RESEARCH CAPITAL CORPORATION

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Investment markets had a good summer, with major equity indices across the globe sprinting further ahead during the three-month period ending September 30th. Canadian and US bonds also rose, and gold hit a record high on the final day of the quarter. US and Canadian economic data released during Q3 was mixed and highlighted the divergence between the two economies, with Canada's clearly weaker. There were no significant breakthroughs for resolving US/Canada trade tensions. **Markets** anticipated interest rate cuts, which the US Federal Reserve and Bank of Canada (BoC) duly delivered in September. Inflation, while substantially lower than 2-3 years ago, remains a key focus for central bankers but was relatively moderate in Q3, although more so in Canada than the US. However, both the Fed and BoC have indicated that softness in labour markets is a growing priority in forming interest rate policy decisions. At the very end of September, markets faced uncertainty amid the risk of a US government shutdown on October 1, which could delay key data releases in the US and add to market volatility.

For the quarter, the S&P/TSX Composite Index jumped 12.50%, the S&P 500 Index rose 8.02%, the Nasdaq Index rose 11.41%, the MSCI World Index was up 7.50% and the MSCI EAFE Index climbed 5.38%. In the U.K., the FTSE 100 Index gained 7.52%, but Germany's DAX Index slipped 0.12%. In Asia, Japan's Nikkei 225 jumped 11.63%. The FTSE Canada Universe Bond Index ended the quarter up 1.51%. Gold rose 16.25% and Brent crude slipped 4.21%.

A final estimate of Q2 **US GDP** released in September pegged Q2 economic growth at an annualized rate of 3.8%, a significant hike from an earlier estimate of 3.3%. The gain was driven by stronger consumer spending than previously reported. Consumer spending accounts for about 70% of the US economy. The revised Q2 data was a welcome rebound from a 0.6% Q1 GDP contraction caused by fallout from Donald Trump's unexpectedly broad and deep tariff announcements.

Markets took in stride a September “benchmark revisions” report from the US Labor Department, which indicated **the job market** was much weaker in 2024 and early this year than previously reported. Revised data indicated employers added 911,000 fewer jobs than originally recorded from April 2024 through March 2025. The Labor Department issues the review annually to better account for new businesses and those that have closed.

August job gains undershot expectations as nonfarm payrolls rose by just 22,000, vs. estimates of 75,000. Previous months were revised lower, including a net loss of 13,000 jobs in June, the first monthly decline since 2020, according to the US Bureau of Labor Statistics. The unemployment rate ticked up to 4.3%, the highest since October 2021. Jobs were lost across manufacturing, construction, government, and professional services. Employers posted 7.2 million job openings in both July and August, down from 7.4 million in June, as the labour market continued to cool.

US manufacturing contracted for a sixth straight month in August, according to the Institute for Supply Management (ISM) survey released in September. The ISM said its manufacturing PMI rose slightly to 48.7 in August from 48.0 in July. A reading below 50 indicates a contraction in manufacturing, which accounts for 10.2% of the economy.

US inflation rose to 2.9% in August, annualized, the highest since January, after 2.7% readings in both June and July. Prices rose at a faster pace for food (3.2% vs 2.9% in July), used cars and trucks (6% vs 4.8%), and new vehicles (0.7% vs 0.4%). Yet consumers continued to backstop the economy in August as retail sales rose 0.6% from July, according to the US Commerce Department, better than the 0.3% bump economists expected. **The retail sales number** for July was also up a revised 0.6%. In a widely anticipated move, the Fed cut interest rates by 25 bps on September 17 to a target range of 4.00-4.25%, citing rising downside risks to the labour market amid slower job gains. Fed Chair Jerome Powell called the move a “risk management cut”.

Canadian economic growth remained tepid. GDP rebounded slightly in July, up 0.2%, after falling 0.4% in Q2 (-1.6% annualized), according to Statistics Canada.

Exports fell as tariffs took hold and business investment in machinery and equipment declined. These declines were tempered by faster accumulations of business inventories, higher household spending, and fewer imports. The preliminary August GDP estimate from Statistics Canada foresees no growth, but not an outright contraction. The economy shed 66,000 jobs in August, and the unemployment rate rose to 7.1%.

Headline inflation was generally benign in Q3; up slightly in August (1.9%, annualized) from July (1.7%), and within the BoCs target range of 1%-3%. Lower year-over-year gas prices helped. But food inflation was up 3.4% in August from 3.3% in July, driven by significantly higher meat prices. Prices for shelter, a key inflation component, increased 2.6% in August (year over year), down from 3% in July as both mortgage and rent costs moderated. **Retail sales** fell 0.8% to $69.6 billion in July, with sales down in eight of nine subsectors. Core retail sales (excluding gas stations and automobile and parts dealers) fell 1.2% in July.

