Monthly Market Commentary

August 2022

The sun sets on summer's rebound.

- Summer break ended early for the equity market as the rally that started in June began to cool by mid-August. Market watchers attributed the reversal to the Federal Reserve—along with several other central banks, including the Bank of Canada—reaffirming their commitment to overcoming high inflation despite anticipated economic pain.
- The bond market's early-summer rebound faltered even sooner in August as interest rates climbed around the world (yields and prices have an inverse relationship).
- There is no denying that rising interest rates slow economic growth. But the timeline remains to be determined since changes in monetary policy affect the economy with a long and variable lag.

Economic Backdrop

Summer break ended early for the equity market as the rally that started in June began to cool by mid-August. Stocks then began a concerted selloff that lasted through the end of the month. Developed-market equities led the slide; while emerging-market shares followed a similar path, they ended August essentially flat due to a milder decline.

Market watchers attributed the rally's reversal to signaling from the Federal Reserve (Fed) that it remains committed to overcoming high inflation despite anticipated economic pain. The Fed's annual Jackson Hole conference for central bankers once again served as a forum to deliver a forceful message on its priorities. Fed Chair Jerome Powell opened the conference by explaining that lower growth and softer labour markets will likely be the unfortunate costs of hiking rates to fight inflation, and that expectations for a premature pivot to looser policy will probably be disappointed.

European shares tumbled harder than other developed-market regions in August, departing from a recent pattern of U.S.-led market action. U.K. shares also declined significantly, while the U.S. and Hong Kong fared less poorly. Japanese equities suffered the mildest slide among major developed markets. Mainland Chinese shares were slightly positive.

The bond market's early-summer rebound, which began at roughly the same time as the bounce in equities, faltered at the start of August as interest rates climbed around the world (yields and prices have an inverse relationship). Government bond rates rose across the yield curve in the U.S., U.K., and eurozone during August, with shorter-term rates outpacing longer-term rates on the upside. The greater move in shorter-term rates lengthened the inversions (that is, when shorter-term rates are higher than longer-term rates) along the Treasury and U.K. gilt yield curves.

Government bonds from developed markets outside of the U.S. were the worst performers in fixed income for the month—trampled by rising rates combined with the accelerating (near-relentless) climb in the U.S. dollar (measured by the U.S. Dollar Index). Local-currency denominated emerging-market debt had the bond market's mildest loss for the month.

The Bloomberg Commodity Index was barely changed for the full month, with a mere 0.16% decline that masked much sharper moves by individual commodity prices. West-Texas and Brent Intermediate crude oil spot prices dropped in August by 9.93% and 8.68%, respectively, while natural gas prices jumped by 11.30%. Wheat prices climbed by 3.10%.

The Group of 7 (G7) set a price cap on Russian oil at the beginning of September, enforced by refusing to allow or underwrite maritime transportation at prices above the threshold. More than 90% of seaborne shipping is insured by G7 member countries, and the U.K. serves an outsized role in the insurance trade.

The threat to Europe's access to natural gas increased as Russia's Gazprom closed the Nord Stream 1 pipeline at the end of August for maintenance, and then announced in early September that it would remain closed for longer than initially projected.

Ukraine mounted a counteroffensive in late August that targeted the region around Kherson, which is in the southern part of the country that has been occupied by Russia since shortly after its invasion.

Russia announced joint military drills with China, India, and other nations taking place in its far east and the Sea of Japan during early September. The exercises will include more than 50,000 troops and 60 warships.

Central Banks

- The Bank of Canada (BoC) raised the policy interest rate by 0.75%, to 3.25%, on September 7. This was the fifth consecutive rate hike, bringing the cumulative increase for 2022 to 3.0%. The BoC's Governing Council noted that while headline inflation eased some, core measures of inflation (those that exclude more volatile items, such as fuel) actually increased, indicating that upward price pressures remained broad based. Given this outlook, the BoC has signaled more rate hikes to come, along with continued quantitative tightening (that is, the reduction of its balance sheet).

- The Federal Open Market Committee (FOMC) did not meet in August after increasing 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 August (and then $60 billion and $35 billion per month, respectively, in September).

- At its early August meeting, the Bank of England's (BoE) Monetary Policy Committee hiked its benchmark rate by 0.50% to 1.75%, the largest individual increase in 27 years.

