Most are glad to see October in the rear-view mirror. It was one of the trickier months for investors this decade. One of my favourite market sayings is that "the market will do what makes the most people wrong." October was a perfect example of that as it seemed that almost everything that had been working earlier this year suddenly stopped working. This was a classic rotation out of momentum and into defensives, and it caught a lot of investors off guard.

There are several reasons for this reversal, but much of the blame can be pointed at artificial intelligence. For the past two years, this has been the dominant market theme and has had an enormous impact on investment markets and the global economy. The capital that is being deployed into data centres has the potential to be the largest investment in history, and as a percentage of GDP is rivalling that of the railway expansion in the 1800s. This capital spending has created a wrinkle in many economic statistics and has the potential to have masked some underlying weakness, which adds to market risk as investors start questioning the sustainability of the theme.

Questions about AI spending is exactly what we are starting to hear. As the largest technology companies began to report earnings, analysts and investors began to focus on the returns on all this AI investment and whether it's sustainable. Suddenly, one of the biggest growth drivers of the entire bull market came under suspicion. When that happens, things can unravel quickly, which is what we saw at the end of October.

The volatility that many had been expecting did appear this year, and unfortunately it doesn't seem to be entirely behind us. The US midterm elections are thankfully over and a resounding request for change was the message from angry voters. This has the potential to define the next few years. The war with Iran has been incredibly inflationary and is having an outsized effect on consumers around the world; markets are now looking at the possibility that after this election, we may move closer to the end of the conflict and a resumption of normal trade flows.

The war has also had a significant impact on the bond market. Remember when this was supposed to be the year of interest rate cuts? That hasn't exactly gone according to plan. The Federal Reserve raised rates in September, and while it paused in October, we believe the message was that another move could be coming in December. In Canada, the Bank of Canada was forced to raise rates last month. While the economy has strengthened, it's not to the point of needing higher interest rates; a large part of this hike is about keeping pace with the US to protect the Canadian dollar. We should expect further matching hikes following the path of the Federal Open Market Committee (FOMC). It's not an ideal situation. Higher rates are not what the Canadian economy needs, but currency pressures and the US Federal Reserve leave the Bank of Canada with limited flexibility.

At the end of the day, what will set the path for the balance of the year will be earnings. With markets trading near all-time highs and valuations looking extended, we needed earnings growth to keep the rally going. That was one of the pleasant surprises earlier this year. Corporate earnings were consistently beating expectations, providing the fundamental support needed to push markets higher. That momentum now appears to be fading. During the most recent earnings season, the US banks started raising some growth concerns, but the bigger issue goes back to technology and AI. AI was supposed to be the growth engine. But we have started to see some cracks in that story.

Google faced difficult questions about its competitive position and threats around its search business before falling over 10%. More importantly, Meta started talking about potentially pulling back on spending, which is a massive risk for the semiconductor sector. On that note, Intel delivered a disappointing outlook, causing the shares to fall over 25%. Intel has received considerable attention and support from the Trump administration, but that support is now being questioned, and Intel likely won't be the last company to face such scrutiny. Given how much of the market's recent performance has been tied to these technology leaders, the path forward on their earnings is very important.

Which brings us back to the path forward into year-end. Being a contrarian is often a popular investment strategy. October certainly made that uncomfortable, but we believe this might be a time to start leaning in rather than running for the exits. A lot of bad news is now being reflected in prices. Sentiment has deteriorated, and the technology sector has been hit hard. Can things get worse? Of course. But how much of the negative news is now well understood and, to a degree, priced into the market?

One area to watch closely is the banks. In our view, banks tend to lead markets, and their weakness this summer preceded the fall sell-off. We are starting to see some encouraging signs of improvement, and with record IPOs being brought to market, capital markets might be ready for a turn higher? Previously, many had suggested that the much anticipated Anthropic IPO could mark a market top, but what if it's closer to a mid-cycle bottom?

October was a painful reminder that markets don't always reward the most popular trades. When everyone is positioned the same way, it doesn't take much to create a meaningful reversal. The good news is that those periods of discomfort may often create some of the best buying opportunities. I'm not suggesting the all-clear has sounded, but we believe it's time to start looking for opportunities rather than focusing exclusively on the risks.

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