Rising Outbreak Worry Weakens Equities
Monthly Market Commentary
January 2020

SEI New ways. New answers.®

- Domestic and U.S. stocks climbed through mid-January before selling off to end the month essentially flat as volatility jumped on rising concerns about the coronavirus outbreak that began in China.
- The U.S. and China formalized a "phase one" trade deal that offered tariff relief to China in exchange for commitments to purchase $200 billion in U.S. products, reforms to its forced technology transfer practices, and the continued opening of its financial-services industry to foreign investors.
- We retain our emphasis on strategic (long-term) investing over tactical (short-term) decision making, as it is impossible to identify with complete accuracy how investors might react to macroeconomic shifts.

Economic Backdrop

Equity markets around the globe were marked by accelerating volatility throughout the month on intensifying concerns about the coronavirus: A deadly strain originated in Wuhan, China, and began spreading at a faster pace as the month progressed. The number of confirmed cases in mainland China skyrocketed from 45 to well over 11,000 over the final two weeks of January, leading the Chinese government to quarantine millions of citizens in Wuhan. The outbreak spread to other countries, prompting Mongolia and Russia to close their borders with China and other countries to erect transportation and quarantine barriers to Chinese trade and travel. Beyond the threat to public health, the outbreak and resulting containment measures evoked concerns about the potential dampening of economic activity at the same time that China has struggled to navigate an economic soft patch.

In this environment, U.S. equities climbed through mid-January before selling off to end the month essentially flat on concerns about the coronavirus. U.K. and European stocks were restrained for much of January—barely advancing or declining—before weakening late in the period. Asian equities followed a similar path as their U.K. and European counterparts: Chinese stocks tumbled sharply given their proximity to the outbreak and potential for greater fallout; Hong Kong equities also sank, although by less; Japanese stocks generally resisted a severe impact.

Energy prices fell throughout most of January, with declines acclerating later in the month due to a likely clampdown on economic activity tied to quarantines, transportation disruptions and national border closures erected as part of outbreak containment efforts.

Government bond rates fell in the U.S., U.K. and eurozone across almost all maturities in January; the declining yields on these safe-haven assets quickened as the month came to a close (bond yields fall when their prices rise). The U.S. Treasury yield curve—which nearly normalized (that is, returned to a positive upward slope) at the end of 2019 after inverting to varying degrees since December 2018—re-inverted across most maturities by the end of January.

China and the U.S.formalized a "phase one" trade deal in mid-January that offered tariff relief to China (via the reduction of existing tariffs and the delay of additional scheduled tariffs). In exchange, China committed to purchasing $200 billion in U.S. products over a two-year period; addressing its long-standing practice of forcing the transfer of intellectual property and technology to Chinese counterparts in exchange for access to the Chinese market; and promising to continue opening its financial-services industry to foreign investors.

The United States-Mexico-Canada trade agreement (USMCA) was approved by the Congress and signed by President Donald Trump in late January, officially replacing the North American Free Trade Agreement (NAFTA). Earlier in the month, President Trump and France's President Emmanuel Macron successfully walked back threats of tariffs that originated with French plans for a digital tax that would have targeted US-based multi-national technology companies. The prospect of a digital tax re-surfaced in other countries—including the U.K., Italy, Austria and Turkey—which prompted more threats of retailiatory tariffs by Treasury Secretary Steven Mnuchin. Sajid Javid, the UK's Chancellor of the Exchequer, disappointed Secretary Mnuchin, his U.S. counterpart, by explaining during a joint interview in late January at the World Economic Forum that the U.K. would prioritize trade negotiations with the EU over a deal with the U.S.

President Trump's impeachment trial unfolded in the U.S. Senate during the second half of January. His eventual acquittal with no expected formal consequences seemed almost universally anticipated—even as the U.S. media surfaced corroborating first-hand accounts of President Trump directing underlying events central to the articles of impeachment. These witnesses—one of which was former National Security Advisor John Bolton, whose depictions were made public by leaks of his as-yet unreleased book manuscript—were blocked by a slim majority from testifying under oath before the Senate.

