Equity Hot Streak Barreled into Late Summer

Monthly Market Commentary

August 2020

- Strong equity-market returns continued in August, led by Hong Kong, Japan and the U.S.
- Government-bond yields increased around the developed world, with long-term government rates growing by more than short-term rates.
- 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

Strong equity-market performance continued around most of the world in August, led by Hong Kong, Japan and the U.S. Europe and the U.K. followed at a distance despite generating elevated one-month returns. Latin America suffered a sharp decline during the period as COVID-19 cases appeared to plateau at high levels there. A steep selloff in early September offset part of August's gains, particularly among the U.S. companies that had led the rally.

The S&P 500 Index (a broad measure of U.S. stocks) registered a new all-time high in late August, marking the fifth consecutive month of gains since the dramatic early-2020 selloff. The U.S. dollar continued to fall versus a basket of major currencies during August, albeit at a slower pace compared to its sharp July decline, settling at its lowest level in more than two years.

Government-bond yields increased around the developed world. In the U.S., U.K. and eurozone, long-term government rates rose by more than short-term rates, leading to steeper yield curves.

The U.S. presidential election cycle formally progressed to its final phase before Election Day, as President Donald Trump accepted the Republican Party's nomination and former Vice President Joe Biden accepted the Democratic Party's nomination at their respective quadrennial conventions during August. Fresh off the July commencement of the United States–Mexico–Canada Agreement (USMCA), the Trump administration announced in August a re-imposition of a 10% tariff on Canadian aluminum that was suspended in May 2019 during USMCA negotiations.

Tensions between the U.S. and China spilled into the social-media sphere as the Trump administration took a series of actions to wrest control of the U.S. branch of TikTok, a popular video-sharing app owned by Beijing-based Bytedance. In early August, President Trump signed an executive order to bar Americans from conducting business with ByteDance after mid-September. Several major U.S. companies in the software, retail and private-equity industries announced intentions to bid on TikTok's U.S. operations; by late August, ByteDance sued the U.S. government over its impending ban and forced sale. China, for its part, contended that any sale of TikTok assets to a U.S. company is subject to Chinese government approval.

Aside from social-media drama, the U.S.-China relationship was strained after a recent Beijing-imposed national-security law drove the Trump administration to end its extradition treaty with Hong Kong. In addition, the U.S. imposed sanctions on senior government officials in China and Hong Kong, including Hong Kong's Beijing-appointed Chief Executive Carrie Lam, over their suppression of political dissent in the territory. Finally, the U.S. formalized accounting rule changes, mandating that U.S.-traded Chinese firms comply with U.S. accounting standards by 2022 or else de-list from U.S. securities exchanges. With regard to the ongoing global pandemic, the U.S. and Hong Kong each reported their first confirmed case of COVID-19 re-infection.

U.K. and EU representatives made only marginal progress toward a trade deal during August. Negotiations hit an apparent impasse as the EU made two demands that had previously been declared non-starters by U.K. negotiators: (1) continued EU fishing rights in U.K. waters, and (2) U.K. adherence to EU state-aid rules that would limit the likelihood of anti-competitive subsidies to U.K. industry.

In late August, Japanese Prime Minister Shinzo Abe announced his intention to resign due to issues with his personal health. Abe is the longest-serving prime minister in Japan's history and a chief proponent of a multi-pronged policy approach to the country's economic revival, which was dubbed "Abenomics."

Central Banks

- The Bank of Canada (BoC) did not hold a monetary policy meeting during August after holding the policy rate firm at a historically low 0.25% following its July meeting. Similarly, neither the European Central Bank (ECB) nor the Bank of Japan (BOJ) held monetary policy meetings in August after having both made no changes at their respective mid-July meetings.

- The Federal Open Market Committee (FOMC) did not hold a meeting in August; however, it announced major updates to its monetary-policy approach. The most significant change centered on the central bank's new average inflation target, which highlights its explicit willingness to allow above-target inflation following periods of below-target inflation. This change indicates that the FOMC will let the U.S. economy run hotter than in the past before taking policy action to temper growth.

- The Bank of England's Monetary Policy Committee voted to leave its key lending rate unchanged at 0.1% and to maintain its existing level of asset purchases at £745 billion. The central bank also lowered its economic outlook—from expecting a complete recovery by mid-2021 to anticipating a return to pre-pandemic levels of economic activity no earlier than late 2021.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) edged down 0.1% in July, reversing June's 1.0% increase. Year-over-year prices were up by 0.1% in July after increasing 0.7% during the prior month. Producer prices continued to climb as well: the Industrial Product Price Index (IPPI) rose 0.7% in July, while the Raw Materials Price Index (RMPI) rose 3.0% due to higher costs for energy and petroleum products. Over the past 12 months, producer prices remained weak; the IPPI slid by 2.3% while the RMPI fell 12.1%. 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 0.7% to 10.2% as employment rose by 246.000 in July.

- U.S. manufacturing activity improved during August on July's modest growth, despite a persistent contrast between strong new orders and shrinking employment. A preliminary report showed that activity in the services sector accelerated during August after halting in the prior month. New U.S. jobless claims briefly dipped below 1 million per week in mid-August before rising back to about 1.1 million later in the month. Existing U.S. home sales surged by 24.7% in July amid historically low mortgage rates; by contrast, the number of delinquent mortgages insured by the Federal Housing Administration reached 16% in August, the highest level on record since 1979.

- The U.K.'s healthy rebound in manufacturing activity accelerated during August. A preliminary report on activity in the services sector during the same month depicted an increase in the U.K.'s already-strong growth. U.K. mortgage approvals jumped to 66,300 in July from 39,900 in June, while consumer credit grew by £1.2 billion in July after contracting during the prior month; both measures exceeded consensus expectations for July.

- The eurozone's recovery in manufacturing activity remained slow during August. Services sector activity eased to a near standstill, according to an early report. The number of loans granted to non-financial corporations increased by 7% in July, keeping pace with the prior two months. The eurozone unemployment rate inched higher from 7.7% to 7.9% in July.

Market Impact (in Canadian dollar terms)

Developed-market equities continued to rally in August, while emerging markets were slightly negative as Brazilian stocks plummeted. Canadian stocks performed in the middle of the developed-market pack—outpacing Europe and the U.K. but lagging Japan and the U.S. Within Canadian sectors, financials had the best performance, trailed by industrials; health care was the worst performer, followed by consumer staples. Canadian small caps outperformed large caps during the month.

Fixed-income markets were mostly negative in August. Domestic markets were led again by real-return bonds, while most other segments declined, and government debt had the largest loss. U.S. high-yield bonds were down in U.S. dollar terms but performed well in currency-hedged terms. Emerging-market debt had the greatest selloff in the fixed-income universe during August.

Index Data (July 2020)

- The S&P/TSX Composite Index was up 2.35%.
- The FTSE Canada Universe Bond Index returned -1.13%.
- The S&P 500 Index, which measures U.S. equities, climbed 4.26%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, gained 3.22%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.96% (currency hedged) and -1.76% (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”—increased from 24.46 to 26.41 at month end.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, rose from US$40.27 on the last day of June to US$42.61 at the end of the month.
- The loonie strengthened versus the U.S. dollar; it ended the month at C$1.30 per U.S. dollar. The U.S. dollar was mixed versus the world’s other major currencies. It ended the month at US$1.34 against sterling, US$1.19 versus the euro and 105.91 yen.

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