Trend & Cycle: The Long View – October 2023

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All values in U.S. dollars and priced as of market close on October 5, 2023 unless otherwise noted

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Secular trends and the current 4-year cycle

- US equity markets are nearing an important long-term inflection point as pullbacks through Q3 approach key support levels in Q4 with interest rates and the US dollar ongoing headwinds for stocks. Our base case continues to be that the secular uptrend and current market cycle remain intact with recent equity declines consistent with seasonal weakness with potential to bottom in Q4 as tactical indicators become oversold and supportive of year-end rally.

- We have remained optimistic since Q4 2022 given the S&P established a typical 4-year cycle low near its long-term term uptrend at its 4-year/200-week moving average. As intermediate-term indicators became overbought and peaked early this past summer, a seasonal pullback appeared likely. In fact, we view weekly indicators as now suitably oversold to support a bottom developing in October and November, which should support further upside into Q1 2024 consistent with the 4-year data illustrated on page 6.

Rates remain an ongoing risk to the cycle

- However, the important, negative macro event that developed in September was the 11-month breakout by the US 10-year yield above the October 2022 high at 4.3% which runs the risk of prematurely aborting the equity cycle recovery that began in Q4 2022. Unfortunately, the trend in interest rates remains up, defined by higher highs, with 5.0-5.15% the next important technical band.

- Looking back at the relationship between US equity markets and interest rates, a move above 4.5-5% was an important inflection point in the secular trend for equities in the 1970s. The obvious risk today is that unless interest rates begin to stall and reverse shortly, equity markets will continue to trend lower. With lower highs versus their 2022 highs established by equity markets this past summer, it is particularly important the S&P bottoms between 4000-4200 support, with 4000 an important downside risk control level. A break below 4000 would likely signal further equity weakness with 3800-3900 next support coinciding with the rising 200-week moving average followed by the October lows at 3500.

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Silver lining

- Today's (10/06) stronger-than-expected employment report has pushed the US 10-year yield interest rates higher toward its next key technical hurdle (5.0-5.15%) pressuring equities lower. However, one silver lining developing for rates as they test their next important upside levels is that some of the most popular exchange traded funds tracking bonds, and bond proxies such as utilities, are showing very early evidence of capitulation with record volume readings developing in their third major downside move from their 2020 highs with momentum indicators moving into deeply oversold territory.

Equity leadership

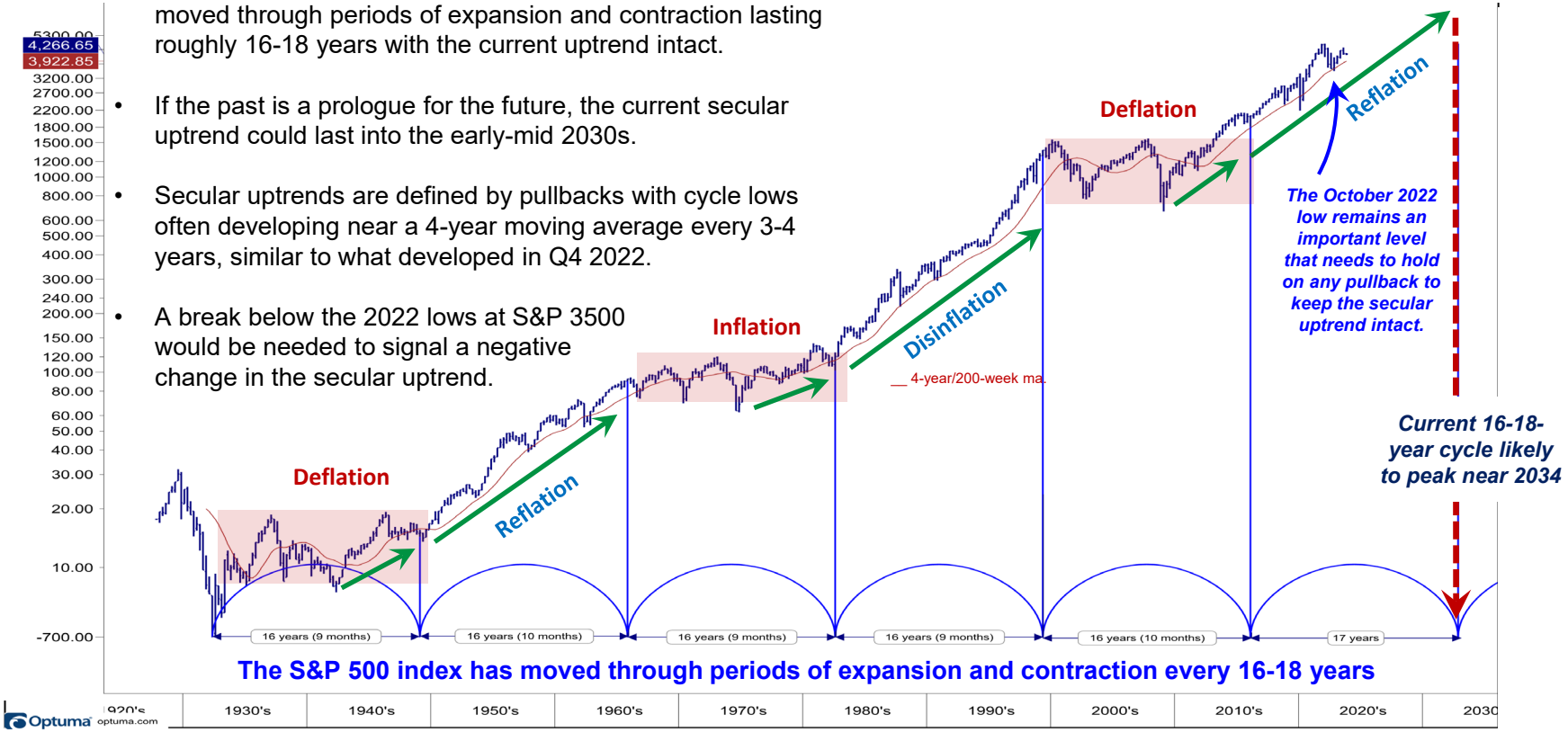
- Almost every sector was weak through Q3 with interest rate sensitive sectors, such as utilities, continuing to lead to the downside in ongoing, although increasingly oversold, downtrends. While it is premature to conclude a major bottom is developing for rate sensitive sectors, they appear to be nearing capitulation lows with potential for bottoms to develop this quarter.
- Growth groups, such as technology, have also been weak but, so far, their corrections are nearing key support in line with seasonal lows developing in October. Interestingly, despite the rise in interest rates, the relative performance of growth versus value has been improving as many value groups remain weak and growth stocks showing incremental evidence of bottoming with potential to strengthen through year-end.
- Lastly, the energy complex remains noteworthy as an emerging sector following its correction in 2022 into this past summer's lows. While a pullback is underway following the rebound through Q3, our expectation is for the correction to be relatively short lived. We view energy to be an attractive sector as part of a barbell exposure with growth stocks.

