Investor Appetites Fuel Broad Advance in Risk Assets

Monthly Market Commentary

August 2021

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- Investor risk appetite increased in most corners of the world during August as equities delivered strong performance in developed and emerging markets alike.
- The summer wave of COVID-19 cases appeared to peak in many countries beginning in mid-August, although Canada seemed to be a bit behind the curve.
- As vaccination rates slow in the developed world, more shots are becoming available to the rest of the world. We expect a rolling reopening of the global economy that will extend well into 2022.

Economic Backdrop

Investor risk appetite increased in most corners of the world during August. Equities delivered strong performance in developed and emerging markets alike, led by Japan and the U.S. within the major economies. European and U.K. shares also posted healthy returns, while China and Hong Kong were slightly down for the month. Globally, the financials sector was the top performer, while materials lagged with a modest decline.

Bonds were mostly a bit lower—aside from higher-risk segments like high-yield and emerging-market debt—as rates increased around the world. Short- to medium-term rates trailed the advance across the gilt yield curve, while they led the climb in eurozone government bonds. Intermediate-term U.S. Treasury rates rose by more than short- and long-term rates.

The U.S. dollar strengthened (according to the DXY Index), peaking in mid-August before giving back a majority of the month's advance. Prices were down across West-Texas Intermediate and Brent crude oil in August as OPEC+ (the Organization of the Petroleum Exporting Countries led by Saudi Arabia, plus Russia) continued to ramp up production.

Inflation-sensitive assets were subdued during the month. The Bloomberg Commodity Index registered a small loss in U.S. dollar terms, and the decline in U.S. Treasury Inflation Protected Securities (TIPS) essentially matched the slide in U.S. Treasurys of comparable maturities.

The summer wave of COVID-19 cases appeared to peak in many countries beginning in mid-August, led by the U.S. in terms of both new reported cases and daily deaths. Canada appeared to be slightly behind the curve. Cases were growing at the fastest rate in Montenegro, Georgia, Kosovo and Israel in late August. Regions contending with at- and near-peak cases were spread across the Western Pacific, the Balkans and the Greater Middle East, as well as the Caribbean and neighbouring countries.

Portugal caught up to the United Arab Emirates' lead on the share of their respective populations that had received at least one dose of COVID-19 vaccine (both around 85% at the end of August). The U.K. surpassed 70% of its population, while the U.S. approached 61%. South Korea was administering more vaccine doses per capita than any other country in late August. (Reuters: COVID-19 Vaccination Tracker)

France instituted the required use of the EU's digital health certificate beginning in early August for patrons to verify their COVID-19 vaccination status to gain access to restaurants, various modes of public transit, sports events, and other public gathering places. Italy also adopted the EU's certificate-based verification method during the month, although on a more limited basis, while Germany's certificate programme varied according to regional infection rates.

The German federal election, which concludes in late September, headed toward an increasingly clear outcome in the race to succeed Chancellor Angela Merkel. The Social Democrats (SPD)—led by Olaf Scholz, the current vice chancellor and finance minister—carved out a polling lead over Merkel's CDU/CSU, its current and traditional senior governing coalition partner.

The EU recommended limiting travel by Americans at the end of August as cases rose stateside, although it yielded the actual decision to member states, which mostly planned to remain open to U.S. tourists.

The Infrastructure Investment and Jobs Act—a plan negotiated by a bipartisan group of U.S. senators that would direct $1 trillion (and $550 billion in new spending) toward infrastructure projects over a five-year period—slipped off the front pages as August progressed. Scheduled congressional summer recesses and a near-universal occupation with the strained U.S. withdrawal from Afghanistan dominated priorities in Washington, DC. The final end-of-August departure of U.S. military troops concluded 20 years of military operations—the longest war in U.S. history—which culminated a decade ago with 100,000 troops stationed in Afghanistan.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) increased by 0.6% and 3.7%, respectively, for the month and year ending July. This represents a reacceleration in prices driven largely by gasoline, which is up over 30% from year-ago levels. Excluding gasoline, the CPI was up just 2.8% over the year. Producer price increases slowed as lumber prices declined 23% in July; still, prices remained sharply higher over the past year. The Industrial Product Price Index (IPPI) declined 0.4% in July, while the Raw Materials Price Index (RMPI) was up 2.2%. Over the past 12 months, the IPPI increased a robust 15.4% and the RMPI jumped 37.7%. The unemployment rate continued to trend lower in August; it declined 0.4% to 7.1%. Employment rose by 90,000 with the bulk of the gains (69,000) coming in full-time employment.

- U.S. manufacturing activity moderated in August, but remained in red-hot growth territory. New orders and production jumped, backlogs lengthened, and price pressures intensified, while employment contracted modestly. Services growth was strong in the U.S. during August, but remained on a softening trajectory following a remarkable period of expansion. New claims for U.S. jobless benefits trended toward 350,000 per week during August, spending an entire month below 400,000 for the first time since March 2020. Overall U.S. economic growth measured an annualized 6.6% during the second quarter, just above the first-quarter pace of 6.3%.

