U.S. Dollar Takes a Dip
Monthly Market Commentary
July 2020

- Canadian and Global equities were reinvigorated with a “risk-on” rally in July as the U.S. dollar experienced its largest one-month drop versus a basket of major currencies since September 2010.
- U.S. negotiations over new fiscal-stimulus terms carried past the end of July despite the expiration of enhanced unemployment insurance benefits and protections from eviction within housing supported by the federal government.
- We believe that an ebb and flow of assorted concerns in the coming months will continue to spark volatility across financial markets. Such periods of instability are expected in any long-term investing plan; as such, at SEI, we are prepared as always to navigate the current wave of deep uncertainty.

Economic Backdrop

Global equities continued to climb sharply during July as the U.S. dollar’s spot price dropped by more than 4% versus a basket of major currencies during the period, marking its largest one-month decline since September 2010.

Emerging-market shares, led by China and Latin America, handily outperformed those of developed markets for July, while U.S. equities outpaced other major developed markets. The gold futures price rose to an all-time high in U.S. dollars during the month, finishing with a gain of more than 10%. Meanwhile, the West Texas Intermediate oil futures price increased by US$1.00 during July, to end the period at US$40.27; OPEC+ (the Organization of the Petroleum Exporting Countries, led by Saudi Arabia—plus Russia) announced plans in mid-July to begin relaxing oil-output cuts that had been instituted earlier in 2020 to counteract falling oil prices.

Government-bond rates generally declined across maturities in the U.S., U.K. and eurozone during July. U.S. and eurozone government-bond rates dropped the most in the longest maturities; in the U.K., gilt rates declined most dramatically in the intermediate-to-long-term segment of the yield curve.

At the end of July, President Donald Trump’s administration was still negotiating new fiscal-stimulus terms with the House of Representatives—despite the end-of-July expiration of enhanced unemployment insurance benefits and protections from eviction within housing supported by the federal government. During the month, the U.S. government reached deals with several pharmaceutical companies (one American, three European) to supply a combined 200 million doses of their pending coronavirus vaccines at a total cost of over $4 billion.

The United States–Mexico–Canada Agreement (USMCA) took effect on July 1, officially replacing the North American Free Trade Agreement (NAFTA), while closure of the US-Canada border was extended (with few exceptions) until August 21.

The wide-ranging labour-market support that the U.K.’s Job Retention Scheme has provided was set to begin receding at the end of July. Effective August, companies are required to begin paying the national insurance and pension contributions for their furloughed workers; companies must also pay 10% of their wages starting in September, and then 20% by October. The expanding burden-sharing raises the possibility that employers will need to permanently lay off workers.

The U.K. Treasury announced a patchwork of programs during July targeted at bolstering dining and tourism. Restaurants and pubs, which opened their doors in July for the first time in several months, are expected to benefit from reduced taxes on food and non-alcoholic drink sales (from 20% to 5%); the tax cut also applies to tourist attractions and travel accommodations. Additionally, a 50% dining discount (up to £10 per diner) is set to begin in August. HM Treasury also unveiled a work placement programme for young adults; it also suspended taxes on some home purchases.

The EU struck a landmark accord to help fund an economic recovery from COVID-19-induced containment measures. The agreement’s €1.8 trillion price tag includes a €750 billion recovery plan (with more than half the figure intended as grants and the balance as loans), as well as funding for EU budgets through 2027. In a first, EU members agreed to partially fund the deal by issuing common EU debt, thereby tightening the fiscal union between member countries.

Tension between the U.S. and China intensified throughout July. In a break from previous U.S. policy that said maritime disputes must be resolved peacefully through UN-backed arbitration, the Trump administration formally denounced China's territorial claims in the South China Sea as illegitimate. The U.S. also imposed sanctions in response to human rights abuses against Muslim Uighurs and ethnic Kazakhs in the Xinjiang region; China issued retaliatory sanctions against U.S. senators who criticized the abuses. The U.S. gave China 72 hours in late July to close its consulate in Houston, Texas, claiming that Chinese diplomats helped steal U.S. medical research on COVID-19; China followed through on its vow to retaliate, closing the U.S. consulate in Chengdu.

The U.K. suspended its extradition treaty with Hong Kong in early July to protest China's new security law for Hong Kong; it also banned using technology that belongs to Chinese telecommunication company Huawei for Britain's high-speed wireless network. At the end of July, Hong Kong postponed elections for the territory's legislature until next year, citing a resurgence of COVID-19 cases; this prompted protests from democratic groups.

At least 68 countries and territories postponed elections between February 21 and July 26, also citing concerns about COVID-19 containment, according to the Wall Street Journal; at least 49 countries and territories committed to holding their elections as scheduled. The U.S. general election is almost certainly going to proceed in early November, as is set by federal law; any delay would require approval by both chambers of the Congress, and one has publically confirmed it would reject any postponement.

