Monthly Market Commentary
February 2022

Russian invasion rattles the world.

- Global equities saw their 2022 losses deepen during February, although they fell by less than in January. Russia was unsurprisingly the worst-performing country.
- Government-bond rates increased across maturities for the month, rising sharply through mid-February before partially retreating during the second half of the period.
- There are always uncertainties to consider when it comes to investing; currently, we are focused on geopolitical risk and the economic fallout from Russia's invasion of Ukraine.

Economic Backdrop

Global equities saw their 2022 losses deepen during February, although they fell by less than in January. Russia was unsurprisingly the worst-performing country, with the MSCI Russia Index plunging by 52.75% for the month; shares cratered as its invasion of Ukraine invited sanctions from around the world that crippled its financial markets.

Russia (which accounted for roughly 3% of the MSCI Emerging Markets Index as of January 31, 2022) weighed on emerging markets, which slightly lagged developed markets in February. A boost from commodity exporters in Latin America helped to minimize the gap between emerging- and developed-market performances.

Among major equity markets, the U.K. was the best performer with a small gain. Japan declined but fared better than both Europe and the U.S., while Hong Kong and China had steeper selloffs.

Value-oriented shares continued to fall 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.) Globally, the only equity sectors with positive performance were materials and energy.

Government bond rates increased across maturities in the U.S., U.K. and eurozone during February. Rates rose sharply through mid-month before partially retreating during the second half of the month. Long-term U.S. Treasury yields fell significantly in late February, flattening the Treasury yield curve.

Emerging-market debt plummeted during the month, most sharply within local-currency assets, and most other areas of fixed income were also down. Inflation-indexed securities were positive.

Commodity prices made a subdued advance for most of February before catapulting higher in the final days of the month (and into the beginning of March) as markets reacted to the unfolding attack on Ukraine. The Bloomberg Commodity Index increased by 6.2% in February, while Brent and West-Texas Intermediate crude oil prices gained 9.8% and 8.6%, respectively, before racing past the $100 per barrel mark on March 1. Russian oil prices actually declined at the end of February as refiners and lenders began to limit financial commitments with Russian producers.

Ukraine’s emergency service reported in early March that more than 2,000 civilians had been killed during Russia’s invasion. The Russian Defense Ministry stated that 498 soldiers had been killed and more than 1,500 wounded, significantly below the 5,800 Russian casualties reported by Ukrainian officials. Approximately one million Ukrainians had fled their country by early March.

Western nations responded to Russia's offenses with an array of sanctions, bans, and other coordinated actions—largely focused on disrupting the country's financial, energy, technology and transportation activities, as well as state-owned enterprises and high-profile individuals in public and business positions.

In addition to having mounted a fierce resistance to Russia's invasion, Ukraine submitted a formal application for admission to the EU. NATO activated its Response Force for the first time, calling up 40,000 troops to bolster the eastern part of the alliance in the face of intensifying aggression toward Ukraine.

The European Commission, France, Germany, Italy, the U.K., Canada, and the U.S. committed to removing Russian banks from the SWIFT (Society for Worldwide Interbank Financial Telecommunication) messaging system for financial payments; block the Russian Central Bank from deploying its international reserves; limit the sale of citizenship to wealthy Russians; and launch a transatlantic task force to freeze the assets of sanctioned entities.

In practice, the moves have essentially blocked Russian entities from trade in major foreign currencies. Upon imposition of these coordinated sanctions, the Russian Central Bank was forced to hike its benchmark rate from 9.5% to 20%; offer unlimited liquidity support to banks as they faced runs; raise capital controls on exporters and residents; and shutter its financial markets.

Corporations across industries began to disentangle their relationships with Russia and Belarus at the end of February and in early March. Major energy companies announced withdrawals from Russian partnerships, including BP's large stake in Rosneft and joint ventures involving Exxon Mobil, Shell, Total and others.

Russian airlines were banned from Western airspace, largely crippling Russia's ability to maintain an international flight industry. Boeing and Airbus announced they would stop providing parts and services to Russian companies, which is expected to disrupt Russian domestic flight as well.

Central Banks

- The Bank of Canada (BoC) raised the policy interest rate by 0.25% to 0.50%. This move was largely expected as inflation has been running higher than the BoC target, which the central bank reiterated was the mid-point of a range of 1% to 3%. The BoC noted that more rate hikes will likely be needed to bring inflation into the target range. The possibility of quantitative tightening (that is, when the BoC would allow its government bond holdings to decline) in the future is another inflation-fighting tool at the bank's disposal.

- The Federal Open Market Committee (FOMC) did not hold a meeting in February. Federal Reserve (Fed) Chair Jerome Powell stated at the beginning of March that he thinks a 0.25% increase in the fed-funds rate would be appropriate; if enacted at the FOMC's mid-March meeting, this would be the central bank's first rate hike since December 2018. The FOMC made a final $30 billion round of new asset purchases in February after releasing a statement in January outlining principles for reducing the size of its balance sheet.

