Insights & Strategies

PRIVATE CLIENT SOLUTIONS

October 6, 2020

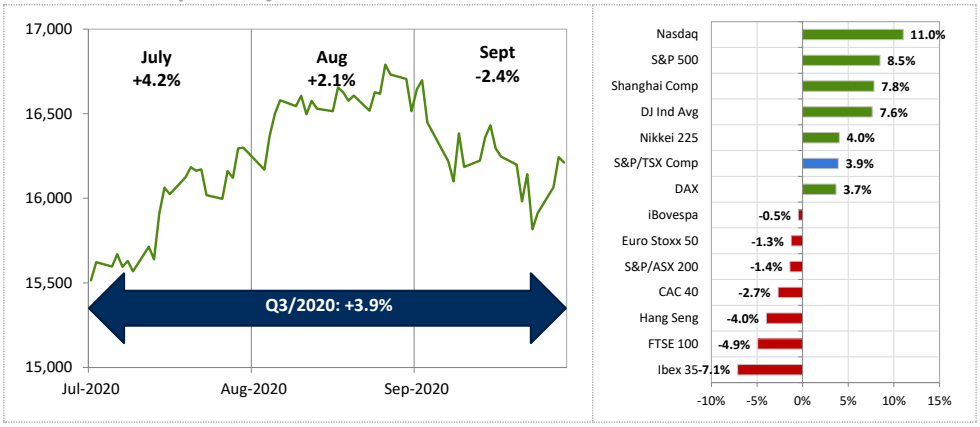
Quarterly Edition

Inside this Issue

Another Solid Quarter

The third quarter ended on a sour note as September lived up to its reputation of being a difficult month, slipping 3.5% to give up some gains made in the prior months. Nonetheless, the quarter finished in the black, building on the strong second quarter. Throughout the period, headlines were dominated by uncertainties about the timing of economic reopening, rising COVID-19 case counts, flaring tensions between the US and China, US social unrest and inequalities, and policy uncertainty surrounding the extension of pandemic relief benefits. However, markets managed to look past these concerns and were driven by the usual suspects: monetary and fiscal stimulus, vaccine progress/hopes, better-than-expected corporate quarterly results and economic data that surprised to the upside. The Bank of Canada, like its US counterpart, pledged to maintain interest rates near current levels for the foreseeable future. On the fiscal side, the minority Liberal government delivered a throne speech promising to do "whatever it takes" to support Canadians through the pandemic. While much of the speech was focused on the current crisis, many of the Liberals' policy initiatives that were announced during the 2019 election were also mentioned. The full cost of the fiscal spending will not be known until the budget, but regardless we know it'll be a big number that will be tacked onto Canada's already swelling debt. Credit rating Fitch already downgraded our nation's credit rating from AAA to AA+ stable in June and reiterated that Canada's current debt-to-GDP ratios are higher than AA+ rated peers. Recognizing the ballooning deficits, the throne speech did pledge the government to fiscal sustainability once we exit the crisis. Finance Minister Christina Freeland also vowed to preserve Canada's reputation of sound fiscal management as the government considers the next steps to drive the economic recovery. If there is a silver lining here it's that interest rates are extremely low and many spending measures are temporary; unlike the 1990s when Canada's deficits were structural and interest payments were a significant drag on spending.

S&P/TSX Comp & Major Indices: Q3-2020 Performance



Source: FactSet, Raymond James Ltd. As at September 30, 2020.

Please read domestic and foreign disclosure/risk information beginning on page 10.

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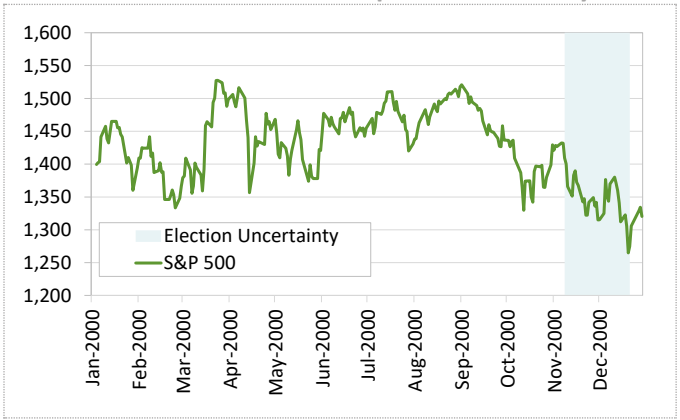
RAYMOND JAMES

With a few concessions, the NDP supported the Liberals during the confidence vote thus Canadians will not be returning to the polling stations anytime soon. The same cannot be said for the US as November's general election is quickly approaching. National polling data has VP Biden in the lead, but the race for the White House will be closer than initially expected as Trump has picked up some ground in recent weeks. In our view, the best outcome for the market is a decisive win by either candidate, while a close election result on November 3 will create further uncertainty as ballots are recounted. If there is one thing markets dislike it is uncertainty.