- U.K. manufacturing activity continued to rapidly expand at a pace in August that was in line with July’s levels, although supply-chain issues worsened (with average supplier lead times at their longest-recorded levels aside from April 2020’s early COVID-19-induced bottlenecks) even as output improved. Services growth also remained strong in the U.K. during August, but was well below the torrid pace that defined most of the first half of 2021. The U.K. claimant count (which calculates the number of people claiming Jobseeker’s Allowance) held at 5.7% of the population in July as the total number of claimants decreased from 2.30 million to 2.29 million. The broad U.K. economy grew by 4.8% during the second quarter and 22.2% year over year, up from -1.6% and -6.1%, respectively, during the prior quarter.

- Manufacturing growth in the eurozone continued to ease in August from its June record high, but still registered extraordinary strength. Relative country-level prospects narrowed as fast-growing countries (Netherlands, Ireland, Germany and Austria) moderated to multi-month lows, while slower growers (Italy, Spain and Greece) improved to multi-month highs, although France remained mired in slower growth. Eurozone services activity in August held just below July’s record pace of expansion (dating back to June 2006). The eurozone unemployment rate declined to 7.6% in July from 7.8% in June. The overall eurozone economy grew by 2.0% during the second quarter and 13.6% year over year, representing a marked improvement over the first quarter’s respective rates of -0.3% and -1.3%.

Central Banks

- As expected, the Bank of Canada (BoC) held its policy rate at a historically low 0.25% following its September 8 meeting. The BoC reiterated that it expects to hold rates low until inflation consistently exceeds 2% (the lower end of its target inflation band), which is not currently expected to occur until the second half of 2022. The next scheduled meeting is October 27.

- The Federal Open Market Committee (FOMC) also held no formal monetary policy meeting during August. Federal Reserve (Fed) Chairman Jerome Powell spoke at the Federal Reserve Bank of Kansas City's annual economic symposium in Jackson Hole—a historical platform for sharing significant evolutions in the central bank's outlook and policy actions—to reinforce that the FOMC could begin to taper, or reduce, asset purchases this year. The FOMC currently purchases $80 billion in U.S. Treasurys and $40 billion in agency mortgage-backed securities per month.

- The Bank of England's (BOE) Monetary Policy Committee (MPC) voted in early August to maintain its policy path: the bank rate remained 0.1% and the maximum allowance for asset purchases was unchanged at £895 billion.

- The European Central Bank (ECB) did not convene a meeting on monetary policy during August. During July, however, the central bank unveiled the results of a strategy review in which it adopted a symmetric inflation target of 2% over the medium-term (meaning that it views deviations above or below its target as undesirable) and an acknowledgement that it anticipates fluctuations over shorter time frames.

- The Bank of Japan (BOJ) had an August holiday from monetary policy meetings as well. It had shared details in mid-July about its green loan initiative, including extending 0% interest-rate credit to banks for their "green" lending efforts, waiving punitive negative interest rates for associated bank reserve requirements, and allowing foreign-currency bonds issued by Japanese companies to be eligible for the program.

Market Impact (in Canadian dollar terms)

Domestic equities posted modest overall gains led by information technology, communication services and industrials. Materials, consumer discretionary and energy declined, and smaller companies were nearly flat for the month. U.S. stocks generally continued to lead other developed markets. Emerging market returns were uneven, but overall gains were strong thanks to significant outperformance from India.

Fixed-income market returns were mixed and down slightly in aggregate. Riskier assets typically performed better; corporate bonds were modestly ahead of government debt. Real-return bonds were down while residential mortgages were up, and short-term bonds were essentially flat. In keeping with the "risk on" theme, U.S. high-yield bonds outperformed.

Index Data (August 2021)

- The S&P/TSX Composite Index was up 1.63%.
- The FTSE Canada Universe Bond Index returned -0.12%.
- The S&P 500 Index, which measures U.S. equities, gained 4.30%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, was up 3.76%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.56% (currency hedged) and 1.78% (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"—briefly spiked above 21 in mid-August, but ultimately moved lower from 18.24 at the end of July to 16.48 at the end of August.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, slid from US$73.95 on the last day of July to US$62.32 on August 20, before recovering to US$68.50 at the end of the month.
- The loonie weakened versus the U.S. dollar; it ended the month at C$1.26 per U.S. dollar. The U.S. dollar was modestly stronger versus the world's other major currencies. It ended the month at US$1.38 against sterling, US$1.18 versus the euro and 109.86 yen.

Index Definitions

The Bloomberg Commodity Index is composed of futures contracts and reflects the returns on a fully collateralized investment in the Index. This combines the returns of the Index with the returns on cash collateral invested in 13-week (3-month) U.S. Treasury bills.

The U.S. Dollar Index (DXY Index) measures the value of the U.S. dollar relative to a basket of other currencies, including the currencies of some of the US's major trading partners: the euro, Swiss franc, Japanese yen, Canadian dollar, British pound, and Swedish krona.

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