

May 2021 market update

Inflation concerns persist globally, the loonie soars and crypto mania hits equity markets.

June 7, 2021



Introduction

The ongoing vaccine rollout and easing lockdown restrictions in some parts of the world helped improve economic activity during May. Globally, manufacturing and services sector activity was strong, signaling improving conditions. U.S. President Biden introduced his new budget, which focused on increasing spending to support households and the broader economy. Some U.S. Federal Reserve Board (“Fed”) members gave speeches and interviews that hinted bond tapering might be on the way.

In Canada, the S&P/TSX Composite Index reached a new high in May. The Materials and Financials sectors led Canada’s main equity index higher. South of the border, U.S. equities posted a small gain, with the Dow Jones Industrial Average and S&P 500 Index both hitting record highs early in the month. Rising inflation and the shift to value stocks weighed on the technology sector, dragging down the NASDAQ Composite Index. Global equities, as measured by the MSCI ACWI Index, advanced over the month. The yield on 10-year government bonds in both Canada and the U.S. fell in May. The price of gold moved higher, supported by expectations for higher inflation. Oil prices also advanced in response to an improving outlook for demand.

Inflation concerns are not abating

Inflation data released in May confirmed expectations that significant inflationary pressures are building in the global economy. Consumer prices have risen markedly over the same time last year. In the U.S., the inflation rate was 4.2% in April, the highest reading since 2008, while in Canada, consumer prices rose at their sharpest pace since 2011, increasing 3.4%. These high rates are likely to ease, but consumer prices could remain elevated as inflationary pressures build at the producer level. Inputs to production, such as lumber, copper and iron ore, are rising to record prices and weighing on businesses. Companies may pass these costs onto customers, which could slow the economic recovery. Given some volatility in equity markets over the month, this is a genuine concern for investors and is likely to persist until inflation rates slow or global central banks act to contain inflation.

U.S. Federal Reserve Board considers tapering

The Fed released the minutes from its April meeting and they confirmed the Fed's outlook to hold its key rate near zero for the next couple of years in response to low employment and a belief that high inflation is transitory. Pressure could mount if high inflation continues and economic conditions improve. Other global central banks are signaling their intent to increase their key interest rates ahead of earlier projections, notably the Bank of Canada ("BoC"), Bank of Korea and the Reserve Bank of New Zealand.

However, the Fed's meeting minutes showed many members signaling a willingness to taper the Fed's bond buying. Vice-Chair Richard Clarida reiterated this willingness when he indicated the discussion about scaling back bond purchases would begin at an upcoming meeting. The Fed initiated these bond purchases last March at the onset of the pandemic when lockdowns forced business activity to a virtual standstill. The Fed started the US\$120 billion of monthly bond purchases to help improve liquidity. Now, economic conditions are improving both in the U.S. and worldwide, driving consideration to reduce bond purchases. The U.S. economy is benefiting from a successful vaccine rollout, which has led many areas of the country to reopen fully.

The soaring loonie

The Canadian dollar advanced markedly against the greenback during the month, rising almost 2% and reaching US\$0.8289 by month-end, a level not seen since 2015. The Canadian dollar is being driven higher by a variety of factors. Rising commodity prices, particularly for oil, have provided the Canadian dollar with some tailwinds. As oil prices rise, it helps Canada's energy sector, which benefits its entire economy. Secondly, the BoC has hinted its central interest rate may increase ahead of expectations. An earlier-than-expected rate increase from the BoC should be constructive for the Canadian dollar. Additionally, the U.S. dollar has come under pressure, particularly in response to rising government spending and expectations for rising inflation, providing yet another tailwind for the loonie. So far, the rising price of the loonie has not had an impact on Canada's economy.

Crypto mania hitting equity markets

Cryptocurrencies, headlined by Bitcoin, have reached new record prices in 2021. The broader adoption of digital currencies by institutional investors has helped push up prices. Many individual investors are using crypto as a potential hedge against the decline of the U.S. dollar and a runup in inflation. However, the extraordinary rise in the price of Bitcoin came to a halt as its price fell 35% in May. What precipitated this drop? Concerns about its impact on the environment. Prominent names such as U.S. Treasury Secretary Janet Yellen and Tesla CEO Elon Musk said the amount of energy used to mine for Bitcoin is unhealthy for the environment. After recently announcing that Tesla would begin accepting Bitcoin as payment, Mr. Musk announced he would not accept or sell any Bitcoin until the mining process becomes more energy efficient.

While cryptocurrencies are in their infancy, the popularity and growth of crypto impact many publicly listed companies. Both Coinbase Global Inc. and Tesla Inc., two companies steeply connected to Bitcoin, have had notable share price declines during the month. There are still many unknowns about cryptocurrencies, but recent events demonstrate their growing acceptance in financial markets and the attention it is garnering from all investors.

Market performance - as at May 31, 2021

Equity Markets	Level	Month to date	Year to date	One year
S&P/TSX Composite Index C\$	19,730.99	3.26%	13.18%	29.87%
S&P 500 Index US\$	4,204.11	0.55%	11.93%	38.10%
Dow Jones Industrial Average US\$	34,529.45	1.93%	12.82%	36.03%
MSCI EAFE Index US\$	2,334.00	2.89%	8.68%	35.30%
MSCI Emerging Markets Index US\$	1,376.21	2.12%	6.58%	47.92%

Fixed Income Markets	Level	Month to date	Year to date	One year
FTSE Canada Universe Bond Index C\$	1,167.71	0.63%	-4.38%	-1.72%
FTSE World Investment Grade Bond Index US\$	250.78	0.78%	-2.80%	3.62%

Currencies	Level	Month to date	Year to date	One year

CAD/USD	0.8289	1.81%	5.43%	14.17%
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Commodities	Level	Month to date	Year to date	One year
West Texas Intermediate (US\$/bbl)	66.91	5.24%	37.90%	88.53%
Gold (US\$/oz)	1,906.87	7.79%	0.45%	10.21%