Bottom line

- In summary, while the current trend in interest rates remains an ongoing concern not to be dismissed casually, rates are becoming extended tactically with potential for a peak developing in Q4. Conversely, equity markets are increasingly oversold short-term and intermediate-term/weekly suggesting a volatile choppy bottoming pattern developing through October during earnings season.

S&P 500 – Generational cycles lasting roughly 16-18 years

- The long-term secular trends for the US stock market have moved through periods of expansion and contraction lasting roughly 16-18 years with the current uptrend intact.
- If the past is a prologue for the future, the current secular uptrend could last into the early-mid 2030s.
- Secular uptrends are defined by pullbacks with cycle lows often developing near a 4-year moving average every 3-4 years, similar to what developed in Q4 2022.
- A break below the 2022 lows at S&P 3500 would be needed to signal a negative change in the secular uptrend.



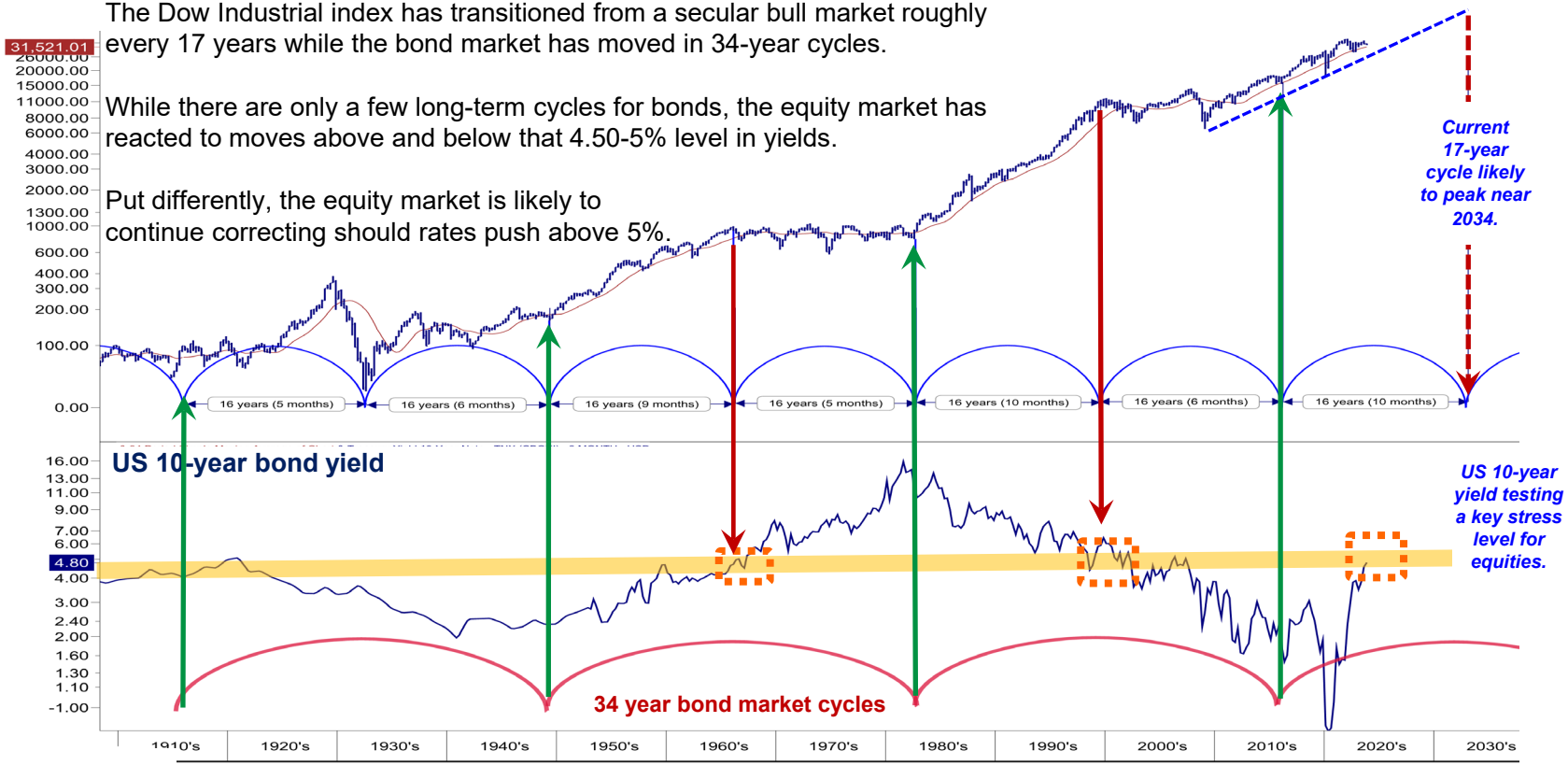
Source: RBC Wealth Management, Bloomberg, Optuma

16-18 year equity market cycles and 34-year interest rate cycles

The Dow Industrial index has transitioned from a secular bull market roughly every 17 years while the bond market has moved in 34-year cycles.

