Monthly Market Commentary
February 2024

Stocks earn their way to a rally.

- Major global equity market indexes moved higher in February 2024. Investors' optimism regarding generally positive corporate earnings offset concerns that stickier-than-expected inflation data may prompt the Federal Reserve (Fed) and other central banks to delay a pivot to interest-rate cuts.
- Despite some pockets of modest gains, Canadian fixed-income markets were generally down for the month. U.S. Treasury yields rose across the curve—with the exception of one-month Treasury bill—for the month (bond prices move inversely to yields).
- It appears that fewer stocks included in the "Magnificent Seven" are having a significant impact on the U.S. equity market—shares of three of the mega-cap tech companies declined during the first two months of 2024—and the January inflation data have dampened investors' hopes for Fed rate cuts in the near term.

Economic Backdrop

Major global equity market indexes moved higher in February 2024. Emerging markets modestly outperformed their developed-market counterparts. Investors' optimism regarding generally positive corporate earnings offset concerns that stickier-than-expected inflation data may prompt the Fed and other central banks to delay a pivot to interest-rate cuts. North America led the major developed markets in February due to strength in the U.S. The Dow Jones Industrial Average and the broad-market S&P 500 Index closed at historically high levels on several trading days in February, while the tech-heavy Nasdaq Composite Index reached a record-high close on the last day of the month. The Pacific region was the primary developed-market laggard in February, as Australia recorded a negative return for the month. The Far East was the top-performing region within emerging markets for the month, led by strength in China. Conversely, Latin America was the most notable underperformer due to relative weakness in Brazil.

Despite some pockets of modest gains, Canadian fixed-income markets were generally down for the month. Global fixed-income assets, as represented by the Bloomberg Global Aggregate Bond Index, declined 1.3% in February. High-yield bonds registered modest gains for the month and led the U.S. fixed-income market, while corporate bonds and U.S. Treasury securities recorded losses. Treasury yields rose across the curve—with the exception of the one-month Treasury bill—in February. Yields on 2-, 3-, 5- and 10-year Treasury notes increased 0.37%, 0.35%, 0.38% and 0.26%, respectively, over the month. The spread between 10- and 2-year notes widened from -0.28% to -0.39% in February, and the yield curve remained inverted.

Global commodity prices, as measured by the Bloomberg Commodity Total Return Index, fell 1.5% in February. The West Texas Intermediate (WTI) and Brent crude oil prices rallied during the month as ongoing geopolitical tensions in the Middle East spurred investors' worries about a disruption in oil exports. The WTI and Brent crude oil prices ended February with gains of 3.2% and 1.7%, respectively. The New York Mercantile Exchange (NYMEX) natural gas price plunged 11.4% over the month amid slowing demand due to above-average winter temperatures in the U.S. The 0.6% decline in the gold spot price was attributable to stronger-than-expected U.S. economic data and the rise in U.S. Treasury yields during the month. (The gold price typically moves inversely to bond yields.) Wheat prices were down 3.2% in February due to relatively weaker demand for exports from the U.S.

Minutes from the Fed's January 30-31 meeting, released on February 21, revealed that most Federal Open Market Committee (FOMC) members expressed concerns about reducing rates too soon at the risk of reigniting inflation. "Most participants noted the risks of moving too quickly to ease the stance of policy and emphasized the importance of carefully assessing incoming data in judging whether inflation is moving down sustainably to 2 percent." On a more dovish note, a couple of meeting participants "pointed to downside risks to the economy associated with maintaining an overly restrictive stance for too long…In discussing risk-management considerations that could bear on the policy outlook, [meeting] participants remarked that while the risks to achieving the Committee's employment and inflation goals were moving into better balance, they remained highly attentive to inflation risks."

On the geopolitical front, the Russia-Ukraine and Israel-Hamas military conflicts continued in February. Russia's invasion of Ukraine marked its second anniversary on February 24, with little hope for a resolution in the near term. Republican Party leaders in the U.S. House of Representatives rejected a bipartisan bill approved in the Senate that would provide military aid for Ukraine, Israel, and Taiwan, as well as immigration reforms. At the end of the month, negotiations on a ceasefire in the Israel-Hamas war appeared to be in jeopardy following a clash between Israeli soldiers and Palestinian civilians in Gaza as many residents were caught in a chaotic rush to obtain supplies from 30 trucks delivering aid to the territory.