- The European Central Bank (ECB) did not hold a meeting on monetary policy during August. At its July meeting, the ECB increased its three benchmark rates by 0.50% rather than the expected 0.25% hikes for the first time in 11 years. 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 Japan (BOJ) did not convene a monetary policy meeting in August but remained committed to its loose-policy orientation 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 0.1% for June, and 7.6% for the one-year period—both figures remained well above the BoC's preferred range. The headline inflation numbers were lower than previous reports as gasoline prices eased. Otherwise, inflation remained broad based, led by transportation and food costs. Producer prices eased in July, but were still notably elevated from a year ago. The Industrial Product Price Index (IPPI) declined 2.1% in July, while the Raw Materials Price Index (RMPI) fell 7.4%. On a year-over-year basis, the IPPI climbed 11.9% and the RMPI rose 19.1%. Prices for petroleum products, metals and crops declined in July even though year-ago prices remained strong. The labour market contracted by 40,000 jobs in August, while the unemployment rate rose to 5.4%.

The Personal Consumption Expenditures Price Index (the Fed's preferred inflation measure) fell to 6.3% year over year through July from 6.8% in June, easing off a 40-year record high. Manufacturing growth in the U.S. continued to slow in August, reflecting a modest expansion after declining sharply in June. U.S. services activity shrank at an accelerating pace in August after tumbling into contraction during July. U.S. nonfarm payrolls increased by 315,000 in August, but the unemployment rate climbed to 3.7% (from 3.5% in July) as the labour-force participation rate increased (thereby expanding the pool of potential workers). U.S. job openings rose to 11.24 million during July from 11.04 million in June. The number of unemployed Americans measured 5.67 million in July, meaning there were about two jobs available for every jobseeker. The overall U.S. economy contracted during the second quarter by an annualized 0.6% after declining by 1.6% during the first quarter.

Consumer prices in the U.K. increased in July by 0.6% during the month and 10.1% over the prior year—up from 0.8% and 9.4%, respectively, in June—and setting a new 40-year high for the year-over-year inflation rate. U.K. manufacturing activity began to contract during August following three months of slowing growth. The U.K. services sector continued to expand at modest-but-healthy levels in August that were roughly in line with the prior three months. The U.K.'s claimant count (which calculates the number of people claiming Jobseeker's Allowance) declined in July for the seventeenth consecutive month—by about 11,000—with total claimants holding firm at 3.9% of the population. The U.K. economy contracted by 0.1% in the second quarter of 2022 (compared to growth of 0.8% in the first quarter) and expanded by 1.9% over the 12 months through June (after gaining 8.7% for the prior one-year period).

Eurozone consumer prices increased in August by 0.5% for the month and 9.1% over the prior year, versus respective gains of 0.1% and 8.9% in July. August'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 July for the third straight month—retaining the lowest level since Eurostat began recording employment data in 1998. A modest contraction in eurozone manufacturing activity that began in July continued through August. The expansion in eurozone services activity essentially ground to a standstill in August after peaking this spring. The eurozone economy grew by 0.6% during the second quarter and 3.9% year over year, compared to 0.5% and 5.4%, respectively, in the first quarter.

Market Impact (Referenced Index Returns are in CAD)

Global developed equity markets stumbled as the summer rally fizzled out. Europe and the U.K. struggled as the Russia-Ukraine war has hit closer to home and natural gas shortages appear likely on the continent. Japan, Canada and the U.S. recorded more modest losses. Emerging markets fared much better, led by Brazil and India. China was also up, but to a lesser degree.

Fixed-income markets remained severely hampered by central bank rate hikes and quantitative tightening policies. Real-return bonds led the way down. Government bonds and corporate debt were also down. Meanwhile, short-term bonds and residential mortgages posted slight gains. Riskier U.S. high-yield bonds were also down.

Index Data (August 2022)

- The S&P/TSX Composite Index was down 1.61%.
- The FTSE Canada Universe Bond Index returned -2.74%.
- The S&P 500 Index, which measures U.S. equities, slid 1.96%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, lost 1.56%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -2.44% (currency hedged) and -0.24% (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”—increased from 21.33 to 25.87.
- WTI Cushing crude oil prices—a key indicator of movements in the oil market—moved lower from US$98.62 to US$89.55 a barrel to end August.
- The Canadian dollar weakened to C$1.31 per U.S. dollar. The U.S. dollar was also stronger versus the world’s other major currencies; it ended August at US$1.01 versus the euro, US$1.16 against sterling and at 138.63 yen.