While there are only a few long-term cycles for bonds, the equity market has reacted to moves above and below that 4.50-5% level in yields.

Put differently, the equity market is likely to continue correcting should rates push above 5%.



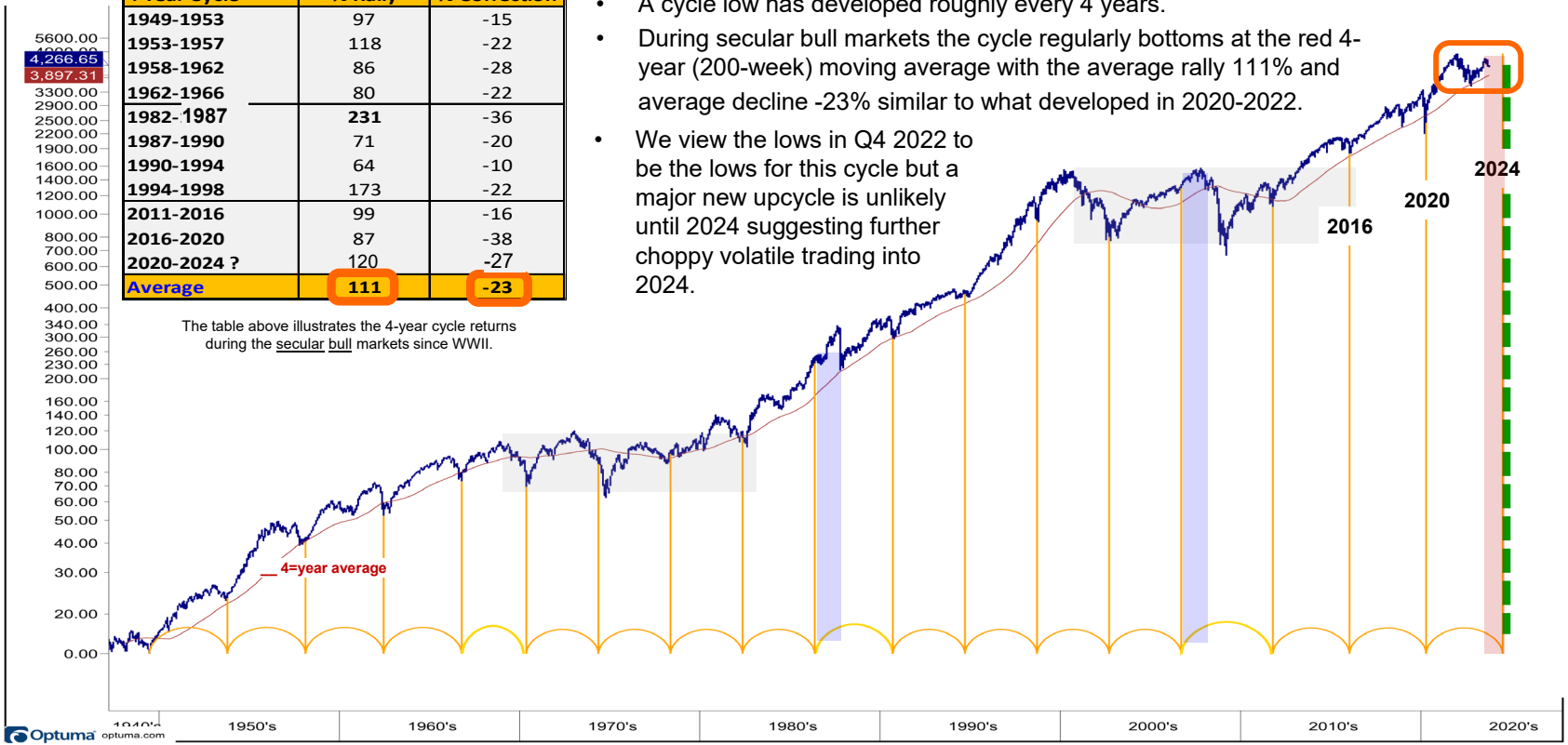
Source: RBC Wealth Management, Bloomberg, Optuma

S&P 500 – A repetitive 4-year cycle to consider when investing

4 Year Cycle	% Rally	% Correction
1949-1953	97	-15
1953-1957	118	-22
1958-1962	86	-28
1962-1966	80	-22
1982-1987	231	-36
1987-1990	71	-20
1990-1994	64	-10
1994-1998	173	-22
2011-2016	99	-16
2016-2020	87	-38
2020-2024 ?	120	-27
Average	111	-23

