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Economic Outlook

First Quarter 2021

Springtime Delayed

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SEI recently released its first-quarter Economic Outlook. A summary of the conclusions is provided below:

- Dealing with COVID fatigue for another few weeks just as it is getting nicer outside is bad enough. Seeing the lack of progress on the vaccination front is even harder. Only 12.3% of all Canadians have received at least one shot of vaccine as of March 29[1]. This share is not much better than most European countries, and lags well behind the United Kingdom and the United States–as well as several other countries that are far less developed economically.

- Canada's economic recovery trails both the U.S. recovery and economist's expectations, and there has been some additional deterioration in Canada's relative performance in the past month.

- Equity investors, in the meantime, are ignoring the prospect of further delays in the economy's return to normalcy. Canadian equities literally beat the world in the first quarter, surging 8.3% total-return through March 31, as measured by the MSCI Canada index. The MSCI ACWI ex USA index managed a 2.2% gain, while the MSCI USA benchmark rose 5.5%.

- The Canadian stock market should continue to benefit from the global economic recovery and the particularly sharp gains likely to be recorded in U.S. business activity. But outperformance versus the U.S. and other countries on a relative basis appears to be very dependent on a strong pricing environment for oil, metals and other commodities, and a continued levitation of home prices. A ramp-up in vaccinations and a return to normal business conditions domestically would also be a big help.

- The war against COVID-19 in the U.S. is not over, but vaccine rollouts show the path to victory. Therefore, business activity is expected to surge during the second half of 2021, not just in the U.S. but in other advanced nations too. Accordingly, U.S. investors appear to anticipate a return to a more normal world.

- This outlook in the U.S. is reflected in the rapid rise in U.S. bond yields—which has been the most important change in the financial environment so far this year. Fueled by sharp gains in U.S. economic growth and concerns about surging government debt, the 10-year U.S. Treasury bond climbed from 0.92% to 1.60% since the start of the year.

- This jump in yields caused outsized price drops in long-term fixed-income securities (bond yields and prices move inversely), which helped fuel a sharp equity-market rotation away from expensive growth stocks and into value-oriented and cyclical sectors around the world.

- Time will tell whether the turn in favour of value will be more than just another ephemeral cyclical advance like those recorded at other points in the past decade. In our view, the economic backdrop strongly supports cyclical-and value-oriented equities in emerging markets, just as it does in developed markets.

- Higher bond yields raise concerns about rising inflation and may cause bouts of indigestion in the stock market, but we do not think they will derail the U.S. bull market. Rather, we expect to see cyclical and value-oriented stocks continue to advance relative to growth and defensively oriented sectors of the market.

A full-length paper is available if you wish to learn more about these timely topics.

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[1] Source: Our World in Data. Data as of 3/29/2021.

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