The U.S.- and U.K.-led coalition (with support from Australia, Bahrain, Canada, Denmark, and the Netherlands) continued to engage in a military conflict with the Houthi movement, an Iran-backed militant group that seized Sanaa, Yemen's capital, in 2014. In late February, the coalition struck 18 Houthi targets in Yemen, including underground weapons storage facilities, missile storage facilities, air defense systems, radars, and a helicopter. In a news release, the U.S. Central Command noted that the military strikes sought to "degrade Houthi capability and disrupt their continued reckless and unlawful attacks on international commercial and U.S. and U.K. vessels in the Red Sea, Bab Al-Mandeb Strait, and the Gulf of Aden." The Houthis have attacked U.S. military bases in Iraq and Syria, as well as numerous commercial ships in the Red Sea. This has forced international shipping companies to reroute their vessels around the Cape of Good Hope in South Africa, putting upward pressure on freight costs.

Central Banks

- As was widely expected, the Bank of Canada (BoC) held its overnight interest rate steady at 5.00% and continued its policy of quantitative tightening following its March 6 meeting. Similar to recent prior statements, the BoC Governing Council once again noted that the global economy slowed, with the U.S. economy being surprisingly robust and resilient, while inflation continued to moderate. The Governing Council envisions inflation to persist around 3% during the first half of this year, before moderating further. The next BoC meeting is scheduled for April 10.

- During a prerecorded interview, which was aired on "60 Minutes," a CBS television network news program, in early February, Fed Chair Jerome Powell said that the central bank is focusing on a timeframe for a pivot to interest-rate cuts. However, he cautioned that a shift in monetary policy is not imminent. Citing the ongoing strength in the U.S. economy, Powell commented, "We feel like we can approach the question of when to begin to reduce interest rates carefully." Powell noted that the Fed is seeking to ensure that it does not leave interest rates too high for too long, leading to an economic slowdown, while simultaneously reducing rates in a manner that does not reignite inflation. "There is no easy, simple, obvious path. We think the economy's in a good place. We think inflation is coming down. We just want to gain a little more confidence that it's coming down."

- In a speech at Cardiff University Business School in Wales on March 1, Bank of England (BOE) Chief Economist Huw Pill said that interest-rate cuts are "some way off." He commented, ""I need to see more compelling evidence that the underlying persistent component of UK CPI inflation is being squeezed down to rates consistent with a lasting and sustainable achievement of the 2% inflation target before voting to lower Bank Rate." Pill also announced that the central bank most likely will implement a new, system for economic forecasting that will evaluate the impact on interest rates of major events such as the total closure of the Red Sea to shipping. The BOE faced criticism after it underestimated the rise in inflation following the COVID pandemic and Russia's invasion of Ukraine. The BOE's next monetary policy meeting is scheduled for March 21.

- During an appearance on Antena 3, a Spanish TV network, on February 28, European Central Bank (ECB) Vice President Luis de Guindos noted that, despite a slowdown in inflation in the eurozone, the central bank needs to see more inflation data before reducing interest rates. De Guindos said, "When the data we receive on inflation, and underlying inflation, make it clear that we're approaching 2%, monetary policy will be modified." He also expressed his view that disinflation will continue "once our projections indicate that the data we receive, on both headline and core inflation, show that we are getting closer to 2%, then the direction of monetary policy will change." The ECB's Governing Council will conduct its next monetary policy meeting on March 7.

- Bank of Japan (BOJ) Board Member Hajime Takata stated that the central bank may discontinue its negative interest-rate policy in the near future. Takata told local business leaders in Shiga, in western Japan, "There are uncertainties for Japan's economy, but my view is that the [2% inflation] target is finally coming into sight." Following Takata's remarks on February 29, the Japanese yen rose 0.7% vs. the U.S, dollar. The BOJ's next monetary policy meeting is scheduled for March 18-19.

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

- According to Statistics Canada, consumer prices (as measured by the change in the Consumer Price Index (CPI)) were flat in January as the year-over-year increase moderated to 2.9%. Gasoline prices were weaker than prior periods, while the price increases for groceries decelerated. Meanwhile, producer prices were mostly weaker, as the Industrial Product Price Index (IPPI) fell 0.1% and the Raw Materials Price Index (RMPI) rose 1.2%, respectively, in January. Year-over-year prices declined 2.9% and 6.4%, respectively, for the IPPI and RMPI. Prices for petroleum products, metals, and wood have been significantly softer from a year ago. The Canadian economy added 41,000 jobs in February; meanwhile, the unemployment rate ticked up 0.1% to 5.8% as population growth outpaced employment growth.

