Investor Concerns Go Viral
Monthly Market Commentary
February 2020

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- Concerns about the international spread of a novel coronavirus (COVID-19) continued to dominate financial markets throughout February.
- Developed-market government bond yields tumbled as investors sought "safe-haven" assets amid equity-market volatility that crescendoed to the highest level since August 2015 (bond yields fall when their prices rise).
- We maintained our emphasis on strategic (long-term) investing over tactical (short-term) decision-making, as it is impossible to identify with complete accuracy how investors might react to macroeconomic shifts.

Economic Backdrop

Concerns about the international spread of a novel coronavirus (COVID-19) dominated conditions in financial markets throughout February, continuing a trend that began in late January. Developed-market shares, as measured by the MSCI World Index, registered their largest decline since May 2012. The U.K. fared the worst among developed markets, followed by Europe and Japan performing in line with each other; the U.S. declined by slightly less than the others. Emerging-market equities outperformed developed markets. Mainland China (where COVID-19 originated) actually finished February with a gain after sharply selling off in January; despite hosting far more COVID-19 cases to date than all other countries combined, China's infection rate slowed considerably while recoveries accelerated as the month progressed.

Developed-market government bond yields tumbled as investors sought "safe-haven" assets (bond yields fall when their prices rise) amid a crescendo of equity-market volatility that peaked on the last trading day of the month, when the CBOE Volatility Index (VIX) hit its highest level since August 2015. U.S., U.K., and European government-bond rates declined across all maturities; long-term U.S. Treasury yields finished the month at historic lows. Energy prices fell sharply during February in light of weakening prospects for global economic growth as governments implemented restrictions to counteract the COVID-19 outbreak that also impact productivity (such as shuttering workplaces, closing schools, quarantining exposed individuals, and imposing trade and travel barriers).

The U.S. Department of Commerce announced new rules that would allow President Donald Trump's administration to impose tariffs on imports from countries deemed to have artificially decreased the value of their currencies for trade advantages.

China cut tariffs in half on $75 billion worth of U.S. products in mid-February, and also announced the suspension of additional tariffs on U.S. industrial goods later in the month. Domestically, the regional government of Hainan, China, planned to take control of China's HNA Group, an aviation-focused conglomerate with an unsustainable debt load that was further crippled by COVID-19-induced travel stoppages.

U.K. Prime Minister Boris Johnson shuffled his cabinet ministers and senior government officials during February, prompting Chancellor of the Exchequer Sajid Javid to resign. Javid was replaced by Rishi Sunak, a senior Treasury official and former banker.

Germany's political fortunes were less certain in February after Chancellor Angela Merkel's intended successor—Annegret Kramp-Karrenbauer, defense minister in Merkel's government and leader of the Christian Democratic Union party—unexpectedly announced that she won't compete for the top post in 2021.

In Ireland's early-February election, the left-nationalist Sinn Fein party secured a historic win—breaking the country's traditional mold of two centrist parties that has defined much of its first century as an independent state. All three parties (Sinn Fein, Fianna Fail and Fine Gael) polled between 20% and 25%, with incumbent Fine Gael having the poorest showing.

Turkey began to allow Syrian refugees passage to Europe at the end of February—a decision that came after the Syrian military attacked Turkish troops stationed in northeastern Syria and the Turkish military responded by shooting down multiple Syrian fighter jets. The resulting flood of refugees immediately led to a renewed migrant crisis in Greece.

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The governments of Hong Kong, Singapore and Macau each announced direct fiscal stimulus measures during February—in the form cash payments or shopping vouchers to their respective citizens—intended to counteract the negative economic effects introduced by the COVID-19 outbreak.

Central Banks

- The Bank of Canada (BoC) did not meet in February but cut the overnight rate by 0.50% to 1.25% at its March 4 meeting. The BoC noted that the Canadian economy is operating close to potential and inflation is on target but the COVID-19 virus represents a material negative shock to both domestic and global economic outlooks. The BoC's next scheduled meeting is on April 15 and the outlook is for more potential rate cuts in 2020.

