February 2021 market update

Treasury volatility, rising commodity prices and continued Canadian labour market challenges.

March 5, 2021

Introduction

Global economic conditions showed some signs of improvement in February, as ongoing vaccine distribution efforts allowed some countries to lift lockdown restrictions. Against this backdrop, consumer prices ticked higher, raising some concerns about the re-emergence of inflation and how it may impact the economic recovery. Investors were also digesting the U.S. House of Representative's approval of a US$1.9 trillion stimulus plan. The American Rescue Plan Act is now awaiting U.S. Senate approval and is on track to pass by March 14, when the current unemployment benefits are due to expire.

Although global equity markets finished higher in February, investors had to endure periods of volatility. Global equities gave back much of their gains early in the month as investor attention turned to long-term government bond yields amid rising concerns about higher inflation and inflated equity valuations. With the renewed interest in fixed income markets and rising yields at the long end of the curve, the U.S. and Canadian yield curves steepened during the month.

Wide swing in yields

Despite the U.S. Federal Reserve Board's ("Fed") accommodative policy to artificially keep borrowing costs low, improving economic conditions and the prospect of a major U.S. stimulus package stoked inflation expectations and pushed yields higher. At the end of February, the yield on the benchmark 10-year U.S. Treasury bond rose by 34 basis points to 1.41% from 1.07%.

Rising yields caused investors to re-examine equity valuations, particularly high growth stocks. At the other end of the quality spectrum, U.S. high yield bonds fell below 4% for the first time in mid-February, amid elevated demand in response to a risk-on sentiment and the ongoing search for higher yield. The drop could spur more below-grade issuers to enter the market to capitalize on the lower borrowing costs. High yield bonds closed out the month at 4.25%.

Challenged labour market

The reinstituted lockdown measures at the end of 2020, which saw the closure of non-essential businesses to slow the spread of COVID-19 weighed on the Canadian economy. The impact was evident in the labour market, with Statistics Canada reporting a loss of 213,000 jobs in January, the most since last April. The job losses were concentrated in part-time positions, mostly in the retail and accommodation and food services industries. In response, the unemployment rate rose to 9.4% in January, from 8.8% in the previous month.

Persistent weakness in the labour market is a concern as it could stall the economic recovery in Canada, particularly as pandemic support from the government gets scaled back. But there is reason to think the setback in the job market may be temporary. Economists are striking a cautiously optimistic tone as parts of the country were reopening at the end of the month and more COVID-19 vaccines become available after a slow start. This should help economic activity return to more normal levels, which could boost hiring activity, particularly in those sectors hit hard by the pandemic.

Despite the lacklustre jobs report, Canadian equities advanced over the month of February. Robust gains to start the month pared back later as rising long-term government bond yields amid rising inflation expectations gave investors pause about equity valuations. The top performing sectors were Information Technology and Consumer Discretionary.

Chance of a double-dip recession

Economic activity across Europe came to a near halt in the fourth quarter as fresh lockdowns were implemented in response to rising COVID-19 cases. These measures substantially impacted the services sector, resulting in a drop in new orders, output and employment. In response, European gross domestic product shrank by 0.6% in the fourth quarter of 2020. Given some of these lockdown measures remain in place, the European economy will likely see a decline in GDP through the first quarter, putting the region back into a recession for the second time in a year. The European economy fell into a recession in the second quarter of 2020 before rebounding to a record 12.4% expansion in the third quarter. Should Europe fall into recession, it may be short-lived as easing lockdown restrictions and wider distribution of COVID-19 vaccines could lift economic activity for the remainder of 2021. Furthermore, strong European trade ties with China, most notably for manufactured goods, could provide the regional economy with another tailwind, particularly as the economic superpower continues to strengthen. European equities, as measured by the STOXX Europe 600 Index, rose during the month. Investors brushed aside concerns of the ongoing lockdowns, maintaining a bullish sentiment towards growth in 2021 as the widespread distribution of COVID-19 vaccines may bring economic conditions back to normal.

Commodity prices in high gear

Commodity prices surged higher in February, with lumber hitting record-highs and copper setting a multi-year high. Renewed demand as economic conditions improve in many parts of the world contributed to the higher demand for commodities. Lumber, in particular, skyrocketed amid strong demand from the construction of new homes and with home renovation projects. The price of lumber reached a record closing high of US$1,021.80 per thousand board feet during the month. Copper hit a multi-year high on strong demand coupled with declining supply from Chinese smelters. On the London Metal Exchange, the price of copper closed at US$9,412.50/tonne on February 25, the highest closing price since 2011. Oil prices also climbed in February in response to falling inventories of crude oil globally, rising 18%. A major snowstorm hit Texas and other parts of the southern U.S. during the month that halted production and restricted supply.

Meanwhile, the Organization of the Petroleum Exporting Countries plus Russia maintained their production cuts in February. Overall, the Bloomberg Commodity Index rose by 6% for the month. The higher prices for commodities may provide a tailwind for Canada's resource-rich economy and could provide some upward momentum for the Canadian dollar.

Market performance - as at February 28, 2021

Equity Markets	Level	Month to date	Year to date	One year
S&P/TSX Composite Index C$	18,060.26	4.17%	3.60%	11.05%
S&P 500 Index US$	3,811.15	2.61%	1.47%	29.01%
Dow Jones Industrial Average US$	30,932.37	3.17%	1.06%	21.74%
MSCI EAFE Index US$	2,168.87	2.11%	0.99%	19.85%

MSCI Emerging Markets Index US$	1,339.26	0.73%	3.72%	33.19%

Fixed Income Markets	Level	Month to date	Year to date	One year
FTSE Canada Universe Bond Index C$	1,177.25	-2.52%	-3.60%	1.09%
FTSE World Investment Grade Bond Index US$	250.65	-1.87%	-2.85%	4.12%

Currencies	Level	Month to date	Year to date	One year
CAD/USD	0.7850	0.30%	-0.10%	5.26%

Commodities	Level	Month to date	Year to date	One year
West Texas Intermediate (US$/bbl)	61.50	17.82%	26.75%	37.40%
Gold (US$/oz)	1,734.04	-6.15%	-8.66%	9.36%