- 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 its first back-to-back rate hike in 18 years with an increase of 0.25% to 0.50%. (A large minority of MPC members voted for a more aggressive 0.50% increase to counteract high inflation.) Additionally, the central bank 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, after which ECB President Christine Lagarde acknowledged that the widespread stress inflation has caused will likely continue over the short term. Following Russia's invasion of Ukraine, Lagarde pledged that the ECB "will ensure smooth liquidity conditions and access of citizens to cash," and that it "stands ready to take whatever action is needed to fulfil its responsibilities to ensure price stability and financial stability in the euro area."

- The Bank of Japan (BOJ) also held no meetings on monetary policy in February. The central bank's policy orientation remained fixed following its mid-January meeting, with its short-term interest rate at -0.1%

and the 10-year government bond yield target near 0%—but its expectations increased for higher inflation. Previously, the BOJ announced that it would revert purchases of corporate bonds and commercial paper to pre-pandemic levels beginning in April.

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

- According to Statistics Canada, the rate of inflation increased (as measured by the change in the Consumer Price Index (CPI)) by a brisk 0.9% for January, and 5.1% for the one-year period—the first time annual inflation has been above 5% since 1991. The main drivers of inflation were higher costs for goods and services, particularly housing, food and gasoline. Producer prices were dramatically higher as well. The Industrial Product Price Index (IPPI) was up 3.0% in January, while the Raw Materials Price Index (RMPI) rose 6.5%. On a year-over-year basis the IPPI climbed 16.9% and the RMPI jumped 30.5%. Prices for crude oil, fuels and lumber were notably higher.

- After cooling slightly in December and January, the still-robust pace of U.S. manufacturing growth accelerated in February as new orders growth jumped and employment growth slowed. Growth in the U.S. services sector accelerated sharply in February after nearly pausing altogether in January. New U.S. jobless claims moderated in February, ranging between 200,000 and 250,000 per week during the month. U.S. economic growth outpaced expectations in the fourth quarter of 2021, accelerating to an annualized pace of 7.0% from an annualized pace of 2.3% in the prior quarter.

- U.K. manufacturing growth edged upward in February, returning to the high side of the generally strong expansion that has prevailed over the last six months. U.K. services activity exploded in February after cooling to a more modest expansion in December and January. The U.K. claimant count (which calculates the number of people claiming Jobseeker's Allowance) declined in December for the eleventh straight month, by roughly 32,000.

- Manufacturing growth in the eurozone remained strong in February, expanding at roughly the same pace as it has since September. The eurozone services sector leapt to heathier growth levels in February after slowing to a relatively anemic expansion in December and January. An early estimate of eurozone consumer price inflation measured 0.9% in February and 5.8% year over year, up from 0.3% and 5.1%, respectively, in January.

Market Impact (Referenced Index Returns are in CAD)

Canadian equities were among the market leaders in February as domestic large companies posted modest gains, while small companies were impressive as they benefited from sharply higher commodity prices. Elsewhere, global equity markets struggled with high inflation, the prospect of rising interest rates combined with slowing future growth, and the Russian invasion of Ukraine. As most regions struggled, Brazil was a notable standout with strong gains; U.S. small companies and U.K. equities were also moderately positive.

Fixed-income markets withered in the face of stubborn inflation and expectations for higher rates. Residential mortgages continued to produce moderate gains. Corporate debt outperformed government bonds, while real return and short-term bonds were down slightly. U.S. high-yield bonds, which are risky and more correlated to equity markets than most fixed-income assets, were down as well.

Index Data (February 2022)

- The S&P/TSX Composite Index rose 0.28%.
- The FTSE Canada Universe Bond Index returned -0.72%.
- The S&P 500 Index, which measures U.S. equities, declined 3.26%.
- 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 -0.89% (currency hedged) and -1.16% (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"—remained elevated, ending the month at 30.15 following the Russian invasion of Ukraine.
- WTI Cushing crude oil prices—a key indicator of movements in the oil market—moved notably higher from US$88.15 to US$95.72 a barrel to end February. Prices continued to move higher in early March as strong demand has been met with dwindling supply. Strong sanctions and now non-existent demand from Western countries for Russian oil exacerbated the price movements.
- The Canadian dollar was unchanged at C$1.27 per U.S. dollar. The U.S. dollar was little changed versus the world's other major currencies as well; it ended February at US$1.12 versus the euro, US$1.34 against sterling and at 115.18 yen.

MSCI Russia Index is designed to measure the performance of the large and mid-cap segments of the Russian market. With 26 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Russia. The MSCI Russia Index was launched on January 1, 2001.

MSCI Emerging Markets Index is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities.

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