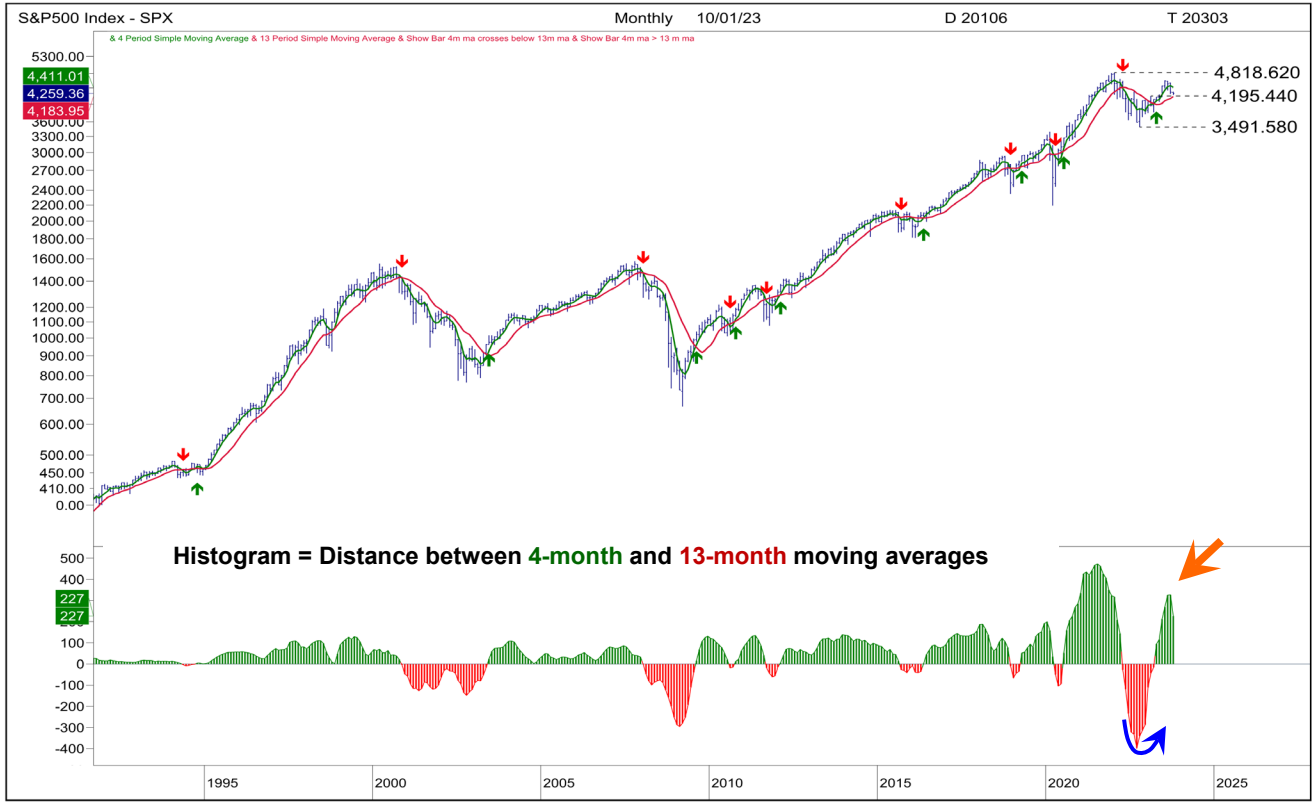
The table above illustrates the 4-year cycle returns during the secular bull markets since WWII.

- A cycle low has developed roughly every 4 years.
- During secular bull markets the cycle regularly bottoms at the red 4-year (200-week) moving average with the average rally 111% and average decline -23% similar to what developed in 2020-2022.
- We view the lows in Q4 2022 to be the lows for this cycle but a major new upcycle is unlikely until 2024 suggesting further choppy volatile trading into 2024.



Source: RBC Wealth Management, Bloomberg, Optuma

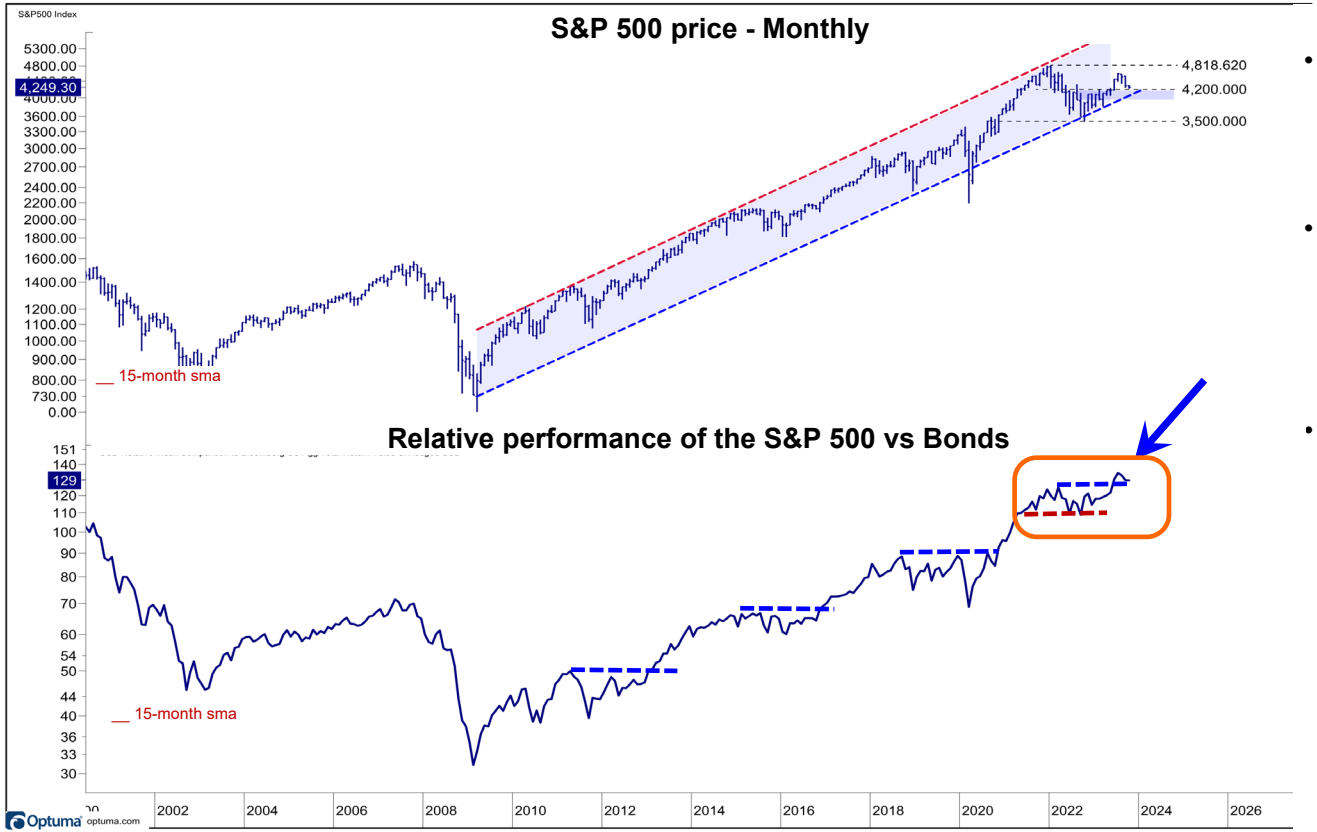
S&P 500 – Monthly with 4- and 13-month moving averages



