Rising Rates Restrain the Rally
Monthly Market Commentary

February 2021

- Stocks were higher around the world until an upward spike in government-bond yields sent chills through markets during the second half of February. Even still, most equity markets finished positive for the month.
- In the U.S., the Centers for Disease Control and Prevention released updated school reopening guidelines in mid-February that spurred state health departments and local school districts to coordinate plans for more in-person learning and fewer virtual classes.
- We anticipate ongoing signs of a global economic recovery as COVID-19 abates and activity normalizes. In the meantime, fiscal spending and accommodative central-bank policy should sustain gross domestic product (GDP) growth and eventually cause inflation to rise.

Economic Backdrop

Risk assets continued their advance through the first half of February without any real setbacks. Stocks were higher around the world until the middle of the month, when government-bond yields (which had been rising slowly since the fall) began to spike further. The specter of a sharp increase in borrowing costs sent chills through markets during the second half of February, leading to selloffs of varying intensity. Full-month equity performance, however, was still positive around most of the world.

Developed-market equities outperformed emerging markets during the month, with mainland Chinese equities negative and Brazil among the worst performers. Canadian stocks led among major developed markets, followed by the U.K., U.S., Hong Kong, eurozone and Japan. Energy and financials delivered the best sector-level performance in February. Value-oriented stocks beat their growth-oriented peers, and small-cap stocks outpaced large caps.

Short-term Treasury rates fell by a small amount, while long-term rates pushed higher. The 10-year Treasury yield—a reference rate for everything from corporate debt to mortgages—briefly rose to its highest level in more than a year near the end of February. U.K. and eurozone government-bond rates increased across all maturities during the month, although long-term rates rose by considerably more than short-term rates.

The U.S. dollar stayed near its January low (relative to a trade-weighted basket of foreign currencies) and remained confined to the range it had established since early December. The West Texas Intermediate crude-oil price climbed from $52.20 to $61.50 per barrel, or 17.8%, during the month.

Estimated daily U.S. COVID-19 case counts had fallen by the end of February toward the low point of September last year. The Centers for Disease Control and Prevention (CDC) released updated school reopening guidelines in mid-February that spurred state health departments and local school districts to coordinate plans for more in-person learning and fewer virtual classes.

The House of Representatives passed a $1.9 trillion economic relief bill at the end of February. The bill will likely be modified by the Senate to exclude a minimum-wage increase that is not allowed in packages passed under the Senate's reconciliation rules (under which bills may be passed with a simple majority rather than the Senate's typical 60% majority requirement—as long as the whole bill directly addresses taxes, spending or the level of the U.S. debt).

Johnson & Johnson's (J&J) COVID-19 vaccine received emergency-use authorization from the U.S. Food and Drug Administration at the end of February. While less effective than the Pfizer-BioNTech and Moderna vaccines that received the first two emergency approvals, the J&J vaccine only requires one dose (as opposed to the others' two-dose regimen) and can be stored at the temperature of a regular refrigerator (as opposed to the sub-zero temperatures required to sustain the others). J&J announced an immediate shipment of four million doses, and plans to ship 100 million doses by June and potentially one billion doses by the end of the year.

In late February, with COVID-19 cases expected to continue declining with the aid of vaccines, U.K. Prime Minister Boris Johnson unveiled a four-stage plan to reopen England:

1) Reopen schools on March 8 and larger outdoor gatherings and sports on March 29.
2) Reopen non-essential retail businesses and cease curfews for restaurants and pubs (still limited to outdoor seating) as early as April 12, depending on the progression of the infection rate.
3) Conclude most social-contact rules (two households will be allowed to meet indoors), and reopen hospitality businesses to indoor service as soon as May 17.
4) Retire any remaining social-contact limits and reopen all still-closed businesses as early as June 21.

Following the January collapse of Italy's governing coalition and subsequent resignation of Prime Minister Giuseppe Conte, Italian President Sergio Mattarella asked former European Central Bank President Mario Draghi to form a technocratic government. Draghi answered his call, and his national unity platform—which includes cabinet ministers from across and outside of the political spectrum—received support from parties in the center, left, and right. He was sworn in as prime minister on February 13.

Economic Data

- According to Statistics Canada, the rate of inflation (as measured by the change in the Consumer Price Index (CPI)) increased by 0.4% and 1.0%, respectively, for the month and year ending January. Higher prices for gasoline and durable goods drove the increase. Although this was a notable acceleration from the prior reading, inflation remained below the Bank of Canada's preferred range. However, producer prices were stronger, indicating the possibility of higher consumer prices soon. The Industrial Product Price Index (IPPI) was up 2.0% in January, while the Raw Materials Price Index (RMPI) was up 5.7%. Over the past 12 months, producer prices have begun to rebound—the IPPI increased 4.0% and the RMPI rose 6.2%. Prices for lumber, petroleum and energy were all strong.

