Monthly Market Matters

Summary for November 2021

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Highlights

Rising case counts in Europe and new COVID variant Omicron rattle global markets.

As expected, the US Federal Reserve announced the beginning of a tapering of their bond-purchasing program. Chair Powell then surprises markets with remarks that the pace of tapering may need to quicken.

Corporate America rounds out another solid quarter of corporate earnings. Profit margins held up well in Q3.

Strong economic data set the stage for the global economy to reaccelerate in Q4.

COVID rears its ugly head once again

COVID concerns returned front and center in November, starting with a spike in European case counts leading to renewed lockdown measures and ending with the discovery of the new Omicron variant originating from South Africa, causing numerous travel bans. Most major equity indices pulled back on the news, while bond yields dropped as investors retreated into fixed income for safety. The news also dampened the demand outlook for oil, sending crude prices plummeting. In turn, the drop in oil prices dragged down bond market inflation breakeven measures. As expected, the US Federal Reserve (Fed) announced they would begin tapering their bond-purchasing program, contributing to the volatile month where the CBOE Volatility Index (VIX) reached a 9-month high. The main deterrent for equity markets continues to be the path of the virus. Although the world is much better equipped to handle an outbreak today (higher vaccination rates, booster shots, new effective treatment methods), November was a blunt reminder that COVID might be on the ropes, but it isn't going to go down easy.

Omicron variant, Powell's hawkish remarks rattle markets

After handling the delta variant rather remarkably, the world faces yet another variant, Omicron. It is still early days in terms of what we know, but conflicting initial findings from drug makers whipsawed markets. Oxford University found no evidence that the new variant could overwhelm the vaccine developed in concert with AstraZeneca. While BioNTech, Pfizer's vaccine partner, announced the current crop of shots is likely to shield against severe disease in people infected with the variant. On the other hand, markets plunged on Moderna CEO's prediction that there would be a material drop in effectiveness for current vaccines, stating it would take months to manufacture new Omicron-specific shots at scale. The extent of the market selloff will be dictated by how severe (if any) the blow will be to global growth and how far ahead (if at all) the world needs to punt the return to normal. The answers to both questions will require patience. According to US Chief Medical Advisor Anthony Fauci, it will likely take researchers two to four weeks to better understand the variant and how the current vaccines fare against it.

Canadian Fixed Income	Level	Month	YTD
FTSE Canada Universe Bond Index	1,171	0.9%	-4.1%
FTSE Canada All Corporate Bond Index	1,358	0.5%	-2.8%
Bloomberg Canada High Yield Index	166	-0.3%	5.1%
Global Equities	**Level**	**Month**	**YTD**
S&P/TSX Composite	20,660	-1.8%	18.5%
S&P/TSX Small Cap	766	-3.7%	17.0%
S&P 500	4,567	-0.8%	21.6%
NASDAQ	15,538	0.3%	20.6%
Russell 2000	2,199	-4.3%	11.3%
UK FTSE 100	7,059	-2.5%	9.3%
Euro Stoxx 50	4,063	-4.4%	14.4%
Nikkei 225	27,822	-3.7%	1.4%
MSCI China (USD)	87	-4.9%	-19.4%
MSCI EM Index (USD)	1,212	-4.1%	-6.1%
Currencies and Commodities	**Level**	**Month**	**YTD**
CDN $	$0.783	-3.1%	-0.4%
US Dollar Index	95.99	2.0%	6.7%
Oil (West Texas)	$66.18	-20.8%	36.4%
Natural Gas	$4.57	-17.4%	51.9%
Gold	$1,775	-0.5%	-6.5%
Copper	$4.28	-1.4%	21.6%
Canadian Interest Rates	**Level**	**Month**	**YTD**
3-month T-bill	0.08	-6	2
GOC bonds 2-yr	0.98	-11	78
GOC bonds 10-yr	1.57	-15	89
GOC bonds 30-yr	1.88	-12	67
Canadian Sector Performance		**Month**	**YTD**
Energy		-5.7%	39.2%
Materials		1.0%	-0.8%
Industrials		-3.4%	15.6%
Cons. Disc.		0.4%	8.7%
Info Tech		1.4%	26.7%
Health Care		-7.9%	-15.3%
Financials		-2.2%	24.3%
Cons. Staples		0.1%	10.7%
Comm. Services		0.9%	15.9%
Utilities		-1.5%	1.8%
Real Estate		-3.8%	25.4%

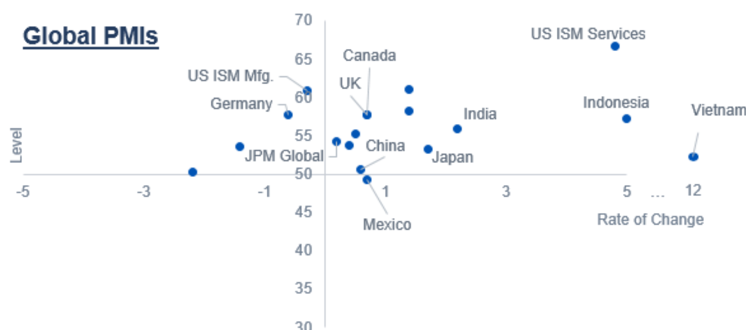
Source: Bloomberg & FactSet November 30, 2021 – local currency unless noted, equity price only returns, bonds total return