- The Federal Open Market Committee (FOMC), Bank of England, European Central Bank (ECB) and Bank of Japan (BOJ) held no meetings on their respective domestic monetary policies during February. Furthermore, each central bank kept their respective benchmark rates unchanged following their January meetings. However, the FOMC announced an off-meeting cut of .50% (bringing the federal funds rate down to a range of 1.00 to 1.25%) on March 3 in an effort to counteract the economic drag introduced by the COVID-19 outbreak.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) was up 0.1% in January, while prices increased at a robust 2.4% rate for the past 12 months. Gasoline and fuel prices were much higher than year-ago levels but were relatively weak in January as the COVID-19 virus hampered demand. Producer prices were weaker than consumer prices—the Industrial Product Price Index (IPPI) slumped 0.3% in January, while the Raw Materials Price Index (RMPI) plunged 2.2%. Over the past 12 months, the IPPI was up a meager 0.5% while the RMPI rose 1.7%. Similar to consumer prices, the trends were largely the result of prices for energy and petroleum products. The economy added 30,000 jobs in February as the unemployment rate ticked up 0.1% to 5.6%.

- U.S. manufacturing growth slowed nearly to a standstill during February, and an early report showed services sector activity contracted in February after expanding at healthy levels in January. Personal spending declined to 0.2% in January from 0.4% in December, and overall fourth-quarter economic growth registered a 2.1% annualized rate.

- A preliminary report on U.K. services sector activity depicted a slower but still sturdy expansion in February, while an early report on manufacturing showed a rebound that was beginning to show signs of healthier growth. Retail sales jumped by 0.9% in January after sliding by 0.5% in December. The claimant count unemployment rate held at 3.4% in January.

- The contraction of eurozone manufacturing activity slowed in February, nearing neutral (that is, neither shrinking nor expanding). A preliminary report on services activity depicted modest improvement with services growth remaining at healthy levels. The unemployment rate held at 7.4% in January, while the economy grew by 0.1% during the fourth quarter and 0.9% during 2019; both measures of economic growth were lower than during the prior period.

Market Impact (in Canadian dollar terms)

Equity markets performed poorly across the board as COVID-19 reached epidemic levels in China before beginning to spread worldwide. Global growth prospects have dimmed as quarantines and travel bans have reduced demand while factory closures in China are likely to create supply chain disruptions. Domestic large companies held up reasonably well but losses for smaller companies approached 10%. U.S. equities slightly trailed Canadian equities while Japanese and European stocks fared worse. Emerging markets were down nearly 4%, easily outpacing developed markets. Notably, Chinese stocks were positive as new cases of COVID-19 were reported to be falling in mainland China by the end of the month.

Investors preferred the relative safety of bonds over equities; fixed-income markets posted solid gains as yields fell (prices and yields move inversely). Real-return bonds generally have longer duration profiles—and hence more sensitivity to changes in yields—and continued their strong year-to-date performance. Government bonds outperformed corporate debt. U.S. high-yield bonds underperformed investment-grade issues as investors moved to safer havens.

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Index Data (February 2020)

- The S&P/TSX Composite Index was down 5.90%.
- The FTSE Canada Universe Bond Index returned 0.71%.
- The S&P 500 Index, which measures U.S. equities, slumped 6.86%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, dropped 6.70%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -1.57% (currency hedged) and -0.08% (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"—spiked notably higher from 18.84 to 40.11 at month end as COVID-19 spread globally.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, plunged from US$51.56 on the last day of January to US$44.76 at the end of February. COVID-19-related travel bans, along with much slower global growth expectations, continued to put significant pressure on crude-oil prices.
- The loonie weakened versus the U.S. dollar; it ended the month at C$1.34 per U.S. dollar. Meanwhile, the U.S. dollar strengthened against the euro and sterling, but was slightly weaker versus yen. It ended the month at US$1.28 against sterling, US$1.10 versus the euro and 107.87 yen.

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