The last US election that was too close to call, and ultimately was decided by the Supreme Court, was in 2000. Florida was the battle ground, a state where George W. Bush won by a slim margin over Al Gore. Given the margin, state law required a recount and resulted in a month-long legal battle which ended in a 5-4 Supreme Court ruling in favour of Bush.

US 2000 Election – S&P 500 Slips on Uncertainty



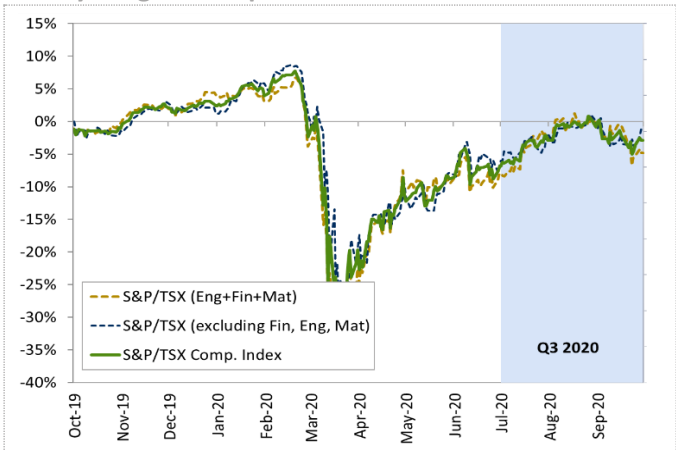
Source: FactSet, Raymond James Ltd.

As if 2020 hasn't thrown us enough curveballs, the passing of Supreme Court Justice Ruth Bader Ginsberg and the nomination of Judge Amy Coney Barrett presents a new twist to the election process. It is uncommon to fill a Supreme Court vacancy so close to an election; historically, it has taken ~55 days to approve a nominee. With less than 30 days to the election, it may prove to be difficult to get Barrett confirmed. The Republicans currently control the Senate but that may not be the case after Election Day as they are defending 23 seats, while the Democratic Party will be defending 12 seats. If the Democrats win a majority in the Senate, confirmation of Barrett is a very unlikely outcome. However, if Senate Republicans can confirm Barrett prior to the election, not only would it tip the balance of power towards conservatives, but could be a deciding factor in a contested election. There are seemingly so many moving parts and potential outcomes over the next few weeks that it will certainly provide market participants with a little more anxiety than normal ahead of the election.

Sector Performance

There was not much variation in our measures of the "Big Three" (B3) (financials, energy and materials), and the "Everything Else" index (EE) until late in the quarter. Weakness in energy and gold stocks in September weighed on B3, giving back significant rallies in both groups from the prior months. Financials were the bright spot following the banks' quarterly results which alleviated near-term concerns about non-performing loans and helped the sector gain 2.8%. Nonetheless, Canadian financials will need to contend with the headwind of interest rates staying lower for longer and the credit deterioration as generous government relief measures become less supportive. Within the EE index, industrials and information technology were the main drivers of return with honorable mentions going to consumer staples and utilities. As one can see in the table below, the advance in the S&P/TSX was broad-based with both cyclical and defensive sectors participating.

"Everything Else" Squeaks out a win in Q3



Sector	Index Weight	Q3 2020 Price Return	1-yr Price Return
Consumer Disc.	3.5%	7.8%	-7.6%
Consumer Staples	4.4%	8.6%	4.7%
Energy	10.8%	-9.4%	-35.2%
Financial	28.4%	2.8%	-15.7%
Health	0.9%	-14.4%	-44.7%
Industrial	12.5%	13.2%	13.2%
Information Tech.	10.3%	3.6%	85.6%
Material	15.5%	8.8%	33.8%
Real Estate	3.2%	2.9%	-22.6%
Communications	5.2%	0.8%	-10.6%
Utilities	5.3%	9.9%	6.8%

Source: FactSet, Raymond James Ltd. As at September 30, 2020.

Expanding our measure of sector breadth, we show the number of S&P/TSX issues trading above their 50-day and 200-day moving averages (MA). Long-term breadth measures improved across most sectors quarter-over-quarter with the greatest improvement occurring in communication services, with almost half the issues now trading above their 200-day MA. Long-term breadth measures suggest continued strength can be found in the materials, technology, industrials and consumer staples as these sector have more than 50% of issues trading above their 200-day MA. While both materials and technology have experienced some near-term consolidation, the long-term drivers remain. For the materials sector, base metals and forestry stocks will continue to benefit from the reflation trade, while precious metals benefit from an environment of negative real rates. As for technology, which had become extremely overextended and was due for some profit taking, the greater adoption of technology during the pandemic has accelerated to present day many trends that were 3-5 years in the future. Even as we move past the pandemic, the accelerated adoption of technologies in our daily lives will support those companies.