Capital markets are focused on the responses from governments and central banks. So far, those responses are a mixed bag. In Europe, sharply rising case counts prompted the reinstatement of some restrictions early in the month, even before detecting the Omicron variant, while US President Biden pledged for no new lockdowns, opting to respond by promoting additional vaccinations/boosters and testing if necessary. Meanwhile, several travel bans have been reinstated globally as a precaution, including in Canada and the US. The other side of the equation is central banks, which have become increasingly hawkish in the face of rising inflation and inflation expectations. After announcing the Fed will begin tapering its bond-purchasing program earlier in the month, Chairman Powell (fresh off being nominated to a second term) signalled that the Fed might need to capitulate on their patient approach, bringing up the possibility of accelerating their US$15 billion/month pace of tapering. This would remove market-friendly liquidity sooner and move up expectations for rate hikes as well – neither is a development capital markets wish to see expedited. Powell also cited his concern that the new variant could add to uncertainty over the inflation path. He warned of a potential slowing in the labour market recovery and ultimately a slowdown in economic growth. The Fed Chairman did note that he still expects inflation to move down significantly next year. Although we agree with Powell that inflation will likely moderate next year due to hefty base effects at play starting in Q2 2022, Omicron-fueled inflation could persist longer than expected for two reasons. First, much of the inflation we have seen has been driven by an excess demand for goods; inflation in the services sector has been held largely in check. If COVID concerns return, consumers will continue spending their excess savings on goods rather than services, further straining global supply chains and thus prices. Second, if the variant sees a return of restrictions, global supply chains could face similar disruptions akin to what we saw from the Delta variant (e.g. factory shutdowns and hesitancy to return to the labour market).

Global economy and corporations continue to hum along

The Omicron variant poses a threat to the economic recovery if the virus proves evasive against current vaccination/treatment methods. However, the second half of this year showed how far we have come in dealing with an outbreak. The new variant adds to lingering headwinds the global economy faces, but the world has dealt with this before. The Delta variant hit in Q3, yet Q3 economic data was more bruised than battered, and corporate earnings results were better than expected, indicating that the global economy is learning to adapt to living with COVID. In Canada, Q3 real GDP rebounded sharper than expected, jumping 5.4% q/q annualized (versus 3.0% expected, from a downwardly revised -3.2%), while US demand for goods has been exceptionally robust. October US retail sales outstripped forecasts, accelerating to 1.7% m/m (versus 1.4% m/m expected, from its 0.8% m/m pace in September). The two previous months' gains were also revised higher. The advance marked the best month since the stimulus-fueled surge in March. US retail sales are up a staggering 16.3% from a year ago and 13% higher than if sales continued to track their pre-pandemic rate. Admittedly, inflation has played a role in the outsized increase. However, backing out the sizzling US CPI 6.2% y/y print in October still leaves retail sales 10% higher than a year ago. Meanwhile, purchasing manager indices are signalling that the manufacturing recovery has remained resilient, and the services sector appears to be benefitting from a return to normal (See Chart in focus for more).

Chart in focus: Solid and expanding PMIs set the stage for a strong Q4



Q3 was littered with bad news ranging from a resurgence in global COVID cases to an anticipated deterioration of corporate earnings due to supply chain disruptions and skyrocketing commodity prices. Despite many of these negative headlines, forward-looking activity measures, such as global Purchasing Manager Indices (PMI), are signalling that the economy is ready to reaccelerate. All but one of the 17 October PMI surveys we track closely sit above the 50-point expansion level. In addition, 12/16 surveys in expansion territory improved relative to a month ago (north-east quadrant). October's standouts were the US ISM Services PMI which jumped 5 points to a record high of 66.7, and the Vietnam Manufacturing PMI, which soared 12 points, rocketing back into expansion territory to 52.1. We see several key takeaways from these impressive results. The manufacturing recovery is resilient, despite rising costs and supply chain snarls. The improvement in many Southeast Asian countries (spearheaded by Vietnam) indicates that some of the world's factories integral to the global supply chain, previously hampered by COVID-related shutdowns, are rapidly resuming production; evidence that perhaps we are past the peak concern over supply chain bottlenecks. Lastly, the US ISM Services PMI surge suggests the slumbering service sector is set to receive an immense boost if COVID concerns fade. The glaring risk to these outcomes is the emergence of the Omicron variant. Investors were moving on from the worst of the COVID concerns, bidding stocks and commodity prices higher - mid-November saw new all-time highs for many equity markets. Hopes are pinned that 2022 will see the untangling of supply chains, combined with the last vestiges of pandemic stimulus and low borrowing costs, that fuels top-line growth to overcome rising cost pressures and interest rates. If Omicron sees the return of widespread lockdown measures, travel restrictions, and eroding sentiment, this is an obvious hurdle for global equity markets in the near term.

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