- U.S. manufacturing growth remained strong in February. Services sector growth continued to heat up during the month, nearing November's highs. New weekly U.S. claims for unemployment benefits broke below 800,000 to start February, but climbed to 861,000 by mid-month before recovering to 745,000 by the end of the period. The overall U.S. economy expanded at an annualized 4.1% rate during the fourth quarter (after annualized changes of -5.0%, -31.4% and +33.4% during the first, second and third quarters, respectively).

- U.K. manufacturing growth improved to healthier levels in February after slowing in January from a relatively brisk fourth quarter. The country's services sector activity was in a holding pattern during February, neither expanding nor contracting, after plummeting in the prior month. The U.K. claimant count (which calculates the number of people claiming Jobseeker's Allowance) decreased by 0.1% to 7.2% in January, representing roughly 2.6 million total claimants. The broad U.K. economy grew by 1.2% in December after breaking a six-month recovery trend in November with a 2.6% contraction.

- Eurozone manufacturing growth jumped in February to strong levels, interrupting a fairly slow and steady recovery that began last spring. Like the rest of the world, the eurozone manufacturing sector was temporarily crippled by the early spread of COVID-19; but it had already been suffering from varying degrees of contraction since early 2019. Eurozone services activity continued to shrink during February, having last experienced growth during a fleeting two-month period that ended in August 2020. The eurozone economy contracted by 0.6% during the fourth quarter of 2020 (after changes of -3.6%, -11.8% and +12.5% during the first, second and third quarters, respectively) and shrank by 5.0% during the 2020 calendar year.

Central Banks

- The Bank of Canada (BoC) did not meet in February. The BoC's policy rate remains historically low at 0.25% ahead of the next meeting on March 10.

- The Federal Open Market Committee did not hold a meeting during February. Federal Reserve (Fed) Chair Jerome Powell pledged to continue supporting the economy via monetary policy during his semi-annual congressional testimony on February 23 and 24. He also weighed in on recent concerns about rising price pressures, stating, "I really do not expect we'll be in a situation where inflation rises to troublesome levels."

- The Bank of England's (BOE) Monetary Policy Committee (MPC) held course at its early-February meeting, keeping the bank rate at 0.1% and retaining a maximum allowance for asset purchases of £895 billion. In response to a banking-system review by the BOE's Prudential Regulatory Authority that found banks would need six months to prepare for negative benchmark rates, the MPC communicated that it has no intention of introducing a negative rate within the next six months.

- The European Central Bank (ECB) held no monetary-policy meeting during February. In testimony to the European Parliament about the inflation landscape, ECB President Christine Lagarde said, "Underlying price pressures are likely to remain subdued owing to weak demand, low wage pressures and the appreciation of the euro exchange rate."

- The Bank of Japan (BOJ) did not hold a meeting on monetary policy during February. The next meeting, scheduled for March 18 and 19, is expected to coincide with a review of the BOJ's tools—with an to eye to the eventual prospect of unwinding its deep market interventions that date back as far as the global financial crisis.

Market Impact (in Canadian dollar terms)

Global equities returned to positive territory in February. Canadian smaller companies nearly registered double-digit gains and notched more than twice the gains of large companies. Sector performance was somewhat mixed: information technology, energy and consumer discretionary posted strong returns. Meanwhile, utilities, materials and consumer staples were down. U.S. stocks had more modest gains and were also led by smaller companies. Outside of North America, most developed markets had modest gains while emerging markets fell as Brazil and China slumped.

Fixed-income losses accelerated in February. Real-return bonds were the worst performers, followed by government debt and corporate bonds. Residential mortgages posted slight gains while 30-day treasury bills were flat. U.S. high-yield bonds, which are riskier than investment-grade bonds, were up slightly on a currency-hedged basis but down in unhedged terms.

Index Data (February 2021)

- The S&P/TSX Composite Index was up 4.36%.
- The FTSE Canada Universe Bond Index returned -2.52%.
- The S&P 500 Index, which measures U.S. equities, gained 1.84%.
- The MSCI ACWI Index (Net), used to gauge global equity performance, was up 1.40%.
- The ICE BofA U.S. High Yield Constrained Index, representing U.S. high-yield bond markets, returned 0.33% (currency hedged) and -0.55 % (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"—briefly fell below 20 (from 33.09 at the end of January) before it ended the month at 27.95.
- WTI Cushing crude-oil prices, a key indicator of movements in the oil market, rose from US$52.20 on the last day of January to US$61.50 at the end of the month, as demand for oil has recently outstripped supply.
- The loonie strengthened slightly versus the U.S. dollar; it ended the month at C$1.27 per U.S. dollar. The U.S. dollar was mixed versus the world's other major currencies. It ended the month at US$1.39 against sterling, US$1.21 versus the euro and 106.54 yen.