S&P/TSX Sector Breadth – Long-term Measures Improve

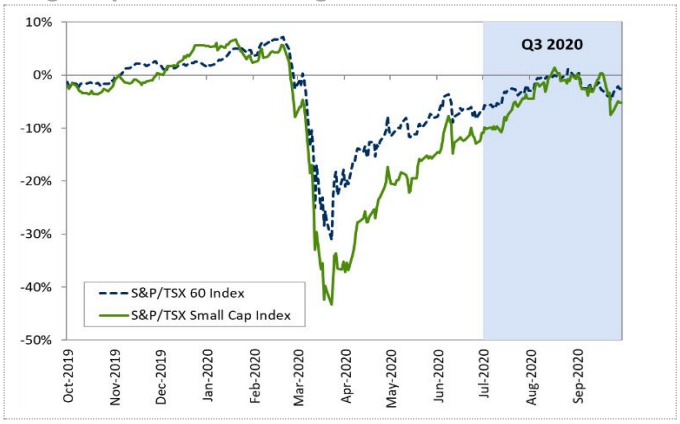
Sector Breadth	No. of issues above 50d	50d vs Prior Qrt	No. of issues above 200d	200d vs Prior Qrt
Communication Services	43%	▲	43%	▲
Consumer Discretionary	23%	▲	23%	▲
Consumer Staples	73%	[-]	82%	▲
Energy	5%	▼	14%	▲
Financials	31%	▼	35%	▲
Health Care	30%	▼	20%	▼
Industrials	54%	▼	64%	▲
Information Technology	40%	▼	70%	▼
Materials	27%	▼	90%	▲
Real Estate	44%	▼	33%	▲
Utilities	69%	▼	63%	▲

Source: FactSet, Raymond James Ltd. As at September 30, 2020.

Large Caps & Small Caps

In the continued risk-on environment, Canadian small caps were the place to be, advancing 13.8% up until August 17. However, a difficult September gave back some of those gains, and small caps finished just below their large cap peers. Improving economic conditions in Canada would favour small caps, but the future economic outlook remains clouded amid rising COVID-19 cases across the country. While localized restrictions will likely be the path forward during the second wave, they will undoubtedly have a negative impact on growth. In such an environment, investors generally seek out the safety of large caps.

Large Caps Eek out a Marginal Win in Q3



Source: FactSet, Raymond James Ltd. As at September 30, 2020.

Value Holding Its Ground

Are Canadian value stocks making a comeback? Maybe, but at least they haven't lost further ground to growth as an investment style in Q3. If value is back in vogue, you only need to look towards our depressed energy sector to find the next value trade. Deep value investing is simple in theory, but it's not easy to carry out because of its challenges, such as the payoff may outlast your patience by a very wide margin. We believe a value rotation will occur, at some point, amid greater confidence the global economy is on the road to recovery. In fact, this is one of the signs we're looking for as the market continues its advance and underperforming areas begin to participate. We recommend approaching growth and value using a barrelling stance by having a mix of both in a portfolio and rotating between the styles depending on the current situation.

Value Stabilizing Relative to Growth

Source: FactSet, Raymond James Ltd. As at September 30, 2020.

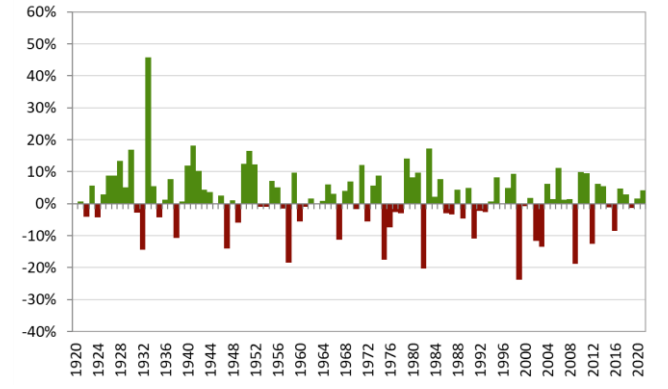
Historical Performance

From a historical perspective, we're entered the strongest seasonal trend for the market, as Q4 and Q1 show the greatest number of positive quarterly returns as well as the best combined average return. This year has produced many records and Q3 was no different. History suggests Q3 should have given back some of the gains from Q2, but that clearly did not occur. As for the next quarter, the history books suggest the S&P/TSX will finish the year on a high note but, as this is a US election year, the pattern may deviate. Historically, markets tend to weaken heading into the presidential election and once a clear winner is identified, they begin to rally. This cycle will likely be prolonged due to the significant number of mail-in ballots that will need to be counted (in some states, mail-in ballots cannot even be opened prior to election night) and the potential for a contested election. Without a decisive win by either candidate on November 3, the likelihood of a delayed election result is a high probability and will cause prolonged uncertainty for the markets.

