Monthly Market Commentary

July 2022

Cooling economic activity ignites market rebound.

- The selloff that shaped the first half of 2022 came to a halt as equities and fixed-income asset classes rallied, recovering at an accelerating pace as the end of July approached.
- Equity performance patterns reversed during July, with U.S. stocks leading major markets. Canadian and European stocks had large one-month gains, while U.K. stocks trailed but nevertheless benefitted from a large rebound.
- There is no denying that rising interest rates will slow economic growth. But changes in monetary policy affect the economy with a long and variable lag. While the financial strength of businesses and households is likely to ebb, the starting point is a very high one.

Economic Backdrop

The selloff that shaped the first half of 2022 came to a halt as equities and fixed-income asset classes rallied in July. Stocks and bonds moved sideways during the first half of the month after climbing off a bottom in mid-June, and then recovered at an accelerating pace as the end of July approached.

Data showing softening economic activity counterintuitively provided investors with a confidence boost, as slower growth and milder inflation would likely mean that central banks won't need to increase rates as much as feared, thereby keeping a lid on borrowing costs.

Equity performance patterns reversed, with U.S. stocks leading major markets after delivering one of the second quarter's worst performances. Japan also had a large one-month gain, as did Europe; U.K. stocks trailed these markets, but nevertheless benefitted from a large rebound in July. Emerging-market equities, meanwhile, generated a small loss as China's second-quarter rebound faltered.

Growth-oriented stocks outpaced their value-oriented counterparts during the month, although the difference was considerably greater within large-cap equities than in small caps.

Short-term U.S. Treasury rates increased, while medium-to-long term rates fell, resulting in a flatter curve that also grew more inverted (that is, when shorter-term rates are higher than longer-term rates). U.K. and eurozone government bond rates fell across most maturities in July, with the steepest declines in the medium-to-long-term segment of the yield curve.

The U.S. dollar ended the month slightly higher than where it began (measured by the U.S. Dollar Index), after its 13-month climb began to reverse in mid-July.

High-yield bonds were the best-performing fixed-income asset class in July in keeping with the resurgent appetite for risk. Most other segments of the bond market were also positive given the general decline in rates (yields and prices have an inverse relationship).

Commodity-price movements were mixed in July. The Bloomberg Commodity Index advanced by 4.08%, but Brent and West-Texas Intermediate crude oil prices slid 6.75% and 4.64%, respectively, and wheat prices fell by 8.63%. Natural gas prices, meanwhile, increased by 52.69% for the full month.

Europe's pipeline-supplied natural gas came under renewed threat at the end of July as Russia cut deliveries to 20% of capacity for the Nord Stream 1 pipeline. The threat of undersupply inhibits Europe's ability to stockpile gas for the high-consumption winter months. EU nations have voluntarily agreed to reduce gas usage by 15% until March 2023 as a partial remedy.

Ukraine's Minister of Infrastructure declared that the "…first grain ship since Russian aggression has left port" on August 1 after the countries struck a UN-Turkey brokered agreement in late July. The ship carried corn destined for Lebanon; approximately 22 million tons of grain that have been awaiting shipment for months may now be transported along agreed-upon safe corridors. Sanctions on Russian grain and fertilizer exports have also been loosened as part of the deal.

U.K. Prime Minister Boris Johnson announced in early July his intention to resign once the Conservative Party elects a new leader. The succession race has boiled down to Liz Truss, the current Foreign Secretary, and Rishi Sunak, the recent Chancellor of the Exchequer. Truss appeared to have the edge at the end of July.

Mario Draghi resigned as Italy's Prime Minister in late July as a confidence vote revealed that he no longer had the backing of the coalition underpinning his national unity government. Elections are scheduled for late September.

The U.S. Congress passed legislation in late July to appropriate $50 billion toward domestic development of semiconductor chip manufacturing and advanced technological research. Semiconductor scarcity has cascaded into an array of supply shortages; the industry's concentration—with an overwhelming majority of production originating in Taiwan—is viewed as a national security risk given China's claim to the territory. President Joe Biden signed the legislation into law on August 2.

Chinese and U.S. military posturing escalated in the vicinity of Taiwan toward the end of July as Nancy Pelosi, the Speaker of the House of Representatives (one of the two deliberative bodies that comprise the U.S. Congress), prepared to visit the territory in addition to Japan, South Korea, Malaysia, and Singapore. Pelosi has been critical of China's authoritarian rule and human-rights record for several decades.

Central Banks

- The Bank of Canada (BoC) raised the policy interest rate by 1.00%, to 2.50%. This was the fourth consecutive rate hike, and a larger hike than was generally expected. The BoC's Governing Council indicated that it preferred to front-load the rate hikes in an effort to bring down inflation. BoC projections are for slower growth ahead, yet the central bank stands ready to continue rate hikes to combat inflation. The BoC's next scheduled meeting is for September 7.

- The Federal Reserve's (Fed) Federal Open Market Committee (FOMC) increased the federal-funds rate by 0.75% toward the end of July—the second hike of its size in this tightening cycle—bringing the benchmark rate to a range between 2.25% and 2.50%. The central bank has also begun to reduce its balance sheet, allowing Treasurys and mortgages to run off (that is, mature without being replaced) at maximum respective paces of $30 billion and $17.5 billion per month in July and August (and rising in September to $60 billion and $35 billion per month, respectively).

