Monthly Market Commentary
January 2023

“January effect” kicks off the New Year.

- Most equity markets rallied into the New Year as generally positive economic data globally bolstered investor optimism, with emerging markets outperforming their developed-market counterparts for the month.
- Fixed-income asset classes ended January in positive territory amid declining bond yields (yields and prices have an inverse relationship).
- “Stagnation” is the best way to describe the state of the global economy, but several regions will likely enter recession in the coming months.

Economic Backdrop

Most global stock markets began 2023 with a strong rally, bolstered mainly by investor optimism amid generally positive economic data and signs that the U.S. Federal Reserve (Fed) will continue to slow the pace of interest-rate hikes. It appears that the so-called “January effect”—which theorises that the financial markets (particularly small-cap stocks) tend to gain more in January than in any other month—has once again prevailed. Emerging-market equities performed particularly well, with Latin America and Emerging Asia generating the greatest returns. Within developed-market equities, gains in the U.S. continued to lag amid ongoing weakness in the U.S. dollar, which boosted the performance of non-dollar-denominated stocks in international markets.

U.S. fixed-income assets generally garnered strong returns in January as bond yields declined (yields and prices have an inverse relationship). High-yield and investment-grade corporate bonds performed in line with each other, outpacing mortgage-backed securities (MBS) and U.S. Treasurys. All Treasury yields with maturities of one year or greater declined during the month, with the intermediate- and long-term segments of the yield curve falling further than short-term yields. Consequently, the yield curve remained inverted (short-term yields exceeded long-term yields).

Regarding the global commodities markets, prices generally decreased during January. The West Texas Intermediate crude-oil spot price was down 1.4% while Brent crude oil fell by 0.4% amid concerns about additional interest-rate hikes from central banks and an increasing supply of Russian crude oil. The NYMEX natural gas price declined by 34% as an unusually mild winter in the U.S. resulted in lower demand and higher inventories. Wheat prices decreased by 3.8% after Russia renewed a deal with the UN, Ukraine, and Turkey that allows the shipment of Ukrainian grain through the Black Sea.

U.S. Treasury Secretary Janet Yellen announced that the Treasury Department began taking “extraordinary measures” after the government reached its $31.4 trillion borrowing limit on January 19. In the U.S. House of Representatives, leaders of the newly elected Republican majority indicated that they would not approve an increased debt limit (commonly referred to as the debt ceiling) unless the administration of President Joe Biden, a Democrat, agrees to specific spending cuts. Yellen estimated that the U.S. government might run out of money and be unable to meet its financial obligations in early June if the House of Representatives does not vote to raise the debt ceiling. She urged Congress to “act promptly to protect the full faith and credit of the United States.”

The International Monetary Fund (IMF) projected that the U.K. will be the lone member of the G7 (an intergovernmental political forum representing the world’s most advanced economies) to face a recession in 2023. According to the IMF, the U.K.’s gross domestic product (GDP) will likely decline by 0.6% this year—a dramatically weaker forecast compared to its initial estimate of 0.3% economic growth issued in October 2022—due to the government’s tighter fiscal and monetary policies. Following the release of the IMF report, U.K.

Chancellor Jeremy Hunt issued the following statement: “The governor of the Bank of England recently said that any U.K. recession this year is likely to be shallower than previously predicted. We are not immune to the pressures hitting nearly all advanced economies. Short-term challenges should not obscure our long-term prospects.” Separately, in a late-January speech to business lobbyists, Hunt outlined his plan to boost economic growth; the U.K. government’s budget proposal, scheduled to debut in mid-March, will not include sizeable tax cuts as the government focuses on curbing inflation. Several members of the lobbyist group expressed concerns about the plan’s lack of new policies and the absence of assistance pledged for smaller businesses.

The U.S., Germany, and several other European allies agreed to send tanks to Ukraine in support of its defense against Russia’s ongoing brutality. The U.S. plans to provide 31 M1 Abrams tanks. Germany agreed to send 14 Leopard2 tanks and plans to work with other European countries to create two tank battalions of Leopard2s, which is equivalent to roughly 90 tanks.

Central Banks

- The Bank of Canada (BoC) raised the policy interest rate by 0.25%, to 4.50%, on January 25 and continued reducing the amount of bonds it holds on its balance sheet—a policy known as quantitative tightening. This was the eighth consecutive rate hike, albeit smaller than previous hikes, bringing the cumulative increase for 2022 and 2023 to 4.25%. The BoC’s Governing Council continued to note that core inflation levels were moderating but remained too high. Still, the BoC noted that it may pause its hiking cycle here if economic developments evolve in line with its expectations. The next scheduled meeting is on March 8.

- As widely expected, the U.S. Fed raised the federal-funds rate by 0.25% to a range of 4.50% to 4.75%—the smallest increase since its rate-hiking policy began in March 2022. The central bank’s policymakers reiterated their commitment to reducing inflation to the 2% target rate, and said they would continue to monitor the labour market, inflation pressures and expectations, and financial and international developments to inform its economic outlook.