Source: RBC Wealth Management, Bloomberg, Optuma

- One technical tool to track the trend of the equity market is to compare its shorter-term trend, measured by the green 4-month moving average (ma), to its longer-term trend, measured by the red 13-month ma.
- **Since Q4 2022 the faster moving 4-month ma has turned and crossed above the 13-month ma signaling the S&P's trend has turned positive.**
- Another way to track the relationship between these two moving averages is to measure the vertical difference between the two and plot the difference as a histogram, as illustrated in the bottom panel.
- This indicator bottomed in Q4 2022 and has built positively into the summer of 2023 but is showing signs of decelerating/stalling.
- We view this recent market pullback to be consistent with seasonal Q3 weakness into Q4 but a decline below 4000 would likely raise the risk the broader cycle recovery is failing.

S&P 500 price and relative performance versus bonds



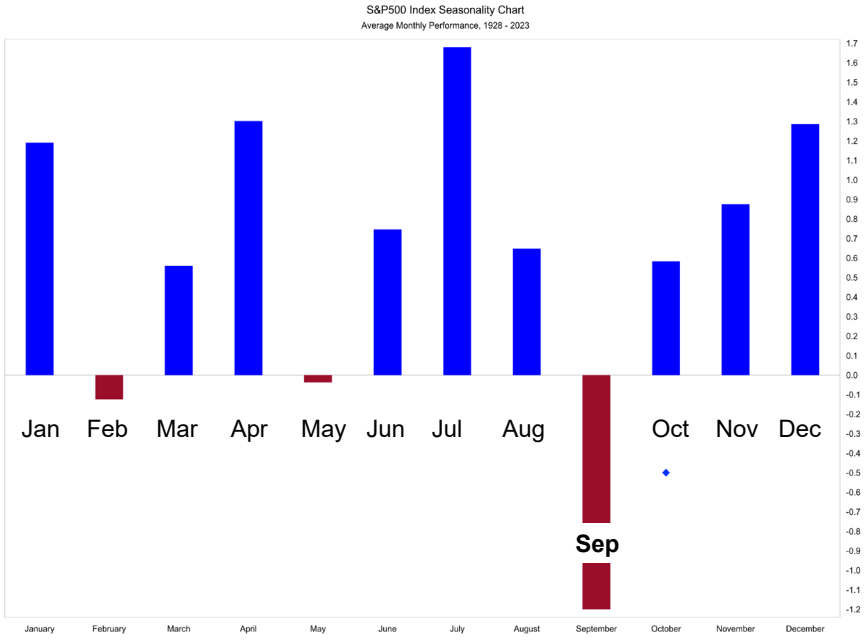
Source: RBC Wealth Management, Bloomberg, Optuma

- After rallying strongly in 1H 2023 the S&P is pulling back to test key support near 4200-4000 near its 200-day ma.
- We view the recent pullback to be consistent with Q3 seasonal weakness heading into Q4 which usually leads to a market recovery.
- The relative performance ratio of the S&P versus the **Barclays All Aggregate Bond Index** is beginning to break out of its 2022-2023 trading range, shifting the longer-term trend from neutral to up for stocks versus bonds.

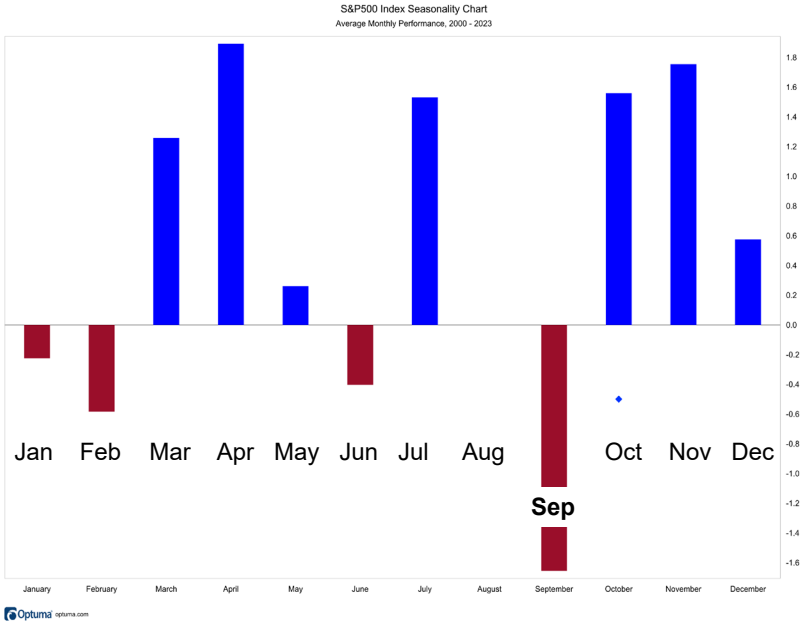
S&P 500 – Seasonality

- Monthly seasonality data varies widely depending on the start date but history suggests markets improve moving into Q4.