- The European Central Bank (ECB) increased its three benchmark rates by 0.50% at its July meeting for the first time in 11 years, surprising investors who were expecting hikes of 0.25%. At the same meeting, the ECB approved the establishment of a Transmission Protection Instrument (TPI) to ensure the smooth transmission of monetary policy normalization across eurozone countries. According to the ECB, the TPI "can be activated to counter unwarranted, disorderly market dynamics" by making "secondary market purchases of securities issued in jurisdictions experiencing a deterioration in financing conditions."

- The Bank of England's (BoE) Monetary Policy Committee (MPC) did not hold a meeting in July after increasing the bank rate to 1.25% in June and redeeming about £3.2 billion in balance sheet assets during July. At its early August meeting, the MPC hiked its benchmark rate by 0.50%, to 1.75%, the largest individual rate increase in 27 years.

- The Bank of Japan (BOJ) remained committed to loose policy at its July meeting. Its short-term interest rate remained at -0.1%, and the 10-year Japanese government-bond (JGB) yield target held near 0%. The central bank continued to offer purchases of 10-year JGBs at 0.25% in order to keep its yield within the BOJ's acceptable range.

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 0.7% for June, and 8.1% for the one-year period—both figures remained well above the BoC's preferred range and the one-year number was the highest in nearly four decades. Inflation was broad-based, led by transportation and fuel costs. Producer price increases eased, but were still notably elevated from a year ago. The Industrial Product Price Index (IPPI) declined 1.1% in June, while the Raw Materials Price Index (RMPI) ticked down 0.1%. On a year-over-year basis, the IPPI climbed 14.3% and the RMPI jumped 32.4%. Prices for energy and petroleum products remained strong, while costs for lumber eased considerably. The labour market contracted by 31,000 jobs in July, but the unemployment rate was unchanged at 4.9%.

- The personal consumption expenditures price index (the Federal Reserve's preferred inflation measure) jumped to 6.8% year over year through June, from 6.3% in May, setting a new record dating to early 1982. Manufacturing growth in the U.S. slowed modestly in July, essentially preserving a mild expansion after declining sharply in June. U.S. services activity tumbled into contraction during July after attaining low growth in May and June. U.S. job openings fell in June, from 11.3 million in May, to 10.7 million. The number of unemployed Americans measured 5.91 million, meaning that there were about 1.8 jobs available for every jobseeker. The overall U.S. economy contracted during the second quarter by an annualized 0.9% after declining by 1.6% during the first quarter.

- Consumer prices in the U.K. jumped by 0.8% in June and 9.4% over the prior year—up from 0.7% and 9.1%, respectively, in May—and setting a new 40-year high for the year-over-year inflation rate. U.K. manufacturing activity settled further into low-growth territory during July for the third consecutive month of slowing expansion. Growth in the U.K. services sector held at modest-but-healthy levels in July that were roughly in line with May and June's expansion. The U.K.'s claimant count (which calculates the number of people claiming Jobseeker's Allowance) declined in June for the sixteenth consecutive month—by about 20,000, with total claimants representing 3.9% of the population in June compared to 4.0% in May. The U.K. economy expanded by 0.4% in the three months to May 2022 and by 3.5% over the prior 12 months. These growth rates were slower than the first quarter rate of 0.8% (and 8.7% for the year through March).

- Consumer prices increased by 0.1% in the eurozone during July, and 8.9% over the prior year, versus 0.8% and 8.6% in June. July's year-over-year inflation figure was the highest since Eurostat began tracking data in 1997. The eurozone unemployment rate held at 6.6% in June—the lowest level since Eurostat began recording employment data in 1998. Eurozone manufacturing began to contract during July, albeit modestly, continuing an uninterrupted decline in activity from January's peak. The expansion in eurozone services activity continued to grind lower from a springtime peak, nearing a standstill in July. The eurozone economy grew by 0.7% during the second quarter and 4.0% year over year, compared to 0.5% and 5.4%, respectively, in the first quarter.

Market Impact (Referenced Index Returns are in CAD)

Global equity markets, led by the U.S., staged a sharp rally in July. Notable developed markets with significant gains included Japan, Canada, and Europe. Domestic gains were broad based, led by industrials, information technology, and the consumer sectors; meanwhile, health care and materials declined. Most emerging-market countries posted gains; however, emerging markets in total were down as China suffered double-digit losses. Volatility has continued to ease.

Bonds also rallied impressively despite persistently high inflation and central banks tightening monetary policy across the globe. Real-return bonds were up the most, while government debt outperformed corporate issues. Short-term bonds were also positive, but residential mortgages bonds continued to fade in the face of an uncertain housing market that is dealing with higher mortgage rates. Riskier U.S. high-yield bonds notched impressive gains.

Index Data (July 2022)

- The S&P/TSX Composite Index was up 4.66%.
- The FTSE Canada Universe Bond Index returned 3.90%.
- The S&P 500 Index, which measures U.S. equities, jumped 8.49%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, gained 6.27%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 5.98% (currency hedged) and 5.31% (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"—eased from 28.71 to 21.33.
- WTI Cushing crude oil prices—a key indicator of movements in the oil market—moved lower from US$105.76 to US$98.62 a barrel to end July.
- The Canadian dollar strengthened to C$1.28 per U.S. dollar. The U.S. dollar was mixed versus the world's other major currencies; it ended July at US$1.02 versus the euro, US$1.22 against sterling and at 133.65 yen.