

U.S. Transition Tested as New Year Twists and Turns

Monthly Market Commentary

January 2021

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- The U.S. presidential transition took a bizarre turn in early January as President Trump's supporters descended on the Capitol Building, interrupting the counting of electoral votes in a violent security breach. Two weeks later, Joe Biden was inaugurated as president under heavy security.
- Emerging-market equities had strong performance in January, yet their developed-market counterparts were generally negative. U.S. large caps and Japanese equities lagged Canadian stocks, which were modestly lower for the full month.
- We expect to continue seeing signs of an economic recovery emerge as COVID-19 abates and activity normalizes. In the meantime, fiscal spending and accommodative central-bank policy should sustain gross domestic product growth and eventually cause inflation to rise.

Economic Backdrop

January set a high bar for memorability. Six days into the month, the U.S. presidential transition took a bizarre turn as thousands of President Donald Trump's supporters gathered in Washington, DC, to protest the formal declaration of Joe Biden's victory. Trump rallied the crowd to descend on the U.S. Capitol Building, where the historically tedious ritual of counting electoral votes in the U.S. Congress was just getting underway. This culminated in a violent security breach of the Capitol by a mob of protesters who successfully delayed—but did not stop—the vote count, while damaging property and causing severe injury to and loss of life both for police officers and rioters.

Trump was impeached by the House of Representatives for inciting an insurrection—the first president in U.S. history to be impeached twice. Still, perhaps the most consequential fallout of the riot was Trump's permanent ban from Twitter, his preferred mode of public communication for much of the last decade. Two weeks later, Joe Biden was inaugurated as president under heavy security provided by 25,000 National Guard troops.

The U.K. and EU parted ways upon entering the New Year, finally fulfilling the Brexit referendum of 2016. They returned to separate political realms for the first time since 1993 (when the U.K. joined the EU) and distinct economic realms for the first time since 1973 (when the U.K. joined the European Communities).

Capital markets were resilient throughout the uncharted political waters that engulfed the first few weeks of January, with equity-market volatility actually declining during these events. Later in the month, however, volatility spiked as subscribers to WallStreetBets (a popular and irreverent community of equity-market speculators within the Reddit social-media sphere) triggered a classic speculative frenzy by focusing their collective trading heft on a handful of unloved stocks. Several hedge fund giants were briefly paralyzed by the amateurs' coordinated trading bonanza. This shift in attention benefited smaller beleaguered stocks, yet weighed on broad market indexes as it detracted from mega-cap technology stocks that have been leading markets in recent years.

Emerging-market equities had strong overall performance in January, with gains in the Asia-Pacific region more than offsetting steep losses in Latin America. In developed markets, stocks were generally negative for the period—excluding U.S. small caps, which were among the best-performing equities. U.S. large caps and Japanese equities lagged U.K. stocks, which were modestly lower for the full month, while European equities had a steeper decline.

Fixed-income sectors, with the exception of inflation-protected securities and high-yield bonds, were also down in January. U.S. investment-grade corporate debt, global sovereign bonds and emerging-market debt had the poorest performance. Government-bond yield curves generally steepened across major developed markets for the month. U.K. gilt rates increased for all maturities, although more significantly for longer-term rates than shorter-term rates. Long-term eurozone government-bond rates also increased, while short-to-intermediate-term eurozone rates were mixed in January. U.S. Treasury short-term rates edged downward, and intermediate-to-long-term U.S. rates increased.

COVID-19 infection rates continued to climb around the world during January. U.S. daily case counts topped in late December, while its daily death toll peaked in mid-January. The pandemic's foothold strengthened as new, more infectious coronavirus mutations that originated in the U.K. and South Africa began spreading around the globe—a disconcerting development that risked setting back timetables for a return to normal.

The new Biden administration worked with the Congress to confirm top-level cabinet positions, enacted a series of COVID-19-related executive actions, and began to tackle a range of other priorities. President Biden also began promoting the “American Rescue Plan,” which proposes a \$1.9 trillion fiscal stimulus package that combines extended unemployment benefits and housing-related protections with tax credits for lower-to-middle-income families along with funding for state and local governments, education, health care, small businesses and direct payments to Americans. Biden’s Democratic Party holds slim majorities in both houses of the Congress and can therefore enact budget-related plans without bi-partisan support; nevertheless, as January concluded, the new administration remained open to negotiations with moderate Republicans over a potential compromise.