The U.K. formally resigned its membership in the EU at the end of the month after the Conservative Party's Brexit deal became law on January 23. European Parliament ratifed the agreement on January 29, paving the way for the split. The two sides will continue to negotiate the terms of their future relationship throughout a transition period that lasts until the end of 2020. Most of the rules that govern trading and travel between the U.K. and EU will remain in the interim, but the U.K. forfeited its participation in the EU decision-making process during the transition. If a deal isn't struck by the end of the year, their trade terms will revert to the rules-based trading system dictated by the World Trade Organization (WTO)—thereby raising tariffs on both sides and slowing the pace of cross-border commerce.

Geopolitical risks ratcheted higher at the start of the New Year when the Trump administration assassinated Qasem Soleimani, a top Iranian general, in Baghdad on January 3. The Iranian military retailiated on January 8 by launching missiles at two U.S. military bases in Iraq, reportedly causing more than 50 traumatic brain injuries of U.S. service members—and then accidentally downing a Ukrainian International Airlines commercial jet mistaken for U.S. military aircraft, killing all 176 passengers.

Central Banks

- The Bank of Canada (BoC) held the overnight rate unchanged at 1.75% following its meeting on January 22. The BoC noted that global economic growth appeared to have bottomed, with the U.S.-China "phase one" trade deal and USMCA representing positive developments. These positives were partially offset by elevated uncertainty given rising geopolitical tensions in the Middle East. The next scheduled meeting is March 4.

- The Federal Open Market Committee (FOMC) made no changes to the funds rate following its late-month meeting. However, it detailed multiple steps to maintain ample reserves and keep benchmark rates in line with their targets, including the continued purchase of Treasury bills at least into the second quarter of 2020; the continued offering of repurchase agreements (repos) at least through April 2020; and the continued reinvestment of principal proceeds from the Federal Reserve's (Fed) balance sheet holdings.

- The Bank of England's Monetary Policy Committee kept the Bank Rate unchanged at 0.75% following its meeting at the end of January. This was the last Monetary Policy Committee meeting for Governor Mark Carney, who will turn his role over to Andrew Bailey before the next meeting in March.

- The European Central Bank (ECB) maintained its existing monetary-policy path following its January meeting. As expected, the central bank's governing council also approved a proposed policy review that will consider, among other issues, how the ECB measures inflation targets and whether it can help counteract climate change.

- The Bank of Japan (BOJ) maintained its accommodative monetary-policy orientation following its January meeting, while upgrading its forecast for economic growth and slightly reducing inflation expectations.

- At the beginning of February, the People's Bank of China (PBOC) reduced short-term reverse repo rates and introduced more than $170 billion in new liquidity to money markets through reverse repos to help offset the increased financial pressures created by the coronavirus outbreak.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) jumped by 0.4% in December, while prices increased at a 2.2% rate for the past 12 months. Gasoline and fuel prices were strong. Producer prices were also higher—the Industrial Product Price Index (IPPI) ticked up 0.1% in December while the Raw Materials Price Index (RMPI) soared 2.8%. Over the past 12 months, the IPPI was up a meager 0.3% while the RMPI rose a more robust 7.9%. The gains in producer prices were largely related to higher crude energy prices. Following a spike in November, the unemployment rate continued to trend lower, falling by 0.1% to 5.5%. January's employment gains were all in full-time work and the unemployment rate once again approached historical lows.

- Multiple reports showed U.S. manufacturing conditions in growth territory during January after indications that activity contracted through the end of 2019. Services sector growth also increased, according to a preliminary report. The U.S. economy grew by a 2.1% annualized rate during the fourth quarter of 2019 and 2.3% for the full year, its slowest calendar-year growth rate in three years.