- The Bank of England (BOE) raised its benchmark interest rate by 0.5% to 4.0% in early February as inflation remained elevated. However, the central bank noted that overall inflation has slowed and likely will decline significantly during the coming year. The BOE also said that, although the labour market remains tight, there have been signs of slower wage growth.

- The European Central Bank (ECB) boosted its benchmark interest rate by 0.5% to 2.5% in early February in its ongoing effort to combat inflation. The ECB commented that it expects to implement another 0.5% increase during its next meeting in March, and then evaluate the direction of its monetary policy.

- The Bank of Japan (BOJ) left its benchmark interest rate unchanged at -0.1% following its meeting in January. The central bank also said it would continue to allow the 10-year Japanese government bond (JGB) yield to move 0.5% above or below the central bank’s 0% target.

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

- According to Statistics Canada, the rate of inflation fell (as measured by the change in the Consumer Price Index (CPI)) to 0.6% for December, and moderated to a 6.3% increase for the one-year period. Declining gasoline prices led to the steepest monthly drop in prices since April 2020. Although the year-over-year price increases have slowed, the pace of inflation remains well above the BoC’s target levels. Producer prices declined in December and year-over-year measures continued to ease. The Industrial Product Price Index (IPPI) was down 1.1% in December, while the Raw Materials Price Index (RMPI) slid 3.1%. On a year-over-year basis, the IPPI climbed 7.6% and the RMPI increased 7.5%. Similar to consumer price, the declines and moderation in inputs can largely be tied to weaker prices for petroleum and crude energy products.

- Core inflation, as measured by the Consumer Price Index for all items less food and energy, rose 0.3% in December and 5.7% year over year, compared to the respective 0.2% and 6.0% monthly and annual increases in November. The slowing inflation spurred investor optimism that the central bank may not need to raise the federal-funds rate as high as previously estimated. Overall inflation (including food and energy costs) dipped 0.1% in December after increasing by 0.1% in November, and registered a year-over-year gain of 6.5%. The Department of Labor reported that U.S. payrolls expanded by a greater-than-expected total of 517,000 in January—up sharply from the 260,000 jobs added in December. The unemployment rate dipped 0.1 percentage point to 3.4%, with the leisure and hospitality, and professional and business services sectors seeing the greatest improvement. Average hourly earnings rose by 0.3% in January and 4.4% year over year, compared to the respective monthly and annual increases of 0.3% and 4.6% in December. According to the Department of Commerce, U.S. GDP growth moderated in the fourth quarter of 2022 to an annualized rate of 2.9% from 3.2% in the prior quarter. The largest increases were in private inventory investment (which measures changes in inventory values), consumer spending, and federal government spending. These gains offset reductions in exports and residential fixed investment (purchases of private residential structures and residential equipment that property owners use for rentals). The Bureau of Economic Analysis reported that consumer spending dipped 0.2% month over month in December; despite the holiday shopping season. A 1.6% decline in purchases of durable and non-durable goods more than offset a 0.5% increase in spending on services.

- The pace of rising consumer prices in the U.K. slowed in December to a rate of 0.4% from 0.5% month over month and to 10.5% from 10.7% in the 12-month period. Restaurants and hotels along with food and non-alcoholic beverages recorded the largest price increases over the calendar year. According to the Office for National Statistics, U.K. GDP expanded by 0.1% in November 2022, but fell by 0.3% for the three-month period ending in November. Downturns in production and services more than offset a 0.3% gain in construction. Manufacturing activity in the U.K. remained in contraction territory for the sixth consecutive month in January but moved closer to expansion than it had in four months. (A reading below 50 indicates contraction.) Activity in the U.K. services sector dipped to its lowest level in two years in January, with the Flash UK Services PMI Business Activity Index falling by 1.9 to 48.0. However, business expectations for 2023 significantly improved on greater optimism with regard to the global economic backdrop and decreasing inflationary pressures in the coming year.

- Inflation in the eurozone slowed in the 12-month period ending December by 0.9% to 9.2%. Food and energy prices saw the largest increases for the month. Eurozone manufacturing activity remained in contraction territory in January, although the S&P Global Flash Eurozone Manufacturing Purchasing Managers Index (PMI) reached a five-month high of 48.8. Services activity in the eurozone expanded for the first time in six months in January, with the S&P Global Flash Eurozone Services PMI rising 1.6 points to 50.7. The eurozone's economy grew by 0.1% in the fourth quarter of 2022, down from a 0.3% gain in the prior quarter. GDP rose by 1.9% year over year and increased by 3.5% for the 2022 calendar year.

Index Data (January 2023)

- The S&P/TSX Composite Index was up 7.41%.
- The FTSE Canada Universe Bond Index returned 3.09%.
- The S&P 500 Index, which measures U.S. equities, gained 4.67%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, rose 5.54%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 3.83% (currency hedged) and 2.33% (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"—decreased from 21.67 to 19.40.
- WTI Cushing crude oil prices—a key indicator of movements in the oil market—moved lower from US$80.26 to US$78.87 a barrel to end January.
- The Canadian dollar strengthened to C$1.33 per U.S. dollar. The U.S. dollar was generally weaker versus the world's other major currencies; it ended December at US$1.09 versus the euro, US$1.23 against sterling and at 130.05 yen.

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