S&P/TSX Historical Quarterly Returns Since 1920

	Q1	Q2	Q3	Q4
# Positive	70	56	63	71
# Negative	31	45	38	28
% Positive	69.3%	55.4%	62.4%	71.4%
Average	2.0%	0.9%	1.7%	2.1%
Median	2.5%	1.2%	1.7%	3.0%
Min	-21.6%	-32.6%	-23.8%	-27.9%
Max	22.0%	58.3%	45.8%	22.2%

S&P/TSX Q3 Historical Returns



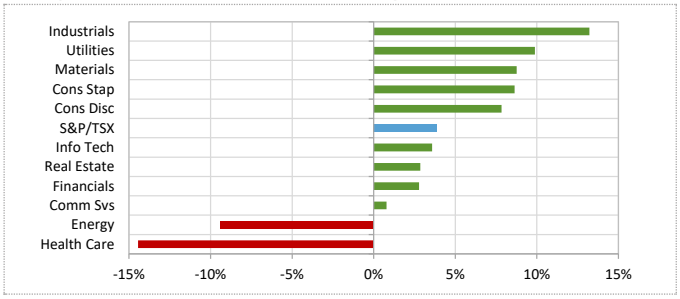
Source: FactSet, Raymond James Ltd. As at September 30, 2020.

Jason Castelli, CFA
VP, Head of Investment Strategy

Q3/20 - Materials and Energy in the Spotlight

The S&P/TSX Composite Index (S&P/TSX) finished Q3/20 up 3.9%, with 65% of the names in the index ending in the positive. Industrials was the best performing sector during the period, with **Canadian National Railway (CNR-T)**, **Canadian Pacific Railway (CP-T)** and **Waste Connections (WCN-T)**, which comprise 67% of the sector's weighting, being the largest contributors to performance, up 18.1%, 17.3% and 8.8%, respectively. **Ritchie Bros. Auctioneers (RBA-T)** ended the past three months up 42.9%, and made it to the top 10 best performing names in Q3/20 on the back of solid Q2/20 financial results when the auctioneer raised its quarterly dividend by 10% and beat top and bottom line Street estimates as customers migrated to its online marketplace. The energy sector made it to the bottom of the pack with 70% of companies in the sector finishing in negative territory. In fact, seven out of the bottom 10 performers were energy names as investors continued to shun the space on the back of commodity prices that remain depressed and an uncertain supply-demand outlook.

S&P/TSX: Sector Returns for Q3/2020



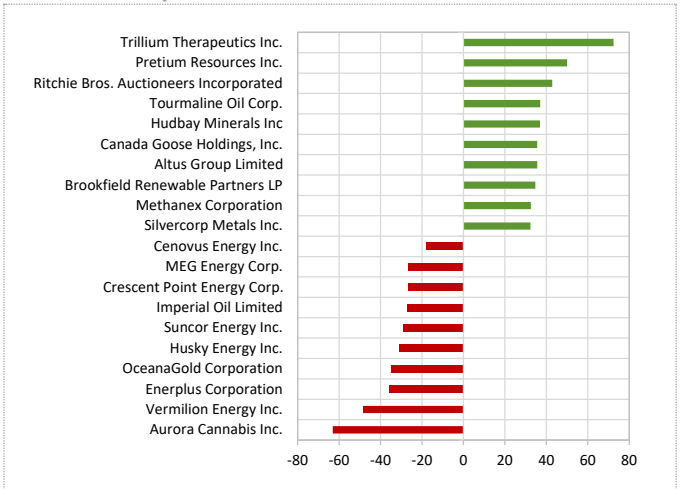
Source: FactSet, Raymond James Ltd. As at September 30, 2020.

Top and Bottom 10

Four companies from the materials sector showed up in the top 10 in Q3/20, ranging from precious and base metals to chemicals industries, most of which either reported strong financial results or saw increases in the commodities they produce. Gold producer **Pretium Resources (PVG-T)**, up 50% during the period, had strong Q2/20 results as the name benefited from higher gold prices, selling its yellow metal at a price more than 30% higher y/y. Copper and zinc producer **Hudbay Minerals (HBM-T)**, which increased 37%, also posted better than expected Q2/20 results and reinstated its 2020 guidance. **Methanex (MX-T)** finished the quarter up 32.5% on the back of more constructive methanol prices. **Silvercorp Metals (SVM-T)**, rising 32.4%, also benefited from strong silver prices, which had also increased ~33% during Q3/20.

The best performing name in the quarter was **Trillium Therapeutics (TRIL-T)**, which ended up 72.4% on news that **Pfizer (PFE-US)** invested $25 mln in the immuno-oncology company. The stock was also added to the S&P/TSX on September 11. Gas-weighted energy producer **Tourmaline Oil (TOU-T)** was up 37.1%, making it one of the few names within the energy sector that finished in the green. **Canada Goose Holdings (GOOS-T)** made it to the top 10, up 35.7% during the period, on a strong quarterly financial print with sales and EPS beating analyst estimates. Sentiment from the Street around the stock was positive as some believed the winter clothing retailer's brand and earnings power may come out stronger post-pandemic. Commercial real estate services provider **Altus Group (AIF-T)** was up 35.6% in the quarter on Q2/20 results that topped analyst estimates on the back of strong property tax revenue and continued demonstration of the company's transition to recurring cloud revenue. **Brookfield Renewable Partners (BEP.UN-T)** increased 34.7% following the company's investor day, which highlighted positive long term opportunities in the renewables space on a global scale as well as solid growth in fund from operations to support the company's dividend distribution.

