Monthly Market Commentary
January 2022

Equities and Bonds Slid Into the New Year on Icy Patch

- **Global equities tumbled into the New Year with the largest one-month decline since March 2020. Value-oriented stocks fell by considerably less than their growth-oriented counterparts, while Canadian stocks were only down slightly.**
- **Government-bond rates rose across maturities in major developed markets; most fixed-income asset classes suffered losses.**
- **Although there have been pockets of speculative behaviour in some areas of the financial world, we do not see the sort of widespread frenzy that would point to a serious equity correction in 2022.**

Economic Backdrop

Global equities tumbled into the New Year with the largest one-month decline since March 2020. Volatility increased slightly during the first half of January, then marched higher before jumping erratically at the end of the month amid dramatic intraday price swings.

The specter of rising rates in the face of persistently high inflation, coupled with geopolitical uncertainty driven by Russia's military encirclement of Ukraine, were widely cited as sources of investor consternation.

Hong Kong and U.K. equities stood apart from other major markets as both registered positive performance in January. In emerging markets, huge gains in Latin America more than offset plummeting stocks in China; this resulted in a considerably smaller decline in emerging-market equities compared to the selloff in developed-market stocks. Japanese equities fell by less than the U.S., while Europe lagged both.

Value-oriented stocks fell by considerably less than their growth-oriented counterparts. (Value stocks are those that are considered to be cheap and are trading for less than they are worth and growth stocks exhibit steady earnings growth above that of the broader market.)

Government-bond rates rose across maturities in the U.S., U.K. and eurozone. Shorter-term rates were the largest gainers in the U.S., while intermediate-to-long-term rates increased by more than other maturities within the U.K. and eurozone.

Local-currency emerging-market debt was essentially flat in January, halting a string of recent negative performance; the rest of the fixed-income universe was negative. Investment-grade corporates had the steepest decline for the month. (Investment grade refers to the quality of a company's credit. To be considered an investment-grade issue, the company must be rated at 'BBB' or higher by Standard and Poor's or Moody's.)

Commodity prices continued a seemingly relentless climb. West-Texas Intermediate and Brent crude oil prices were up a respective 17.2% and 14.8% in January, while the Bloomberg Commodity Index advanced by 8.8%.

With a growing Russian military presence at Ukraine's border, Nord Stream 2—Russia's not-yet-operational (although completed) natural gas pipeline that runs along the Baltic seabed directly to Germany—became the subject of renewed Trans-Atlantic interest in late January given the leverage it would provide the Kremlin over Europe. U.S. senators introduced a bill directed at preventing the pipeline from being put into service. German Chancellor Olaf Scholz has been scheduled to visit President Joe Biden at the White House in early February.

U.S. deliveries of liquefied natural gas to Europe via cargo ships accounted for nearly half of the Continent's record imports in January—helping to restock depleted reserves as year-ago levels nearly tripled.

The U.S. deployed 2,000 troops to Germany and Poland, mobilized 1,000 troops to Romania, and ordered additional troops to stand by for deployment at the beginning of February, after having prepared an initial 8,500 troops to deploy in January.

Shortly after January's close, U.K. energy regulator Office of Gas and Electricity Markets (Ofgem) announced that a cap on energy prices is set to increase by more than 50% this spring, effectively guaranteeing dramatically higher household energy bills. The U.K. Treasury reportedly intends to help counteract rising living costs via discounts on energy bills, accommodative loans to suppliers, and larger disbursements this year from a reserve established to help low-income households cover spikes in fuel costs each winter.

Central Banks

- The Bank of Canada (BoC) held its first 2022 policy meeting on January 26. As expected, the deposit rate remained unchanged at a historically low 0.25% following the meeting. Notably, however, the BoC stated that economic slack has been removed and, as such, the extraordinary forward guidance on low interest rates was removed. Meanwhile according to its projections, the BoC expects economic growth to moderate from a robust 6.75% in 2021 to approximately 3.5% in 2022 and 2023. The next BoC meeting is scheduled for March 2.

- The Federal Open Market Committee (FOMC) met toward the end of January. In its post-meeting statement, the central bank affirmed its expectation that high inflation and a strong labour market will necessitate an increase in the federal-funds rate in the near future; Federal Reserve (Fed) Chair Jerome Powell echoed this in his press conference. The FOMC also confirmed a final $30 billion round of new asset purchases will take place in February before it can consider increasing rates, and it released a statement following its January meeting outlining its principles for reducing the size of its balance sheet. Powell had referred to high inflation as a severe threat earlier in January during his Senate reconfirmation hearing.

- The Bank of England's (BOE) Monetary Policy Committee (MPC) reconvened at the beginning of February for its first meeting since raising its bank rate in December 2021, and issued another increase—by 0.25% to 0.50%—for the first back-to-back rate hike in 18 years. A large minority of MPC members voted for a larger 0.50% increase to counteract high inflation. The central bank also said it intends to reduce the size of its balance sheet by ceasing to re-invest proceeds from its asset-purchase program.