- The contraction in U.K. manufacturing appeared to pause during January, while a preliminary report showed services-sector activity accelerated to healthier levels from an essential standstill. The U.K. claimant-count unemployment rate increased to 3.5% in December from 3.4% during the prior month. The average U.K. unemployment rate for the September-to-November period held at 3.8% from the prior period, while average year-over-year wage growth slid from 3.5% to 3.4%.

- Eurozone manufacturing activity shrank by less in January than during the prior month. Growth in the services sector cooled, however. The EU unemployment rate declined to 7.4% in December from 7.5% during November. An early report of overall economic activity showed the eurozone grew by only 0.1% during the fourth quarter of 2019 and 1.0% year over year, down from 0.3% and 1.2%, respectively, in the third quarter.

Market Impact (in Canadian dollar terms)

Domestic equities were mixed to start the year. Large companies performed well, while smaller companies—which include a higher concentration in the energy and materials sectors that were hit hard by coronavirus concerns—slipped. Markets in Asia, particularly China and other emerging markets, also lost ground over fears the coronavirus would limit future growth. Meanwhile, U.S. equities retained their leadership role as technology and technology-related companies continued to perform well.

Fixed-income markets posted strong gains as yields fell (prices and yields move inversely) with investors preferring the relative safety of bonds. Real-return bonds generally have longer duration profiles—and hence more sensitivity to changes in yields—and interest rates performed the best. Government bonds outperformed corporate debt. U.S. high-yield bonds were essentially flat on a currency-hedged basis.

Index Data (January 2020)

- The S&P/TSX Composite Index was up 1.74%.
- The FTSE Canada Universe Bond Index returned 2.91%.
- The S&P 500 Index, which measures U.S. equities, rose 1.95%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, climbed 0.86%.
- The ICE BofAML U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned -0.01% (currency hedged) and 1.99% (unhedged).
- The Chicago Board Options Exchange Volatility Index—a measure of implied volatility in the S&P 500 Index also known as the “fear index”—spiked notably higher from 13.78 to 18.84 during the month.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, plunged from US$61.06 on the last day of December to US$51.56 at the end of January. Travel bans to and from China, along with fear of slower growth due to the coronavirus outbreak, have put significant pressure on crude oil prices.
- The loonie weakened versus the U.S. dollar; it ended the month at C$1.32 per U.S. dollar. Meanwhile, the U.S. dollar modestly strengthened against the euro and sterling, but was essentially unchanged versus yen. It ended the month at US$1.32 against sterling, US$1.11 versus the euro and 108.39 yen.

SEI Investments Canada Company, a wholly owned subsidiary of SEI Investments Company, is the Manager of the SEI Funds in Canada.

The information contained herein is for general and educational information purposes only and is not intended to constitute legal, tax, accounting, securities, research or investment advice regarding the Funds or any security in particular, nor an opinion regarding the appropriateness of any investment. This information should not be construed as a recommendation to purchase or sell a security, derivative or futures contract. You should not act or rely on the information contained herein without obtaining specific legal, tax, accounting and investment advice from an investment professional. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. There is no assurance as of the date of this material that the securities mentioned remain in or out of the SEI Funds.

This material may contain "forward-looking information" ("FLI") as such term is defined under applicable Canadian securities laws. FLI is disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action. FLI is subject to a variety of risks, uncertainties and other factors that could cause actual results to differ materially from expectations as expressed or implied in this material. FLI reflects current expectations with respect to current events and is not a guarantee of future performance. Any FLI that may be included or incorporated by reference in this material is presented solely for the purpose of conveying current anticipated expectations and may not be appropriate for any other purposes.

Information contained herein that is based on external sources or other sources is believed to be reliable, but is not guaranteed by SEI Investments Canada Company, and the information may be incomplete or may change without notice.

There are risks involved with investing, including loss of principal. Diversification may not protect against market risk. There may be other holdings which are not discussed that may have additional specific risks. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavourable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size and lesser liquidity. Bonds and bond funds will decrease in value as interest rates rise.

Index returns are for illustrative purposes only, and do not represent actual performance of an SEI Fund. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