S&P/TSX: Top and Bottom 10 Performers in Q3/2020



Source: FactSet, Raymond James Ltd. As at September 30, 2020.

Among the bottom 10 performers for the quarter was **OceanaGold (OGC-T)**, which declined 35.1%. **Aurora Cannabis (ACB-T)** was the largest laggard, down 63.1% in Q3/20, as the cannabis company reported weak Q4/20 financial results on the back of recreational cannabis revenue declining sequentially, in contrast to the overall industry, which experienced double-digit growth during the same period.

Larbi Moumni, CFA
Sr. Equity Specialist, Portfolio Manager

Reviewing the Case for Fixed Income

Over the third quarter of 2020, we saw little movement in the fixed income space. Although there was some change from month to month, by the end of the period, we ended around the same levels at which we started. Benchmark Government of Canada bonds saw yields fall modestly in the short- to medium-terms, with the long end rising slightly. Corporate bonds reflected this movement as well, as the corporate yield curve steepened in line with sovereigns. During the second quarter, at the peak of the crisis, the Government of Canada issued a staggering $325 billion in additional treasury bills, up from $85 billion QoQ and $79 billion YoY. Just a quarter later (Q3/2020), though still elevated, issuance approached historical norms ($82 billion), although the potential for a second wave will certainly put additional pressure on the government to provide economic support. Looking forward to future interest rate policy expectations for the US and Canada, economists are not predicting any meaningful moves in either direction. This comes on the back of a historic change in the way the US Federal Reserve targets inflation, moving to average inflation targeting rather than an absolute level of inflation at the time of review. This change has implications for investors' fixed income holdings. In this article, we take a step back and revisit the importance of fixed income from a broader portfolio perspective.

Back to Basics: Why Do Investors Hold Fixed Income?

A discussion of the merits of fixed income in a portfolio is best prefaced with a review of the fundamentals. When investors think of "fixed income", the next word that often comes to mind is yield. However, that is just one characteristic of fixed income and, in most cases, should not be thought of as the most important. In our view, there are three primary reasons why investors hold fixed income securities:

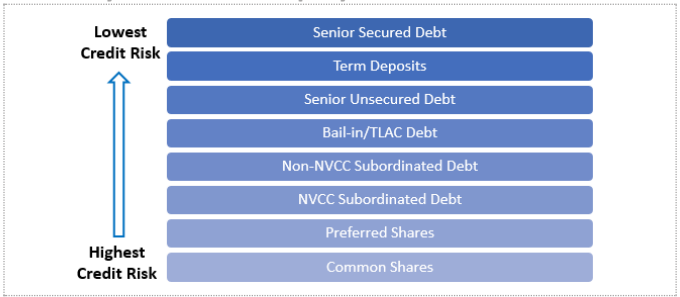
(i) Capital Preservation
(ii) Income
(iii) Reduce Portfolio Volatility

(i) Capital Preservation

In general, fixed income is thought of as a "safe" asset class. This is generally true relative to equities when considering senior securities from investment grade issuers, like quality corporations or governments. However, not all bonds are created equal; high-yield debt, or "junk bonds", may entice investors with larger payouts, but have an increased chance of default – the inability of the issuer to return the principal when the bond matures. Furthermore, good companies can issue multiple bonds that rank differently in their capital structure, also affecting their safety in the case of an adverse event.

Though they can't be relied on with certainty, credit ratings give an investor a general sense of the creditworthiness of a security, giving them more confidence in knowing their invested capital will be returned at the promised time.

Seniority of Debt and Equity Instruments



Source: Raymond James Ltd.

Looking at average calendar year performance over the past 17 years, corporate and government bonds have earned lower average total returns compared with equities, ranging from 3%-7% depending on issuer and term, while the S&P/TSX has averaged a total return of ~8.5%. However, the path using fixed income is far more consistent, with fewer years of negative returns, and drawdowns that are less than a third of what equities have seen historically. What this translates into is a more reliable, less volatile trip for your investment.

(ii) Income

The current yield environment is challenged and is expected to remain that way for the near term. With central banks clearly signaling that interest rates will remain at accommodative levels for at least the foreseeable future, bond rates will also remain low across treasury and spread products. Investors searching for yield have done primarily two things: extended the term (investing for a longer period), and/or accepted a security with lower credit quality (decreasing the safety of capital). While we understand that at current rates, bonds may not provide the income stream that they once did, we caution investors against moving into non-investment grade securities just for the modest pickup they may provide unless additional research has been completed.

The yields on equities are higher than bonds across the spectrum; however, investors must consider the differences in the risk of different types of investments used to generate income. If an investor required $500,000 in late March of this year, in the equity market, they would have had to taken a haircut on the capital proceeds. If they had instead opted to purchase a high-quality bond that had a maturity to align with this date, they would have almost certainly received their principal back with no adverse effects.

