

Investors Looked Forward to Looser Lockdowns

Monthly Market Commentary

May 2020

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New answers.®

- Global financial markets continued their sharp rallies in May amid loosening lockdowns, promising progress toward COVID-19 vaccine development, and the ongoing extraordinary support of central banks.
- Domestic markets also continued to rally, but the pace slowed.
- We remain mindful of the known risks inherent to investing in the capital markets as well as the potential for devastating surprises such as the COVID-19 pandemic that struck in early 2020 and remains a threat today.

Economic Backdrop

Global financial markets continued their sharp rallies in May, albeit short of their remarkable April rebounds. The “risk-on” sentiment came amid a push by local governments to slowly reverse lockdowns of non-essential economic activity; the promising news of progress made in the race to develop COVID-19 vaccines; and the sustained extraordinary support of central banks.

Equities around much of the world experienced a choppy first half of May that ultimately gave way to a strong second half for the month. However, mainland Chinese and Hong Kong stocks were outliers; both came under pressure as the month progressed, with the island territory finishing the period with a steep loss. U.S. and European stocks generated solid monthly performance, while U.K. stocks delivered more subdued gains.

The blended earnings of S&P 500 Index constituents declined by 14.6% during first-quarter 2020 from a year earlier (based on 97% of companies that had reported results) putting the Index on track for its deepest year-over-year decline since third-quarter 2009. U.S. investment-grade corporate-bond issuance continued an unprecedented recovery from its standstill in March, racing past \$1 trillion in year-to-date issuance in late May; the \$1 trillion issuance milestone wasn't broken in 2019 until November.

Government-bond rates followed divergent paths from country to country. Short- and long-term U.S. Treasury rates increased as intermediate-term rates declined for the month. Rates mostly declined for U.K. gilts, yet increased for those with the longest maturities, while they increased across all maturities for eurozone government-bonds.

In the U.S., the total recorded number of COVID-19-related deaths surpassed 100,000 in late May—out of about 350,000 total worldwide. President Donald Trump's administration imposed travel restrictions on Brazil amid the South American nation's struggle to contain the outbreak; the federal government also prolonged its mandate for land-border closures with Canada and Mexico by one month, now effective through June 22. State-by-state responses continued to vary widely, with some local governments facing challenges to the legality of their orders: Wisconsin's state supreme court overturned the governor's stay-at-home order in mid-May; the U.S. Supreme Court rejected a California church's challenge to the legality of placing restrictions on gathering in places of worship—thereby validating California's state government to enforce such restrictions.

U.S. legislators continued to explore ways to improve the Paycheck Protection Program—a government loan designed to incentivize small businesses to keep workers on the payroll—legislation passed the Congress in early June that would extend the period during which companies can spend loan proceeds and remain eligible for loan forgiveness, as well as allow a lower minimum share of loan proceeds to go toward covering payroll. Toward the end of May, the House of Representatives also passed an additional \$3 trillion in COVID-19 relief funds, but the legislation was held up in the Senate with unclear prospects for approval.

The U.K. COVID-19-related death toll eclipsed that of Italy in early May, reaching the highest number of losses in Europe (although Italy lost a greater percentage of its smaller population). U.K. Chancellor of the Exchequer Rishi Sunak announced his intention to extend the government's mortgage-payment holiday beyond June as its initial three-month timeframe approached. As of mid-May, U.K. banks had granted these repayment holiday terms to 1.7 million homeowners.

Italy provided reason to celebrate halfway through the month as its number of new COVID-19 cases per day fell below 100 for the first time since March. The peninsular nation announced plans to begin reopening borders in early June. Prime Minister Giuseppe Conte proposed a €55 billion relief package intended to freeze corporate taxes for many businesses; provide forgivable grants of up to €40,000 for small businesses and emergency incomes of up to €800 for struggling families; extended unemployment payments; and offer funding for healthcare, tourism, research and agriculture, among others initiatives. The Italian government's announcement preceded the mid-May proposal by the European Commission for nearly €2 trillion across the EU, with €750 billion devoted to recovery efforts and another €1.1 trillion to budgets over the next seven years.

The National People's Congress in China concluded the month with its approval of a resolution to impose new national-security laws on Hong Kong amid ongoing anti-Beijing protests, marking a significant dilution of the "one country, two systems" governance ethos that has defined the relationship since the U.K.'s handoff of Hong Kong to China in 1997.

Several governments around the world condemned this development and began to explore concrete responses. U.K. Prime Minister Boris Johnson said Britain was considering a path to citizenship and relocation for British Nationals (Overseas) (a class of British nationality extended to Hong Kong residents prior to the 1997 handover). Meanwhile, the U.S. began examining Hong Kong's special territorial exemptions and evaluating multiple avenues for putting economic pressure on China—including sanctioning the mainland Chinese financial sector and imposing limitations on technology sharing by adding dozens of Chinese entities to trade blacklists.

The increasingly tense U.S.-China relationship was further stressed in May by a U.S. push for more transparency in the ownership of U.S.-listed Chinese companies and the U.S. government's barring of certain Chinese holdings from its retirement plans. Canada's relationship with China was also strained during the month after a Canadian judge ruled in favor of a U.S. petition to extradite a Chinese telecommunications executive. China, for its part, imposed an 80% tariff on all barley imported from Australia over the next five years in an apparent response to the Australian government's call for an independent inquiry into the origins of COVID-19.

