Markets Tumble as New Variant Complicates Return to Normal

Monthly Market Commentary

November 2021

- Global equities started November on promising footing. Shares advanced for the first week, then treaded water through mid-month before declining—modestly at first, and then sharply during the last week.
- U.S. Treasurys were the best-performing fixed-income segment, while emerging-market debt continued to sustain the deepest losses.
- This lowering of the bar for next year could allow for upward revisions in analysts' earnings estimates—assuming, as we do, that the renormalization of global economic growth gets back on track with wider vaccine distribution.

Economic Backdrop

Global equities started November on promising footing. Shares advanced for the first week, then treaded water through mid-month before declining, modestly at first, and then sharply during the last week.

Developed-market stocks continued to perform better than emerging markets. China, Hong Kong, the U.K. and Europe sustained sharp one-month drops. Japan's losses were less severe, and the slide in U.S. shares was mild compared to other major markets.

Short-term U.S. Treasury rates increased, while intermediate-to-long-term rates declined, resulting in a flatter yield curve. Government-bond rates declined across all maturities in the U.K. and eurozone; yields went negative on eurozone bonds with maturities all the way out to 30 years (negative yields were out to 12 years at the end of October). Treasurys were the best-performing fixed-income segment, while emerging-market debt continued to sustain the deepest losses.

Commodity prices reversed lower in November. The Bloomberg Commodity Index was mostly flat until a selloff during the last week of the month, finishing November down by 7.3%. Crude-oil prices moved slightly lower throughout the month, and then similarly tumbled to end November. The West Texas Intermediate crude oil price dropped by 20.8% for the full month, while the price of Brent crude fell by 17.3%.

Emergence of the omicron coronavirus variant in southern Africa was a key factor in rattling investors as November progressed. Omicron appears to contain significantly more mutations than other variants, which could potentially make it more effective in sidestepping neutralization by antibodies generated from earlier infections and vaccinations.

The U.S. reported the highest number of new COVID-19 infections per day at the end of November, followed by Germany, the U.K., France and Russia. Daily deaths associated with COVID-19 were highest in Russia, then the U.S., Ukraine, India and Poland.

Vaccination drives mirrored stock performance in November: the UAE, Cuba and Chile have the highest population shares with at least one dose of vaccine. The two best-performing country-level equity performances for the month were the UAE and Chile.

For the second time this fall, U.S. Congressional negotiators appeared on the verge of a last-minute agreement to fund the government in early December ahead of a funding lapse that would otherwise take effect on December 4. The agreement, which has already passed the House of Representatives, would provide funding through mid-February.

U.K. Chancellor of the Exchequer Rishi Sunak faced scrutiny from House of Commons Treasury Committees at the beginning of the month for tax increases included in his Autumn Budget. He contended that the revenue raisers—including a 1.25% bump in national insurance contributions set to begin in the spring, as well as a long-telegraphed increase in the corporations tax—are needed to fund necessary spending and intended to be temporary.

The cost side of the budget included a notable pair of adjustments for low-income workers: a reduction in the universal credit's taper rate (from 63% to 55%, meaning that the credit will phase out more slowly) and an annual £500 increase in work allowances. Brick-and-mortar stores will also see more relief via a temporary 50% cut in business rates and no increase in 2022.

Germany's new governing coalition came together in late November. The center-left Social Democrats (SPD, with 25.7% of the September election's vote share) will work with the progressive environmentalist Greens (14.8%) and pro-business Free Democrats (FDP, 11.5%). SPD leader Olaf Schultz will head the government as chancellor, while Christian Lindner, the FDP's leader, will serve as finance minister.

The coalition's policy pledges include a hefty environmental agenda, including an accelerated coal phase-out, greater reliance on rail transport, an ambitious goal for electric-vehicle adoption, and the promotion of an EU-wide air-travel surcharge. An increase in the minimum wage, plans to construct 400,000 apartments per year, and reforms to the immigration and citizenship eligibility system also made it to the top of the agenda.

Germany's "debt brake" will be re-instated in 2023, limiting government borrowing to 0.35% of GDP, and the FDP extracted a commitment to no new taxes or tax increases in order to join the coalition, raising the question about how the government will fund its goals.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) increased by 0.7% and 4.7%, respectively, for the month and year ending October. Energy prices, especially fuel oils and gasoline, have been driving inflation higher—excluding energy, the CPI was up 3.3% over the year. Producer price increases also accelerated. The Industrial Product Price Index (IPPI) was up 1.3% in October, while the Raw Materials Price Index (RMPI) was up 4.8%. Over the past 12 months, the IPPI jumped 16.7% and the RMPI rose 38.4%. The unemployment rate declined sharply, dropping 0.7% to 6.0% at the end of November. Employment rose by a robust 154,000 jobs and is now well above the pre-pandemic level, while the unemployment rate is just 0.3% above its pre-pandemic level.