Monthly seasonality since 1928

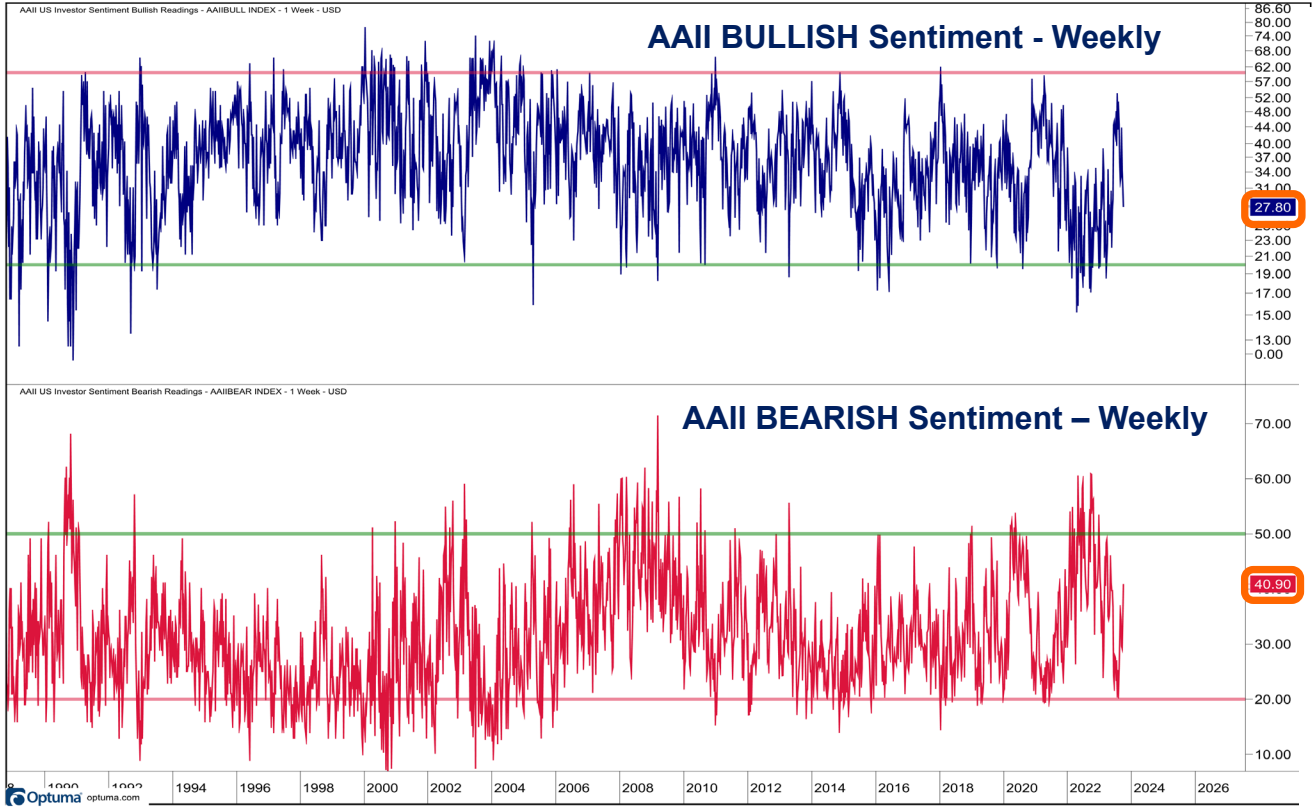


Monthly seasonality since 2000



Source: RBC Wealth Management, Bloomberg, Optuma

AAII US Investor Bullish and Bearish Sentiment (contrarian indicators)



- AAII bullish sentiment readings (top panel) continue to decline from the moderately advanced levels that developed heading into the summer while bearish sentiment (bottom panel) is rising.
- While these readings are not at contrarian levels associated with a major low, they are moving in the right direction to support a Q4 rebound.

Source: RBC Wealth Management, Bloomberg, Optuma

S&P/TSX Composite – Monthly

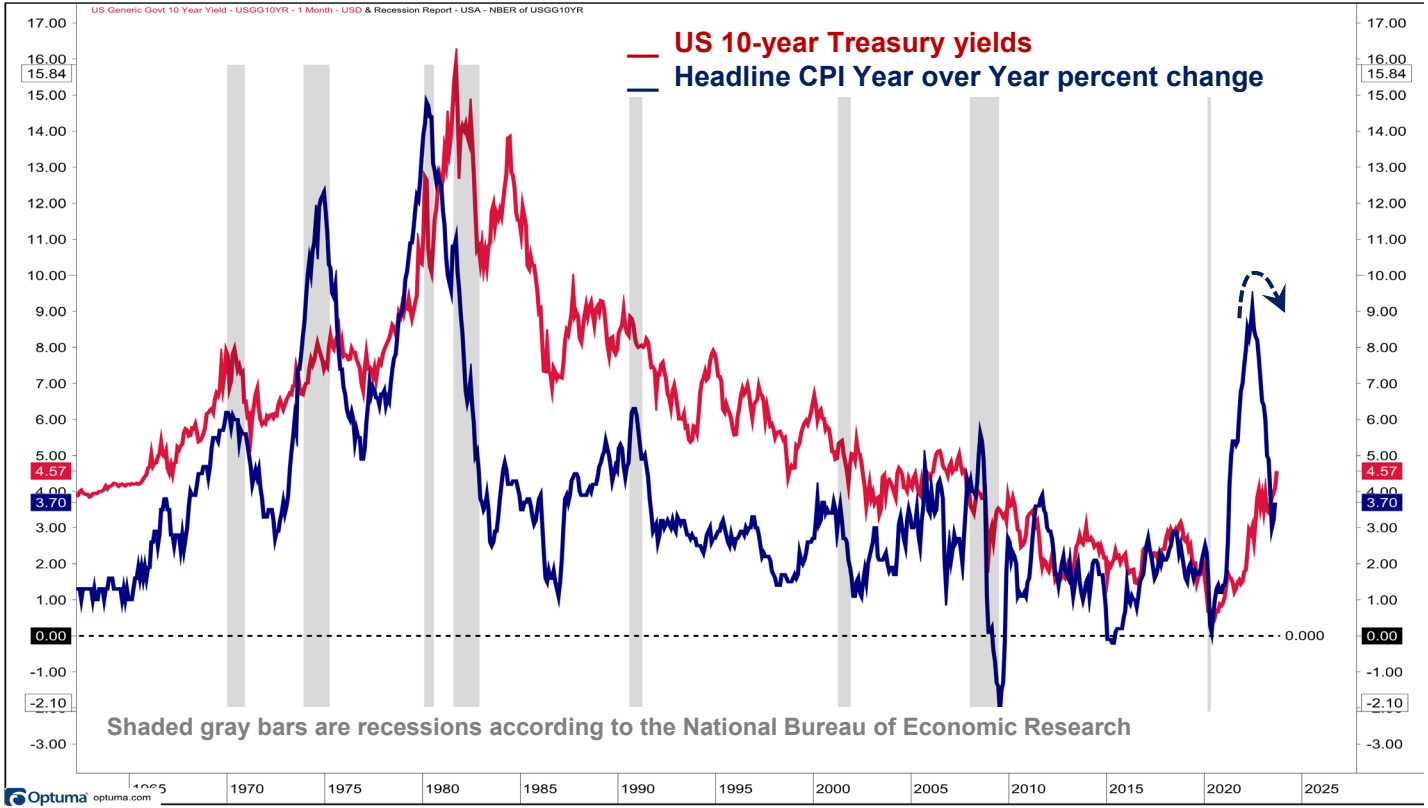
Source: RBC Wealth Management, Bloomberg, Optuma