- The Department of Labor reported that the U.S. consumer-price index (CPI) rose 0.3% in January following a 0.4% upturn in December. The CPI advanced 3.1% year-over-year—matching the annual increase in December and exceeding market expectations. Costs for energy services (electricity and utility gas services) and housing were the largest contributors to the month-over-month rise in the CPI, increasing 0.5% and 0.4%, respectively. Food prices were up 0.4% in January and rose 2.6% over the previous 12-month period. The 3.9% rolling 12-month rise in core inflation, as measured by the CPI for all items less food and energy, was unchanged from the year-over-year upturn in December—the smallest annual increase since August 2021. Core inflation was up 0.4% in January, marginally higher than the 0.3% month-over-month rise in December. According to the second estimate from the Department of Commerce, U.S. gross domestic product (GDP) grew at an annualized rate of 3.2% in the fourth quarter of 2023, slightly lower than the initial estimate of 3.3% and down from the 4.9% rise in the third quarter. The U.S. economy expanded by 2.5% for the 2023 calendar year, topping 2022's 1.9% annual rise, bolstered mainly by increases in consumer spending—which comprises more than two-thirds of U.S. GDP—and nonresidential fixed investment (purchases of both nonresidential structures and equipment and software). The largest contributors to GDP growth for the fourth quarter included consumer spending, exports, state and local government spending, and nonresidential fixed investment. The government attributed the lower economic growth rate in the fourth quarter relative to the previous three-month period primarily to slowdowns in private inventory investment (a measure of the changes in values of inventories from one time period to the next) and federal government spending.

- The Office for National Statistics (ONS) reported that inflation in the U.K., as measured by the Consumer Prices Index (CPI), fell 0.6% in January, following a 0.4% upturn in December. The CPI advanced 4.0% year-over-year, matching the annual increase for the previous month. The largest contributors to the 12-month rise in inflation included alcohol and tobacco, as well as communication. These more than offset a decline in housing and housing services costs. Core inflation, which excludes volatile food prices, rose at an annual rate of 5.1% in December, unchanged from the year-over-year increase in December. It appears that the U.K. economy slipped into recession—defined as two consecutive quarters of negative GDP growth—at the end of last year. According to the initial estimate of the ONS, U.K. GDP fell 0.2% over the fourth quarter of 2023, following a 0.1% dip during the third quarter. However, GDP was up 0.1% year-over-year versus the fourth quarter of 2022. Production output decreased 1.0% over the last three months of 2023, hampered mainly by a notable slump in manufacturing. The services sector dipped 0.2% in the fourth quarter, as weakness in the wholesale and retail trade, motor vehicles and motorcycles repair, and education subsectors counterbalanced growth in administrative and support service activities. Output in the construction sector fell 1.3% during the fourth quarter, attributable primarily to significant downturns in new work, particularly private new housing.

- Eurostat pegged the inflation rate for the eurozone at 2.8% for the 12-month period ending in January, marginally lower than the 2.9% annual increase in December. Prices for food, alcohol and tobacco rose 5.6% year-over-year in December, but the pace of acceleration slowed from the 6.1% annual rate for the previous month. Costs for services and non-energy industrial goods were up 4.0% and 2.0%, respectively, year-over-year. Conversely, energy prices plunged 6.1% over the previous 12 months following a 6.7% annual decline in December. Core inflation, which excludes volatile energy and food prices, rose at an annual rate of 3.3% in January, down 0.1 percentage point from the 3.4% year-over-year increase in December. According to Eurostat's second estimate, eurozone GDP was flat in the fourth quarter of 2023, a slight uptick from the 0.1% decline in the third quarter, but increased 0.5% for the 2023 calendar year. The economies of Slovenia, Portugal, and Cyprus were the strongest performers for the fourth quarter, expanding 1.1%, 0.8% and 0.8%, respectively. Conversely, Ireland's GDP fell 0.7%, while the economies of Estonia, Romania, and Finland each contracted by 0.4% during the quarter.

Index Data (February 2024)

- The S&P/TSX Composite Index gained 1.82%.
- The FTSE Canada Universe Bond Index fell 0.34%.
- The S&P 500 Index, which measures the performance of U.S. equities, rose 6.94%.
- The MSCI ACWI (Net) Index, used to gauge global equity performance, gained 5.88%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.26% (currency hedged) and 1.82% (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"—was moderately lower, as it moved from 14.35 to 13.40.
- The WTI Cushing crude oil price—a key indicator of movements in the oil market—climbed from US$75.85 to US$78.26 a barrel to end February.
- The Canadian dollar weakened to C$1.36 per U.S. dollar. The U.S. dollar was generally stronger against the world's other major currencies, ending January at US$1.098 versus the euro, US$1.26 against sterling, and at 149.670 yen.

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