- The U.S. manufacturing expansion continued at a high pace in November. Services activity remained strong during November despite moderating after October's sharp acceleration. New weekly U.S. jobless claims held just below 270,000 for most of November before declining to 194,000 later in the month, the lowest level since 1969. The broad U.S. economy grew at a 2.1% annualized rate during the third quarter, down from the second quarter's 6.7% pace.

- The expansion in U.K. manufacturing activity held in November at a strong pace of growth. Services growth settled slightly lower in November, but remained quite robust. The U.K. claimant count (which calculates the number of people claiming Jobseeker's Allowance) declined further in October by roughly 15,000 claimants, lowering the claimant share of the population from 5.2% to 5.1%. The U.K. economy expanded by 0.6% in September, improving on August's more modest growth and nearing its pre-coronavirus level of economic activity.

- Growth in eurozone manufacturing activity continued during November in line with the robust pace of the prior two months. Eurozone services growth strengthened in November after slowing in October. The eurozone unemployment rate continued to decline in September, hitting 7.4%. The overall eurozone economy expanded by 2.2% in the third quarter, in line with the second quarter's 2.1% rate.

Central Banks

- The Bank of Canada (BoC) did not meet in November and held its final 2021 policy meeting on December 8. As expected, the deposit rate remained unchanged at a historically low 0.25% following the meeting. The BoC reiterated its October projections that it expects to hold rates low until economic slack is absorbed and inflation consistently exceeds 2% (the lower end of its target inflation band), which is not expected to occur until the middle of 2022.

- The Federal Open Market Committee (FOMC) announced a long-anticipated timetable to reduce its asset purchase program following its early-November meeting. The central bank will shrink its monthly asset purchases by $15 billion—split between a $10 billion reduction in Treasury purchases (from purchases of $80 billion per month in October) and $5 billion in agency mortgage-backed securities (from purchases of $40 billion per month in October)—in November and again in December. Reductions were expected to continue until asset purchases conclude altogether in June 2022, although the pace can be adjusted "if warranted by changes in the economic outlook." At the end of November, in testimony to the U.S. Congress, Federal Reserve (Fed) Chair Jerome Powell expressed that high inflation could drive the FOMC to reduce asset purchases at an accelerated pace and conclude the program a few months earlier than planned. Powell was nominated for a second term as Fed Chair by President Biden during the month.

- The Bank of England's Monetary Policy Committee left its policy orientation unchanged at its early-November meeting, with the bank rate remaining at 0.1% and the maximum allowance for asset purchases at £895 billion. The central bank's November report on monetary policy upgraded its inflation forecast to peak at 5% in spring 2022, and indicated that a rate hike would be necessary if its economic outlook comes to pass.

- The European Central Bank (ECB) did not hold a meeting on monetary policy during November and continued to pursue a moderately lower pace of net asset purchases under the pandemic emergency purchase program (PEPP) than the target of approximately €80 billion per month that prevailed over the summer. The European Commission's Autumn Economic Forecast, released in November, showed inflation projections above the ECB's 2% target in 2021 and again next year, with import prices contributing steeply and compensation to a lesser extent.

- The Bank of Japan (BOJ) did not hold a monetary policy meeting during November. Its short-term interest rate remained at -0.1% and its 10-year government bond yield target held near 0%, while continuing open-ended asset purchases. The central bank downgraded its near-term consumer inflation forecast in its latest quarterly economic outlook.

Market Impact (in Canadian dollar terms)

Global equities faltered in late November due to fears the omicron variant may cause another COVID-19 spike. Canadian equities reversed course as healthcare, energy, industrials and smaller companies led the declines. Meanwhile, information technology and materials notched modest gains. U.S. equities were positive, although this was primarily due to currency fluctuations. Most other foreign developed markets were negative, although Japan posted slight gains. Chinese equities continued to struggled and weighed on emerging markets.

Fixed-income markets climbed as real-return bonds spiked higher thanks to falling rates and continued inflationary pressures. Government debt outperformed corporate bonds while residential mortgages had modest gains. U.S. high-yield fell on a currency-hedged basis as investors moved away from these risker bonds.

Index Data (November 2021)

- The S&P/TSX Composite Index was down 1.62%.
- The FTSE Canada Universe Bond Index returned 0.87%.
- The S&P 500 Index, which measures U.S. equities, gained 2.77%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, was up 1.00%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -1.07% (currency hedged) and 2.42% (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"—moved sharply higher from 16.26 at the end of October to 27.19 at the end of November.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, plunged from US$83.57on the last day of October to US$66.18 at the end of the month.
- The loonie notably weakened versus the U.S. dollar; it ended the month at C$1.28 per U.S. dollar. The U.S. dollar was generally stronger versus the world's other major currencies. It ended the month at US$1.32 against sterling, US$1.13 versus the euro and 113.55 yen.

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