- Monthly cycle momentum bottomed in Q4 2022 as the TSX rallied from support near 18,000 at its longer-term uptrend from the late 1970s.
- Our expectation is that the TSX remains in a trading range between tactical support at 18,000 and resistance at 22,000.
- Relative performance remains flat to weak versus the S&P and would need to push above the 2020-2022 highs to support overweighting.

US 10-year yield

Source: RBC Wealth Management, Bloomberg, Optuma

US 10-year yields (red) and CPI Inflation YoY (blue)



- CPI inflation (blue) has peaked, pulling back to 3.7% following a bounce from 3.2% with the 10-year yield pushing to new cycle highs through Q3 and early Q4.

Source: RBC Wealth Management, Bloomberg, Optuma, Bureau of Labor Statistics, National Bureau of Economic Research

US Dollar DXY Index – Monthly

- Monthly momentum, which tracks the direction multi-year cycles, remains negative but is working toward oversold levels.

- After correcting from the cycle high of 113-114 the US dollar index has rebounded strongly from 100 support to challenge its next resistance level near 107 where we expect a pause to develop.

Source: RBC Wealth Management, Bloomberg, Optuma

Canadian dollar / US dollar – Monthly

Source: RBC Wealth Management, Bloomberg, Optuma

- Monthly cycle momentum for the Canadian dollar is bottoming and turning up, which generally signals a bottoming pattern.
- Overall, the price behavior of the Canadian dollar continues to track the pattern of a cycle bottom, with a break below the 2022 lows at 0.717 needed to negate that view. Next support at 0.682.
- Our expectation is for the Canadian dollar to bottom and hold key support at 0.717 moving through Q4.

WTI Oil future – Monthly

Source: RBC Wealth Management, Bloomberg, Optuma

- Monthly cycle momentum for WTI is bottoming after correcting from 130 back to key support between 60-70.
- WTI has now rallied above a key resistance band in the low 80s with next resistance near 93.
- Support is near current levels followed by 77-78 near the 100- and 200-day moving averages.
- Note: For reference, we are using 10 to be the low end of WTI's long-term trading range for the Fibonacci retracements rather than the temporary spike into negative territory at -40.