Against this lackluster backdrop, **the Bank of Canada (BoC)** trimmed its overnight rate 25 bps to 2.50% on September 17, citing a softer labour market and easing core inflation as some key factors. Governor Macklem signalled a data-dependent approach going forward, noting federal fiscal plans will be considered once known in detail. A week later, the parliamentary budget officer released projections foreseeing the federal deficit rising substantially this fiscal year and next.

In Europe, a preliminary flash estimate from Eurostat, the statistical office of the European Union, pegged seasonally adjusted GDP growth for Q2 at 0.1% in the euro area, down from a 0.6% gain in Q1. The early estimate is based on incomplete data and is subject to further revisions. Euro area inflation ticked up in August to 2.1%, annualized, from 2% in July. Core inflation remained unchanged at 2.3%, while services inflation eased to 3.1% from 3.2%. Retail sales dropped 0.5% in July from June, while the unemployment rate held at 6.2%. The European Central Bank (ECB) left policy rates unchanged at 2%, half the level of its mid-2024 peak. The ECBs growth forecasts were revised slightly higher for the rest of 2025 but remain weak overall. Inflation forecasts were largely unchanged.

German industrial production bounced back in July despite a further fall in exports to the US. Industrial output in Europe's largest economy rose 1.3%, the first increase since March, while June data was also revised upward to a decline of 0.1% from the 1.9% slump previously reported, according to Destatis, Germany's statistics agency.

The Bank of England (BoE) held rates at 4.0%. Inflation data for August was modestly better, helped by falling energy and travel costs, but services inflation remains persistent. UK economic growth remained weak, with effectively zero growth in July after a 0.4% GDP expansion in June. Services and construction activity rose in July, but industrial production fell 0.9% and manufacturing sank 1.3%.

In Japan, Q2 GDP growth reported in September came in at 2.2% on an annualized basis, well above an initial estimate of 1.0% and a strong rebound from a downwardly revised 0.3% increase in Q1. It was the fifth straight quarter of annual growth and the fastest pace since Q3 2024, boosted by solid consumer activity as government measures helped cushion rising food and energy prices. The Bank of Japan kept its policy rate at 0.5%. While headline inflation remains above target, underlying inflation excluding volatile items is subdued. Tokyo CPI for September was slightly below expectations, with inflation easing to 2.5%, annualized, from 2.6% in August.

In China, retail sales and industrial production surpassed estimates in August, but fixed asset investment growth continued to slow amid ongoing real estate weakness. Exports slumped 5.2% in August while imports fell 4.8%. Inflation declined 0.4%, annualized, led by further food price deflation, while the Producer Price Index, which tracks price changes for industrial products, remained in negative territory for the 35th consecutive month. The People's Bank of China (PBoC) kept the 1-year and 5-year loan prime rates unchanged for a fourth straight month, as expected.

In Australia, GDP growth in Q2 was 0.6%, quarter over quarter, a better-than-expected outcome and up from 0.3% in Q1. Solid consumer activity helped. Inflation remained benign and the labour market registered modest employment gains. Businesses reported further improvement in conditions in August, with upticks in orders across both mining and non-mining sectors. Consumer goods businesses indicated a positive outlook for household consumption. The unemployment rate was unchanged in August at 4.2%. On September 30th, the Reserve Bank of Australia announced it was keeping its cash rate unchanged at 3.6%, in line with market expectations.

What can we expect now?

New highs for equity indices were reached in Q3, and key North American indices closed the period just below record levels hit earlier in September. Benchmark bond yields fell as bond prices rose. Gold and silver notched large gains, with gold ending September at a record high and a year-to-date return that eclipsed most stock indices. And despite Canada's weak economic picture, the S&P/TSX outperformed the S&P 500 again on a quarter, year-to-date, and rolling one-year basis, aided in no small part by the strong rally in gold stocks and the broader materials sector. Yet much remains to be seen – in addition to our own critically important trade negotiations, China and the US continue to meet in efforts to head off a potentially destabilizing trade war between the world's two largest economies. Job creation is slowing on both sides of the border, and a shutdown of the US government could be an unpredictable factor as Q4 begins. As we noted last month, we welcome the opportunity to discuss your portfolio asset allocations considering the rise in equities year to date and your personal investment goals and requirements.

We are here to assist you in achieving those goals and look forward to discussing any questions you may have about how best to do that.

Sincerely,

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Note:
All index performance is in Canadian dollars.