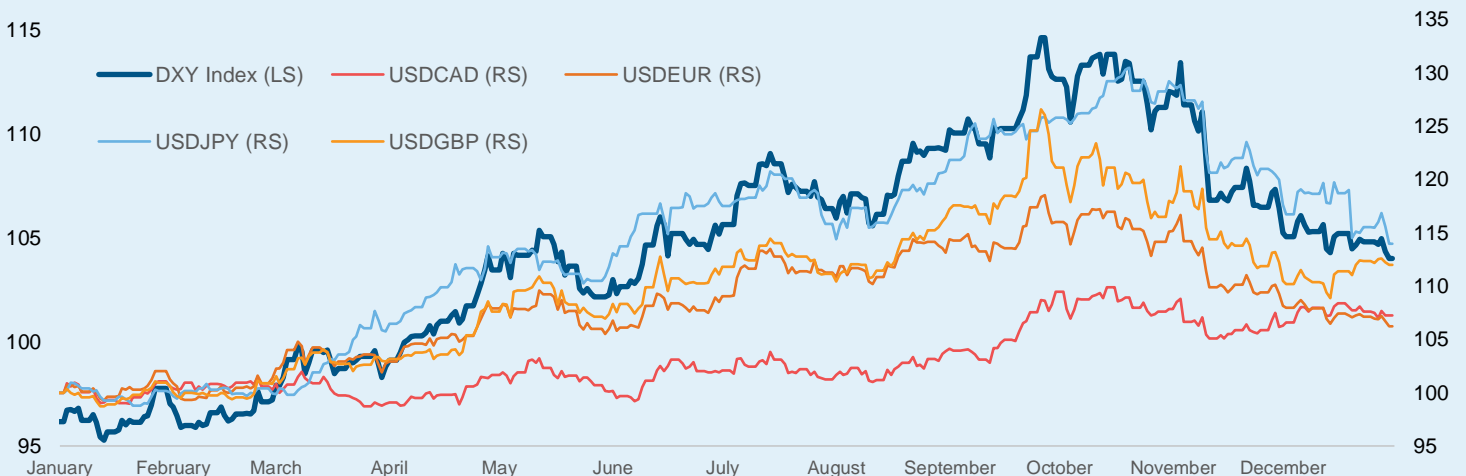
CAD performance vs. global currencies (indexed to 100)



Source: Bloomberg December 30, 2022

The US dollar jumped sharply in the year, with the DXY Index rising 8.2%. The index was up 19% at one point, reaching a two-decade high. The sudden hawkish shift from the US Federal Reserve (Fed) in reaction to the highest inflation in four decades drove the move higher for the greenback. The Fed's most recent Summary of Economic Projections (dot plot) in December now estimates the Fed Funds Rate at 5.1% in 2023, substantially higher than their 1.6% forecast just one year ago in December 2021.

USD performance vs. global currencies (indexed 100)



Source: Bloomberg December 30, 2022



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