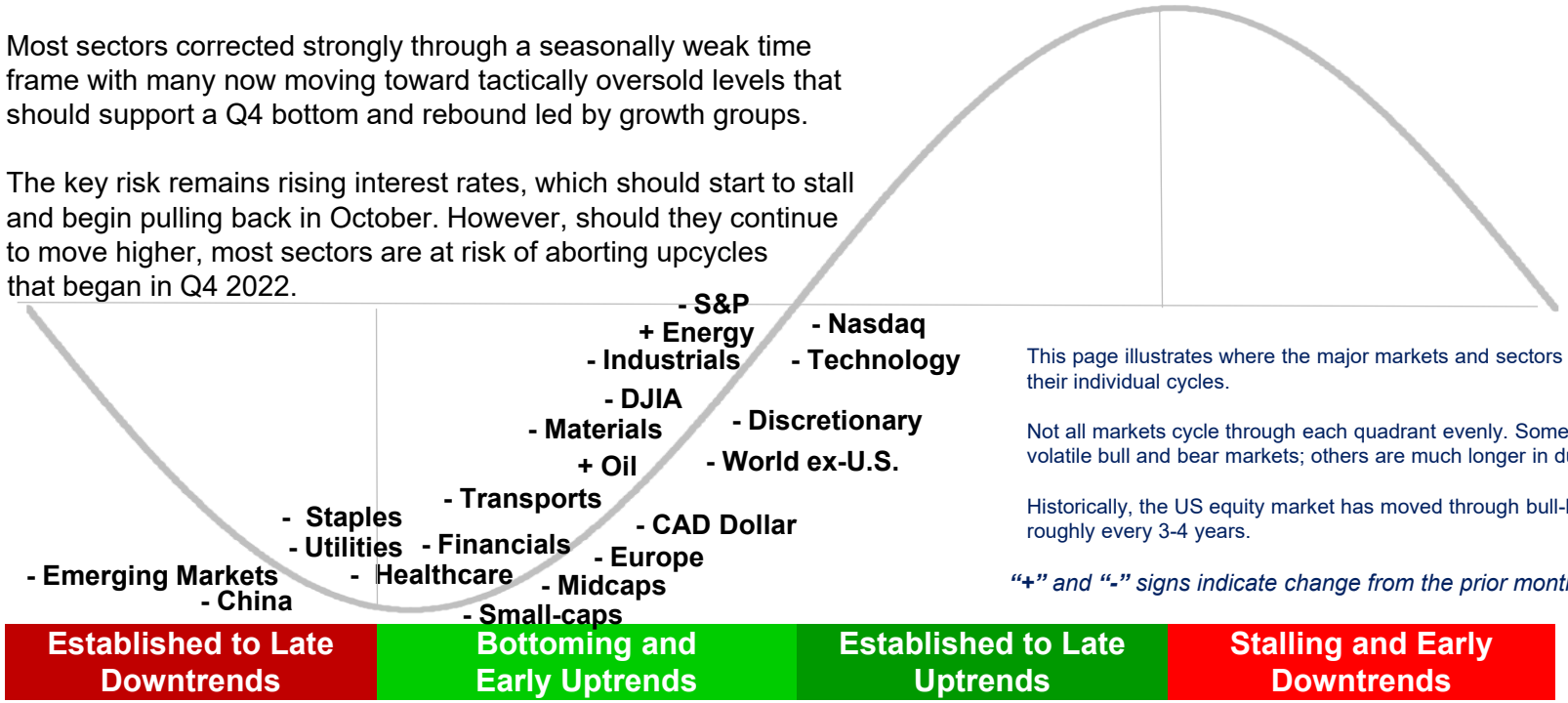
Gold – Monthly

- We continue to view gold to be range bound under resistance near 2000-2075.
- An intermediate-term pullback is underway as interest rates and the US dollar continue to move higher.
- Next key support is between 1729-1804, which we expect to see gold begin stabilizing near in Q4.
- Longer-term, a breakout above 2075 is needed to confirm a new uptrend taking hold for gold.

Source: RBC Wealth Management, Bloomberg, Optuma

Major markets and S&P sector cycles

- Following up on last month's commentary in this space, almost every sector and asset class were weak through September with the exception of Oil and the Energy sector.
- Most sectors corrected strongly through a seasonally weak time frame with many now moving toward tactically oversold levels that should support a Q4 bottom and rebound led by growth groups.
- The key risk remains rising interest rates, which should start to stall and begin pulling back in October. However, should they continue to move higher, most sectors are at risk of aborting upcycles that began in Q4 2022.



This page illustrates where the major markets and sectors are within their individual cycles.

Not all markets cycle through each quadrant evenly. Some have short, volatile bull and bear markets; others are much longer in duration.

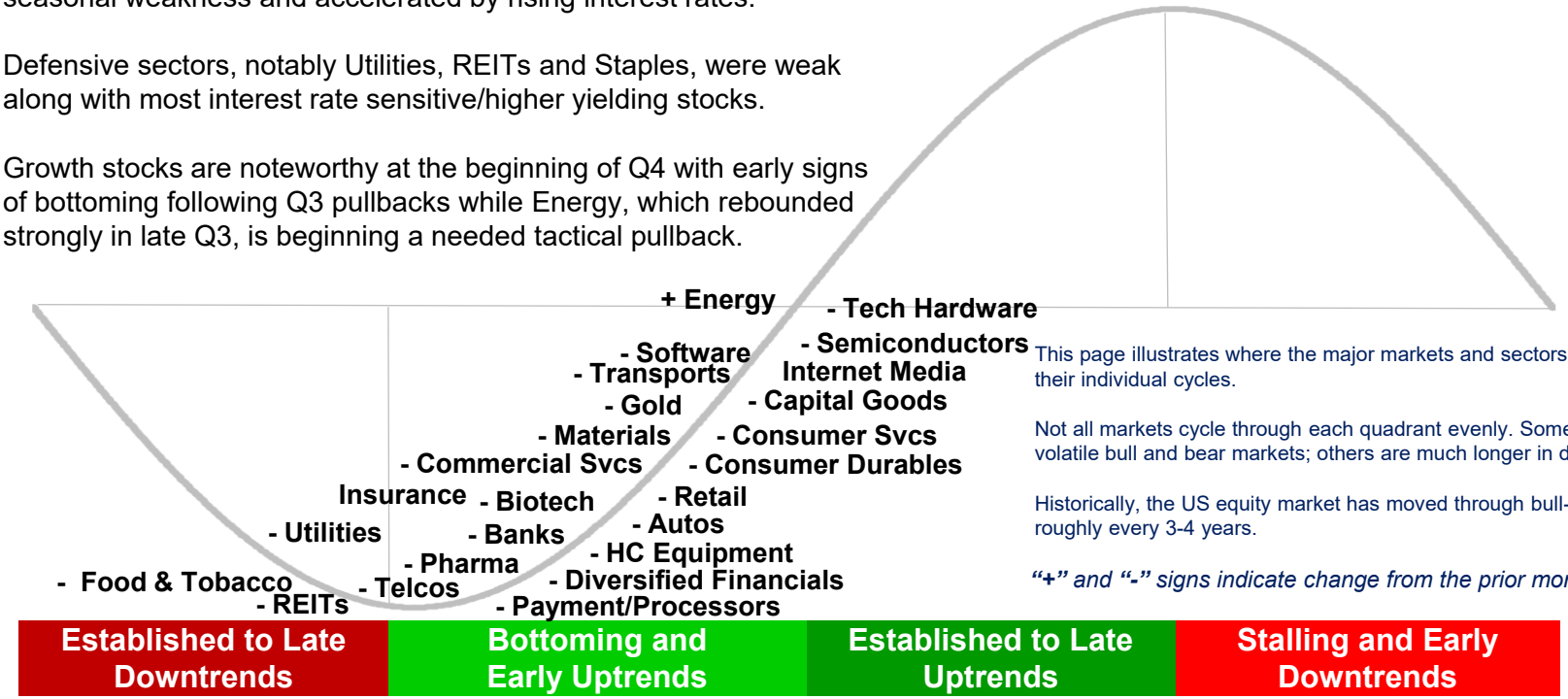
Historically, the US equity market has moved through bull-bear phases roughly every 3-4 years.

"+" and "-" signs indicate change from the prior month.

Source: RBC Wealth Management, Bloomberg, Optuma

Industry group cycles

- Similar to the sector and asset class distribution on the prior page, almost every industry group declined in September, consistent with seasonal weakness and accelerated by rising interest rates.
- Defensive sectors, notably Utilities, REITs and Staples, were weak along with most interest rate sensitive/higher yielding stocks.
- Growth stocks are noteworthy at the beginning of Q4 with early signs of bottoming following Q3 pullbacks while Energy, which rebounded strongly in late Q3, is beginning a needed tactical pullback.



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