Central Banks

- The Bank of Canada (BoC) held the policy rate firm at a historically low 0.25% following its June 3 meeting. The BoC curtailed the frequency of its Term Repo and Bankers' Acceptance Purchase Facility operations, but is still providing significant liquidity and support to markets. The BoC's next scheduled meeting is on July 15.
- The Federal Open Market Committee held no meeting in May after maintaining its monetary-policy orientation at a late-April meeting. As part of its crisis-period response, the Federal Reserve (Fed) began buying corporate bond exchange-traded funds on May 12 to support secondary-market liquidity. Fed Chair Jerome Powell announced near the end of May that the central bank's Main Street Lending Program—introduced to support the small-business loan market—would be operational within days.
- The Bank of England's (BoE) Monetary Policy Committee held course following its May 7 meeting, keeping the Bank Rate at 0.1% and reiterating a commitment to purchase £200 billion in gilts and investment-grade corporate bonds (at its current pace of buying, this would bring the BoE's stock of asset purchases to £645 billion by the beginning of July). The central bank's May policy statement cited data that point to a significant drop in household consumption and plummeting expectations for sales and business investment during the second quarter.
- The European Central Bank (ECB) did not meet to address monetary policy in May following its end-of-April unveiling of a new lending program called the pandemic emergency longer-term refinancing operations, or PELTROs, to help facilitate proper functioning of money markets. Germany's constitutional court ruled during May that the ECB must produce justification for the legality of its bond-buying programme, which began in 2015, in order to determine whether the Bundesbank could continue to participate.
- The Bank of Japan (BOJ) did not conduct a meeting on monetary policy during May. At its late-April meeting, the BOJ committed to open-ended purchases of Japanese government bonds in an effort to keep yields low and stable, and announced a ramp-up to its purchases of corporate bonds and commercial paper to a target of ¥20 trillion.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) fell by 0.7% in April, while year-over-year prices were down by 0.2%—the first annual decline since September 2009. Producer prices were weak as well: the Industrial Product Price Index (IPPI) slumped by 2.3% in April, while the Raw Materials Price Index (RMPI) plunged 13.4%. Over the past 12 months, the IPPI slid by 0.6% while the RMPI plummeted 36.7%. Markedly lower energy and petroleum prices played an outsized role in the poor inflation reports. From February to April, 5.5 million people either lost their jobs or were absent from work due to COVID-19. Employment rebounded slightly in May as the economy began to re-open and added 290,000 jobs. Despite the job growth, unemployment rose to 13.7%—the highest rate on record—as more people returned to the labour force.
- U.S. consumer spending fell by 13.6% during April, registering the sharpest one-month decline since the data series began in 1959. New jobless claims for U.S. unemployment benefits declined from more than 3 million per week in early May to about 2 million later in the month; continuing claims fell during the week of May 16 for the first time since COVID-19 lockdowns began in the U.S. Nearly 15 million U.S. credit card bills went unpaid during April, and more than 8% of U.S. mortgages were in forbearance as of mid-May. U.S. gross domestic product (GDP) declined by an annualized 5% during the first quarter of 2020, the largest annualized quarterly decline since the final three months of 2008.
- The U.K. economy shrank by 5.8% during March, representing the largest monthly decline in more than 20 years of U.K. GDP measurements. Economic activity contracted by 2% over the first quarter of 2020. The U.K. claimant count (which measures the number of people claiming unemployment benefits) jumped from 3.5% in March to 5.8% in April. Retail sales in the U.K. fell in April by 18.1% from the prior month and by 22.6% from a year earlier.
- The eurozone contracted by 3.8% during the first quarter and 3.2% over the one-year period. Construction output dropped 14.2% in March after slipping just 0.5% in February. Loans to non-financial corporations climbed by 6.6% in April, following an increase of 5.4% in March, continuing a corporate-credit bounce from February's ebb.

Market Impact (in Canadian dollar terms)

The rebound in equity markets continued, but at a slower pace. Information technology and consumer discretionary remained among the leading domestic sectors, while smaller companies also continued to outperform. Most foreign developed and emerging markets were strong, although China and India were notable exceptions.

Fixed-income markets were also positive, led by riskier segments. U.S. high-yield bonds benefitted from continued Fed action and much stronger crude oil prices. In domestic markets, corporate and mortgage bonds outperformed government debt.

Index Data (May 2020)

- The S&P/TSX Composite Index was up 3.04%.
- The FTSE Canada Universe Bond Index returned 0.31%.
- The S&P 500 Index, which measures U.S. equities, climbed 4.25%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, gained 3.84%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 4.51% (currency hedged) and 4.03% (unhedged).
- The Chicago Board Options Exchange Volatility Index—a measure of implied volatility in the S&P 500 Index also known as the “fear index”—declined from 34.15 to a still-elevated 27.51 at month end.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, nearly doubled from US\$18.84 on the last day of April to US\$35.49 at the end of the month. Significant production cuts helped better balance the supply and demand in oil markets.
- The loonie strengthened versus the U.S. dollar; it ended the month at C\$1.38 per U.S. dollar. Meanwhile, the U.S. dollar was mixed versus the world's other major currencies. It ended the month at US\$1.24 against sterling, US\$1.11 versus the euro and 107.74 yen.

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