Central Banks

- The Bank of Canada (BoC) held the policy rate firm at a historically low 0.25% following its July 15 meeting. The BoC also stated its intention of maintaining this low level of rates and its quantitative easing program until inflation targets are met.
- The Federal Open Market Committee made no monetary-policy changes following its late-July meeting, but reiterated its commitment to using its full range of programs to help support current economic challenges. During July, the Federal Reserve (Fed) Board of Governors announced extensions of temporary U.S. dollar-liquidity-swap and repurchase-agreement facilities with other central banks through March 2021.
- The Bank of England's Monetary Policy Committee did not hold a meeting during July. Following its mid-June meeting, the central bank announced that it would expand its stock of asset purchases (from an initial £200 billion increase announced in March) by another £100 billion to £745 billion.
- The European Central Bank (ECB) held its benchmark interest rates firm after a mid-July monetary policy meeting, and emphasized the demand for and utility of its asset-purchase and lending programs.
- The Bank of Japan (BOJ) made no changes following its mid-July monetary policy meeting, maintaining its short-term rate and its target rate for the 10-year Japanese government bond.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) jumped 1.0% in June. While year-over-year prices were up by a more modest 0.7%, they improved by 1.1% versus year-ending May prices, which were down by 0.4%. This is the largest positive change in annual prices in over nine years as many businesses reopened from COVID-19 closures. Producer prices were higher as well: the Industrial Product Price Index (IPPI) rose 0.4% in June, while the Raw Materials Price Index (RMPI) rose 7.5% due to higher costs for energy and petroleum products. Over the past 12 months, producer prices remained weak; the IPPI slid by 3.1% while the RMPI fell 13.5%. Despite the recent rebound, markedly lower energy and petroleum prices played an outsized role in the poor year-over-year inflation reports. The unemployment rate dropped by 1.4% to 10.9% as employment rose by 419,000 in June. Despite strong gains from the May to July period, employment remained about 7.0% below pre-COVID-19 levels in February.
- U.S. manufacturing activity expanded at a modest rate during July; new orders accelerated, while employment continued to contract. Services sector activity essentially maintained pace during the month, according to an early report, after moving lower in June. New U.S. jobless claims bottomed in mid-July at 1.3 million per week before increasing through the end of the month. The U.S. economy shrank at a 32.9% annualized rate during the second quarter, its sharpest decline on record since 1947.

- Solid growth returned to the U.K.'s services sector, according to an early July report, while manufacturing continued to rebound at a steady and moderate pace. Mortgage approvals re-accelerated to about 40,010 in June after bottoming at approximately 9,270 in May; associated lending jumped from about £290 million to approximately £1.22 billion in the same period. The latest available information on U.K. gross domestic product (GDP) showed a contraction of 19.1% from March to May 2020.

- The recovery in eurozone manufacturing remained subdued in July, while services activity accelerated, according to a preliminary report. Across the euro area, the unemployment rate increased by 7.8% in June, from 7.7% in May. The first reading of second-quarter GDP for the eurozone showed a contraction of 12.1%, its largest quarterly drop on record. Germany's economy shrank by 10% for the second quarter, while Italy, France and Spain contracted by 12.4%, 13.8% and 18.5%, respectively; Lithuania's 5.1% second-quarter decline was the mildest in the eurozone.

Market Impact (in Canadian dollar terms)

The rebound in equity markets continued, but with some rotation of leadership. Materials stocks, which include gold miners, were the top performers domestically as small companies also performed well. While information technology continued its strong run, the more traditional defensive sectors of consumer staples and utilities also outperformed. Financials, energy and healthcare trailed the overall market while still producing modest gains. The performance of emerging markets was strong, while developed-market performance was more mixed—U.S. equities were up, but Japanese stocks slumped.

Fixed-income markets were also positive, led by riskier segments. U.S. high-yield bonds benefitted from continued Fed action and the stabilization of crude oil prices. Domestic markets were led by real-return bonds, corporate bonds and mortgage bonds which outperformed government debt.

Index Data (July 2020)

- The S&P/TSX Composite Index was up 4.48%.
- The FTSE Canada Universe Bond Index returned 1.27%.
- The S&P 500 Index, which measures U.S. equities, climbed 3.89%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, gained 3.55%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 4.66% (currency hedged) and 3.02% (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 30.43 to a still-elevated 24.76 at month end.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, rose modestly from US$39.27 on the last day of June to US$40.27 at the end of the month.
- The loonie strengthened versus the U.S. dollar; it ended the month at C$1.34 per U.S. dollar. The U.S. dollar was also weaker versus the world's other major currencies. It ended the month at US$1.31 against sterling, US$1.18 versus the euro and 105.73 yen.

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