(iii) Reduce portfolio volatility

In recent years, the correlations between bonds and equities have increased. Massive quantitative easing programs have been a contributing factor in reducing the diversification benefits of fixed income products. However, government bonds still maintain attractive diversifying properties given their correlation with equities has remained low. Using federally-issue securities can thus help to reduce portfolio volatility, ultimately providing better risk-adjusted returns over the long run. In the following table, we can see the historical benefit of including fixed income with equities. Across different investor profiles, the higher the fixed income weight, the higher the Sharpe ratios and less volatile returns.

Improved Risk Adjusted Outcomes with Fixed Income

	Cap Pres	Cons.	Mod.	Growth	Agg. Growth
Cash	8%	8%	10%	10%	8%
Bonds	72%	62%	40%	20%	2%
Can Equities	15%	15%	15%	20%	25%
US Equities	5%	15%	25%	35%	45%
Int'l Equities	0%	0%	10%	15%	20%
Total Return (annualized)	8%	9%	9%	9%	10%
Annualized Std Dev (36 months)	5%	6%	7%	9%	12%
Best 12 month Rolling return	47%	48%	46%	46%	48%
Worst 12 month Rolling Return	-8%	-11%	-19%	-26%	-33%

Source: FactSet, Raymond James Ltd. As at June 30, 2020, Inception Jan 1971. Performance statistics are calculated using C$ monthly returns that are rebalanced every calendar year using the recommended asset class weightings for each profile (cash weighting has been rolled up into the bond weighting).
Benchmarks: Bonds = FTSE/TMX Canada Universe Bond TR Index; Canadian Equities = S&P/TSX Composite TR Index, US Equities = S&P 500 TR Index; International Equities = MSCI EAFE TR Index.

The Bottom Line

In the face of record low interest rates, we've had many conversations with investors who remain fixated on the low return potential of bonds, and therefore use that as a reason to reduce allocations to the asset class. However, this way of thinking is incomplete when capital preservation and portfolio volatility are investment objective considerations. In turbulent times such as now, investors should recognize the defensive nature of bonds within the context of the broader asset allocation framework.

Chris Antony, CFA
FX and Fixed Income

Charlotte Jakubowicz
VP, Fixed Income

Generating Financial and Social Returns with Gender Diversity Funds

Diversity in the workforce is a critical component of any successful business and can be an important consideration for your investments as well. Striving for a diverse workplace is an important goal here at Raymond James. In September we held our 26th Annual Women's Symposium, which recognizes and celebrates the leadership and contribution of women at the firm. Given the timing of this annual event, coupled with growing interest from our client base in these types of products, we wanted to take the opportunity to review how you can build a more inclusive and gender diverse portfolio.

Understanding the process that an investment fund goes through to select stocks is an important first step to finding the right product for your portfolio. This is true whether you are considering a passive ETF or an actively managed solution. A key component to any investment process is looking at ESG factors (Environmental, Social and Governance), and how those factors help drive the investment selection in a given managed money product. Governance, in particular, has usually been a key consideration for active managers and we are starting to see similar screening introduced to passive, index-tracking funds. Gender diversity is a core topic on the governance side, specifically representation of female leaders within a company.

The idea of investing in companies because they are more diverse and inclusive sounds great, but as investment professionals, we must always be cognizant of generating actual returns. As it turns out, there is a plethora of research available from both academics and investment professionals that has analyzed the value a female leader can bring. Most research differs significantly in methodology but the results are overwhelmingly similar. Studies show that having female representation at or near the top of a company's org chart often results in better corporate and financial market performance. In particular, these companies tend to have higher sales growth, higher returns on investment (ROI), better share price performance and, typically, have higher institutional ownership than their male-run counterparts. The sample size of female led companies is still unfortunately small and growing slowly, but the trend is ultimately positive.

Looking at the investment funds universe, we find a few investment products dedicated to gender diversity, specifically investing in companies founded by or run by women. An important note is that these do not simply select stocks by running a screen to see if a female is at the top of the helm. This is just the base criteria as only high quality companies that meet strict traditional fundamental screening criteria are ultimately included in the respective funds. Also interesting is that there is no one-size-fits-all approach to this type of investment opportunity. Below we summarize the investment processes of three respective funds, which differ in terms of process as well as geographic exposure.

Fidelity Women's Leadership Fund

Rather than employing a rules-based approach with strict criteria, Fidelity combines active security selection with proprietary research conducted by their global army of analysts to identify companies that meet three specific criteria:

- **Leadership** – Focus on companies with a female CEO or that have other influential women on the senior management team
- **Board Composition** – At least 33% of a company's board of directors is comprised of women or companies with three or more women on the board
- **Corporate Policy** – Best-in-class gender internal diversity initiatives and policies

The fund's universe is US equities and the above criteria are only the beginning of its investment selection process. Following the initial idea generation screen, the fund manager focuses on fundamental factors to identify high quality companies with potential growth opportunities.