U.K. Chancellor of the Exchequer Rishi Sunak announced a one-time grant programme for hospitality, leisure and retail businesses at the beginning of January. The programme pledges to appropriate £4.6 billion for grants of up to £9,000, which the treasury projected would reach 600,000 businesses.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) increased by 0.1% and 0.7%, respectively, for the month and year ending December. Gasoline prices rose for the first time since July. Shelter costs have continued to climb at a brisk pace while air travel costs remained weak as COVID-19 has lowered demand. Producer prices were up sharply in December: the Industrial Product Price Index (IPPI) jumped 1.5%—the largest monthly increase in just over three years—while the Raw Materials Price Index (RMPI) was up 3.5%. Over the past 12 months, producer prices remained weak; the IPPI increased 1.8% while the RMPI fell 0.7%. Prices for petroleum and energy improved in December but remained well below year-ago levels. Meanwhile, prices for lumber and metals have shown strong year-over-year increases. Employment reports were weak as the economy shed 213,000 jobs—mostly in Ontario and Quebec part-time retail jobs—leading the unemployment rate to rise by 0.6% to 9.4%—its highest level since August 2020.
- U.S. manufacturing growth remained strong during January. Services sector activity returned to a high level of growth for the month after its strengthening trend was interrupted in December. New U.S. claims for unemployment benefits were volatile, reaching nearly one million per week in early January before declining to about 850,000 toward the end of the month. The overall U.S. economy expanded at an annualized 4.0% rate during the fourth quarter (after annualized changes of -5.0%, -31.4% and 33.4% during the first, second and third quarters, respectively) and contracted by 2.3% for the 2020 calendar year.
- U.K. manufacturing growth weakened during January after strengthening throughout the fourth quarter. Activity in the country’s services sector plummeted for the month after working its way out of a contraction in November and December. The U.K. claimant count (which calculates the number of people claiming Jobseeker’s Allowance) increased by 0.1% to 2.6 million in December, generally in line with elevated levels that have become the norm since last spring. The broad U.K. economy shrank by 2.6% during November after recovering for six consecutive months.
- Eurozone manufacturing activity continued to expand at a healthy pace in January. Services sector activity remained mired in a contraction that began in September. The eurozone unemployment rate held at 8.3% during December, having edged lower in prior months from a September climb. The eurozone economy contracted by 0.7% during the fourth quarter of 2020 (after changes of -3.6%, -11.8% and 12.5% during the first, second and third quarters, respectively) and shrank by 5.1% during the 2020 calendar year.

Central Banks

- As expected, the Bank of Canada (BoC) held its policy rate firm at a historically low 0.25% following its first 2021 meeting on January 20. The BoC noted that the current surge in COVID-19 is a serious setback to economic recovery; however, the continued vaccine rollout may improve the prospects for a sustained recovery in the second half of 2021 for Canada and other developed countries. Further, the BoC stated it would continue to help Canadians and the economy during this difficult time. The next scheduled meeting is March 10.
- The Federal Open Market Committee (FOMC) retained its existing monetary policy stance at its late January meeting. The federal-funds rate target continues to range between 0.0% and 0.25%, and the FOMC remains committed to purchasing Treasuries and agency mortgage-backed securities (MBS) at respective rates of \$80 billion and \$40 billion per month.
- The Bank of England's Monetary Policy Committee did not hold a meeting in January. It abstained from new actions during its mid-December meeting, having just committed in November to a new £150 billion toward bond purchases (for a total of £895 billion). Its next scheduled meeting is on 4 February.
- The European Central Bank (ECB) made no new monetary policy changes at its January meeting after increasing the scale of asset purchases associated with its Pandemic Emergency Purchase Programme (PEPP) by €500 billion to a total of €1.85 trillion in December.
- The Bank of Japan (BOJ) held firm at its January meeting. BOJ Governor Haruhiko Kuroda indicated to the press that a monetary policy review available in March will consider how to eventually begin unwinding the BOJ's deep market interventions since the global financial crisis.

Market Impact (in Canadian dollar terms)

The global equity rally paused in January. Canadian large companies were down modestly, while smaller companies had slight gains. Sector performance was fairly mixed: healthcare stocks had impressive gains while energy and utilities were also up. Consumer staples and materials were down the most. U.S. stocks were also down, although smaller companies had strong gains, continuing to build on a recent rally. Elsewhere in the developed world, the U.K. was essentially flat while Europe and Japan suffered moderate losses. Emerging markets, on the other hand, posted solid gains led by China.

Fixed-income markets were generally weak. Real-return bonds were the worst performers, while short-term bonds were relatively flat. Corporate bonds outperformed government debt as investment-grade bonds declined. U.S. high-yield bonds, which are riskier than investment-grade bonds, were up slightly, aided by the continued recovery in crude oil prices.

Index Data (January 2021)

- The S&P/TSX Composite Index was down 0.32%.
- The FTSE Canada Universe Bond Index returned -1.11%.
- The S&P 500 Index, which measures U.S. equities, fell by 0.74%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, was nearly flat at -0.19%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.38% (currency hedged) and 0.66% (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”—jumped from 22.75 to 33.09 at month end. The Index was fairly stable throughout the month until it spiked in late January as volatility jumped with the WallStreetBets trading frenzy.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, rose from US\$48.52 on the last day of December to US\$52.20 at the end of the month, as the vaccine rollout continued to lead to speculation of future increased oil demand.
- The loonie strengthened slightly versus the U.S. dollar; it ended the month at C\$1.28 per U.S. dollar. The U.S. dollar was little changed versus the world's other major currencies. It ended the month at US\$1.37 against sterling, US\$1.21 versus the euro and 104.70 yen.

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