- The European Central Bank (ECB) also held its inaugural meeting of 2022 at the beginning of February. It remained committed to the policy path it articulated in December—yet ECB President Christine Lagarde avoided affirming her recent expectation that a 2022 rate increase would be unlikely, and acknowledged that the widespread stress that inflation has caused will likely continue over the short term. She also said that asset purchases would need to conclude before rates can increase; this would necessitate a policy change as asset purchases are currently scheduled to continue on an indefinite basis once they decline in size over the course of 2022.

- The Bank of Japan (BOJ) was the first major central bank to hold a monetary policy meeting in the New Year as its governors convened in mid-January. While the central bank's policy orientation remained fixed—with the short-term interest rate at -0.1% and the 10-year government bond yield target near 0%—its expectations increased for higher inflation. The BOJ announced after its December meeting that it would revert purchases of corporate bonds and commercial paper to pre-pandemic levels beginning in April.

- The People's Bank of China (PBOC) cut its one-year-loan prime rate by 0.10% to 3.7% in January after having made a smaller cut in December and reducing its reserve-requirement ratio (which dictates the amount of money banks are required to hold in reserves) in the same month.

Economic Data (unless otherwise noted, data sourced to Bloomberg)

- According to Statistics Canada, the rate of inflation slowed (as measured by the change in the Consumer Price Index (CPI)) by 0.1% for December, but rose a robust 4.8% for the one-year period. The main drivers of inflation were higher costs for food, passenger vehicles and housing-related costs. Excluding gasoline, prices were up 4.0% over 12 months. Producer prices were mostly higher as well. The Industrial Product Price Index (IPPI) was up 0.7% in December, while the Raw Materials Price Index (RMPI) slid 2.9%. On a year-over-year basis the IPPI rose 16.1% and the RMPI jumped 29.0%. Energy prices were generally weaker in December, but remained significantly elevated from year-ago levels. Lumber costs were also up sharply for the year. Canada's labour market lost 200,000 jobs in January, pushing the unemployment rate up by 0.5% to 6.5%. Job losses resulted from the return of stricter public health measures due to the rapid spread of the COVID-19 Omicron variant.

- U.S. manufacturing growth remained healthy in January but continued to slow from the feverish pace that prevailed for most of 2021, reaching the lowest rate of expansion since late 2020. The expansion in U.S. services activity almost slowed to a halt in January after a long trend of healthy-to-red-hot levels that extended back to summer 2020. New weekly U.S. jobless claims climbed, peaking at 286,000 in mid-to-late January, as receding seasonal employment and a cresting COVID-19 Omicron wave put upward pressure on joblessness. The broad U.S. economy grew at a 6.9% annualized rate during the fourth quarter (up from the third quarter's 2.3% pace) and a 5.7% rate for the 12-month period ending December.

- The expansion in U.K. manufacturing activity remained strong in January, generally maintaining the same rate since autumn. U.K. services growth continued at a healthy but subdued pace in January, in line with the prior month. The U.K. claimant count (which calculates the number of people claiming Jobseeker's Allowance) declined in December for the tenth straight month, by roughly 43,000, lowering the claimant share of the population from 4.8% to 4.7%.

- Manufacturing activity in the eurozone sustained its sharp expansion in January, although at a softer rate than the surge that unfolded in the spring and summer of 2021. Growth in eurozone services activity remained modest during January after having returned to its slowing trend in December following a temporary burst of strength in November. The eurozone unemployment rate edged down by 0.1% to 7.0% in December, continuing a persistent decline that began in March 2021. Overall eurozone economic growth slowed to 0.3% in the fourth quarter from 2.2% in the third quarter, yet accelerated in the year over year to 4.6% from 3.9% for the one-year period ending September.

Market Impact (Referenced Index Returns are in CAD)

Equity markets began 2022 on a sour note; most major indexes and regions were down. Despite modest losses, Canadian equities were among the top performers for the month. Domestically, energy posted significant gains, followed at a distance by financials; notable laggards included information technology and healthcare. Smaller companies slightly trailed larger companies. With the notable exception of U.K., most foreign developed markets, including the U.S., were down. Emerging markets fared a bit better, but were still down, as Brazil helped push Latin America to strong gains even as other regions struggled.

Expectations for higher interest rates amid persistent inflation pummeled fixed-income markets. Real-return bonds performed particularly poorly due to their longer duration (higher sensitivity to interest rates) profile. Corporate debt slightly outperformed government bonds. Residential mortgages were the lone bright spot, posting a meager gain in January. U.S. high-yield bonds were also down.

Index Data (January 2022)

- The S&P/TSX Composite Index fell 0.41%.
- The FTSE Canada Universe Bond Index returned -3.40%.
- The S&P 500 Index, which measures U.S. equities, declined 4.53%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, dropped 4.26%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -2.08% (currency hedged) and -2.76% (unhedged).
- The Chicago Board Options Exchange Volatility Index, a measure of implied volatility in the S&P 500 Index that is also known as the "fear index," swung wildly during January as it moved from 17.22 to 24.83. Intra month, the VIX reached as high as 31.96.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, moved sharply higher from US$75.21 to US$88.15 a barrel to end January.
- The Canadian dollar weakened slightly to C$1.27 per U.S. dollar. The U.S. dollar was mostly stronger versus the world's other major currencies. It ended January at US$1.12 versus the euro, US$1.34 against sterling and at 115.23 yen.

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