BMO Women in Leadership ETF (WOMN-T)

BMO's philosophy on gender diversity is simple yet effective: invest in companies with strong diversity while avoiding those with low diversity, and use its influence as an investor to encourage better diversity. However, companies that are excluded from the portfolio for not having enough diversity are not forgotten; the team at BMO actively engages with them in

Gender Diversity Funds

Name	Symbol	Investing Universe	MER	Active/Passive
Fidelity Women's Leadership Fund	--	US Equities	Ser A: 2.54% | Ser F: 1.18%	Active
BMO Women in Leadership ETF[1]	WOMN-T	North American Equities	0.39%	Active
BMO Women in Leadership Fund[1]	--		Ser A: 1.51% | Ser F: 0.38%	
RBC Vision Women's Leadership MSCI Can ETF	RLDR-T	Canadian Equities	0.29%	Passive

Source: Raymond James Ltd., Company Reports

1. This fund comes in both ETF and mutual fund format but the underlying investment process is identical.

dialogue to help drive change. To build the portfolio from a gender diversity perspective, eligible companies must meet at least one of the below criteria:

- **Leadership** – Company has a female CEO
- **Board Composition** – Company has at least 25% representation of women on the Board

This fund is actively managed by an experienced PM team, which runs a rigorous process to select the best candidates to include in their concentrated portfolio of US and Canadian companies. An important note is that this fund is available as an ETF as well as a mutual fund.

RBC Vision Women's Leadership MSCI Canadian ETF (RLDR-T)

This fund is a passive mandate, meaning there is no active decision making by a portfolio manager – instead, the fund employs a set of technical screening criteria to create its

portfolio. The ultimate goal of the fund is to provide investors with exposure to broad Canadian equity but with particular emphasis on companies that have demonstrated a commitment to gender diversity. The ETF takes a universe of Canadian equities and screens them based on three conditions:

- **Number of Women in Leadership Positions** – Companies must have at least 30% female directors OR at least 3 female directors OR have at least 2 female directors with at least one woman in a current executive leadership role (i.e. CEO, Co-CEO, or CFO).
- **Percent of Women on Board** – The percentage of females on a given company's board must be greater than the average of the index's universe of companies.
- **Discrimination and Workforce Diversity Controversy** – Companies selected must not have faced or currently be facing any severe diversity-related controversies.

As we can see, investing in a future with a more equal playing field among workers is not only the right thing to do from a social perspective, it also has the potential to be a fruitful financial decision for your investment portfolio. The universe of companies in North America with women at or near the top remains small but investors are becoming aware of the reasons for changing that. Ultimately, we hope for a future where gender diversity products aren't necessary but, for the time being, they provide a vehicle for capitalizing on this growing trend.

Chris Antony, CFA
FX & Fixed Income

Spencer Barnes, MSc., CIM
AVP, Mutual Funds & ETFs

Cracks in the USD's Crown

The third quarter ended with the USD down nearly 4% against a basket of G10 currencies, as measured by the US Dollar Index (DXY), and off almost 9% from its mid-March high. The USD has emerged from the COVID-19 pandemic on a clear defensive footing as a diminished economic growth outlook and an eroded yield advantage that it had historically enjoyed over its peers has weighed heavily on the currency. While risk markets have reaped the benefits from aggressive monetary policy action from global central banks coupled with fiscal support, the complications with reopening and recovery phases along with elevated fears of a second wave have resulted in some whipsaw price action as of late. Since the beginning of the year, G10 central banks have collectively slashed overnight lending rates while simultaneously injecting trillions of dollars into public markets utilizing both primary and secondary market operations in order to keep the liquidity wheel well greased. The result of converging policy rates among developed markets means the carry trade (i.e., borrowing a low interest rate currency to invest in a higher interest rate currency) among G10 currency pairs has all but disappeared; we expect this theme to continue over the medium term. Given the massive amount of USD liquidity injected into the system courtesy of the Fed, it ought to have a negative effect on the USD's outlook going forward, while being supportive for risk markets, as we navigate this public health crisis.

3Q/2020 G10 Performance vs. USD

Currency	%	Currency	%
DKK - Danish Krone	4.43%	NOK - Norwegian Krone	3.14%
EUR - Euro	4.34%	CHF - Swiss Franc	2.87%
GBP - British Pound	4.19%	BZD - New Zealand Dollar	2.53%
SEK - Swedish Krona	4.06%	JPY - Japanese Yen	2.32%
AUD - Australian Dollar	3.75%	CAD - Canadian Dollar	1.93%

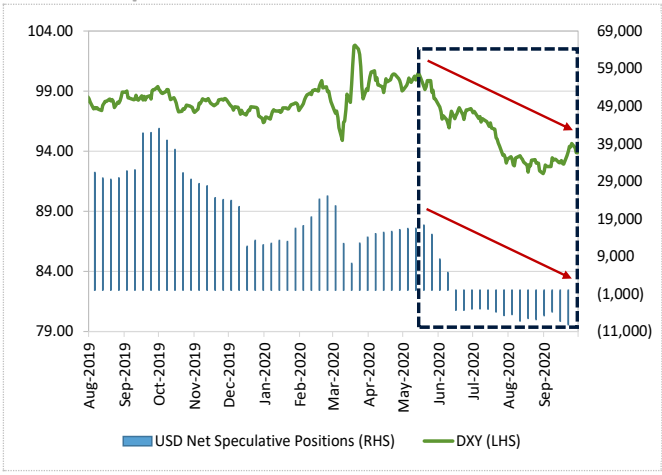
Source: FactSet, Raymond James Ltd.

Looking at the USD's performance in the G10 space for Q3/2020, the main highlight was our beloved CAD, which ranked dead last (up a measly 1.93% against the USD). The CAD has clearly underperformed on a relative basis and has failed to differentiate itself from its big dollar brother despite stable crude prices in Q3 (WTI crude oil up +2% over the period) and a decent slate of domestic economic data. Despite the Bank of Canada clearly on hold for the next few years with respect to rate changes, Canada is enjoying a relative yield advantage at the shorter-end of the yield curve versus the United States (from 3 months out to 5 years). While speculators raised their bearish bets on the loonie during the month of August, as per the US Commodity Futures Trading Commission's (CFTC) Commitment of Traders Report, bullish bets began to pile in during the month of September. This has us believing that CAD

has room to play a bit of catch-up with the rest of its G10 peers and can very well make up some lost ground against the USD in the long term.

Looking at the latest CFTC positioning report for the USD, a similar picture emerged as speculators also added to their bearish bets on the big dollar. Looking at the DXY US Dollar Index, the index fell over 4% in the month of July alone (the weakest monthly performance since May 2009), before slipping into a 2-month sideways range where price action became pinned within the 92-94 range. In the last few trading sessions of Q3, the USD did manage to catch a slight bid as investors began unwinding some of their short positions that were built up over the summer months along with a slight rise in real US yields; however, the index has since slipped back into that key 92-94 range. This may lead some to think that this recent corrective rally in the USD is beginning to lose momentum, and we may very well see the USD continue to trade on weaker footing in the very near term. However, election risk may lead to USD strength over the next few weeks and, not to mention, the market is still very short the USD (the CFTC's latest report shows the first increase in new USD short positions in 4 weeks).

USD Net Speculative Positions vs. DXY

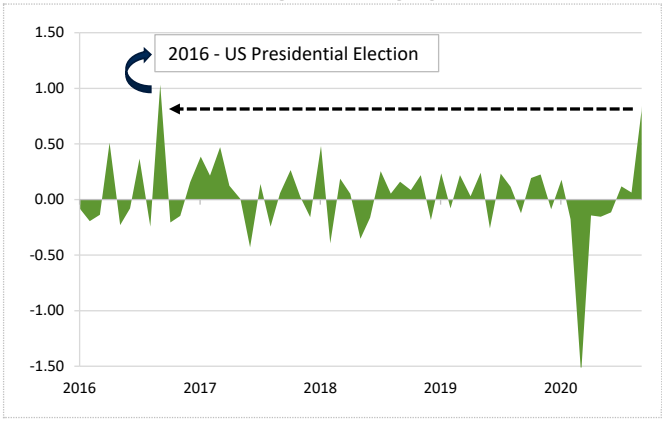


Source: FactSet, Raymond James Ltd.

The EUR was a clear top performer in the G10 space for Q3, courtesy of a weaker USD. Sentiment around the euro also improved considerably after the European Union agreed on an historic and unprecedented step of passing a €750bln economic recovery fund, which includes the issuance of joint debt in order to finance weaker member states who were hit the hardest by the pandemic. Looking at the bigger picture, it is important to note that the fundamental and structural challenges facing the USD still remain intact. These include unprecedented fiscal/monetary policy expansion, collapse in US real yields, over-accommodative Fed with USD lending/funding facilities extended into the next year, a diminished economic growth outlook, and the loss of an historic yield advantage, among other reasons. The general consensus view of a broadly weaker USD is still unchanged at this point.

Now that we have recapped some of the important FX stories over the third quarter, it makes sense to take a brief look at what is in store over the final stretch of 2020. The upcoming US Presidential election is shaping up to be an historic one, to say the least, and we are beginning to see glimpses of how the market is positioning itself in anticipation of a whirlwind of uncertainty and volatility. Looking under the hood of the FX options market, the spread between 2- and 1-month at-the-money implied volatility for the USDCAD pair (i.e., a measure of the market's expected future volatility of USDCAD from now until the option expiry) paints a pretty clear picture of a market expecting higher volatility around election time.

USDCAD At-the-Money Volatility Spread (2M-1M)



Source: FactSet, Raymond James Ltd.

Sticking to the FX options market, there is another discernable trend that we have noticed. Option positioning in the USDJPY pair has been telling quite an interesting story. There is a clear demand for downside protection through the purchase of puts on the pair (a put on USD and a call on JPY). Looking at these options with a November expiry, strike prices are scattered within the 99-103 range (JPYUSD is currently trading at a 105 handle at the time of writing). Looking out to December, strike prices have been pushed even lower to a range of 95-103. This suggests the market is positioning itself by going long the JPY as a hedge against a potentially drawn-out US election. Time will tell if this insurance was required.

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