Monthly Market Monitor

July 2020

NEI

HIGHLIGHTS

Strong quarter for stocks

U.S. stocks had their best quarterly return since 1998 and the S&P/TSX Composite return was the best in over a decade based on encouraging economic data. Both leading and lagging indicators point to a bottom where the worst of global economic data is likely behind us. The pace of recovery, however, remains uncertain.

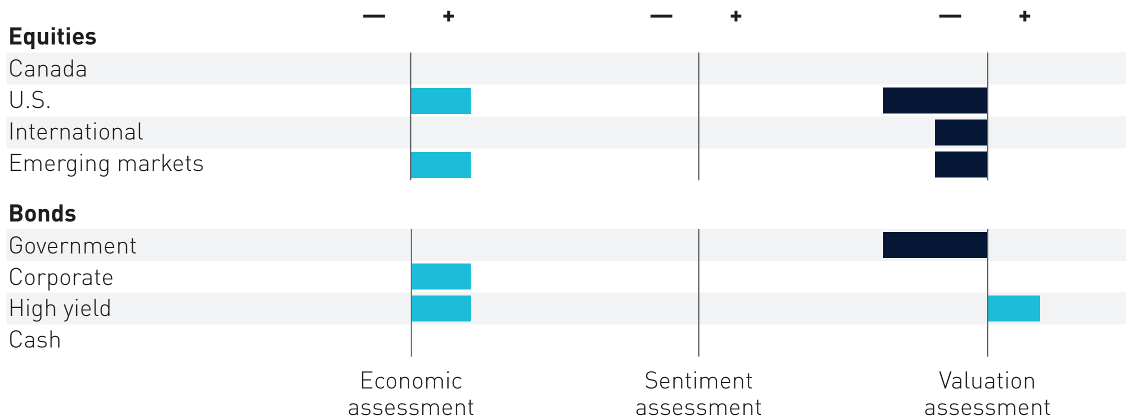
Re-openings leading to surge in new cases

As feared, pockets of new infections are rising in some re-opened U.S. states. As healthcare systems have had time to ramp up capacity, this is not a huge concern for markets for the time being. Should the trend continue, we may see the economic recovery stretched out even longer.

Continued caution

Economic data seems to have finally started catching up to the equity market rally, but we wouldn't be overly optimistic. Increases in new infections, weak fundamentals, and U.S.-China tensions are some of the reasons we continue to stay cautious in the near term.

OUTLOOK SUMMARY



Source: NEI Investments. Data as of June 30, 2020.

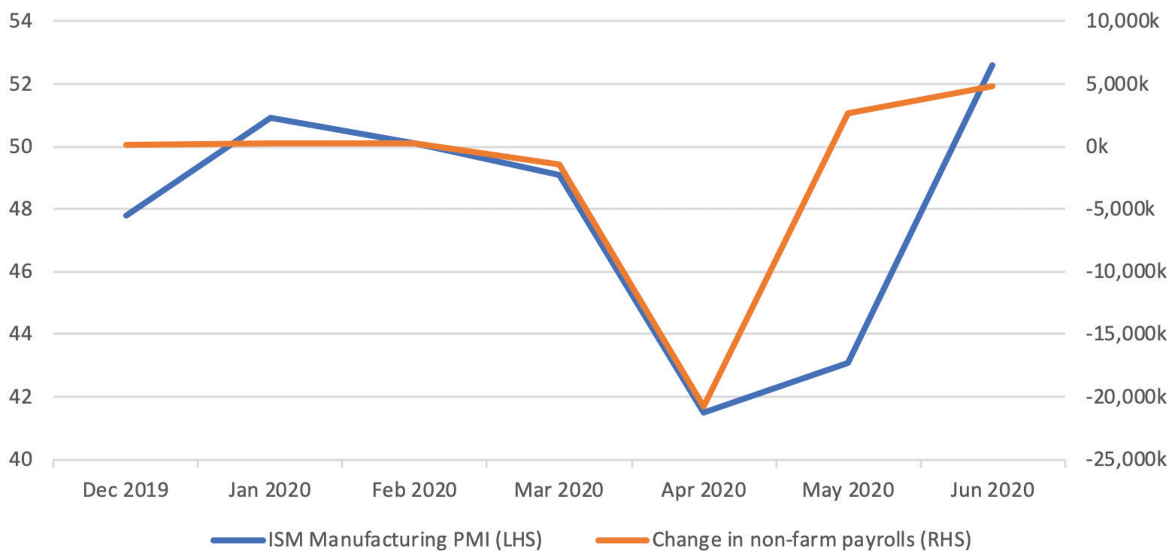
ALLOCATION INDICATOR

MARKET REVIEW AND OUTLOOK

Q2 2020 marked the best quarterly return for U.S. stocks since 1998 as the S&P 500 posted a local currency return of 20.5%, highlighting the strong recovery rally that has taken place since the March 23 bottom.

Within our asset allocation solutions, we were neutrally positioned between stocks and bonds on a tactical basis, and risks indeed emerged balanced in that manner. Economic data in early June marked what could be the trough in what many economists have dubbed the worst global economic downturn since at least World War II and perhaps even the Great Depression. Improving business activity and a surprise gain in U.S. non-farm payrolls, on the back of more stimulus measures from the U.S. Federal Reserve and European Central Bank, pushed the S&P 500 to within 5% of its all-time highs in early June.

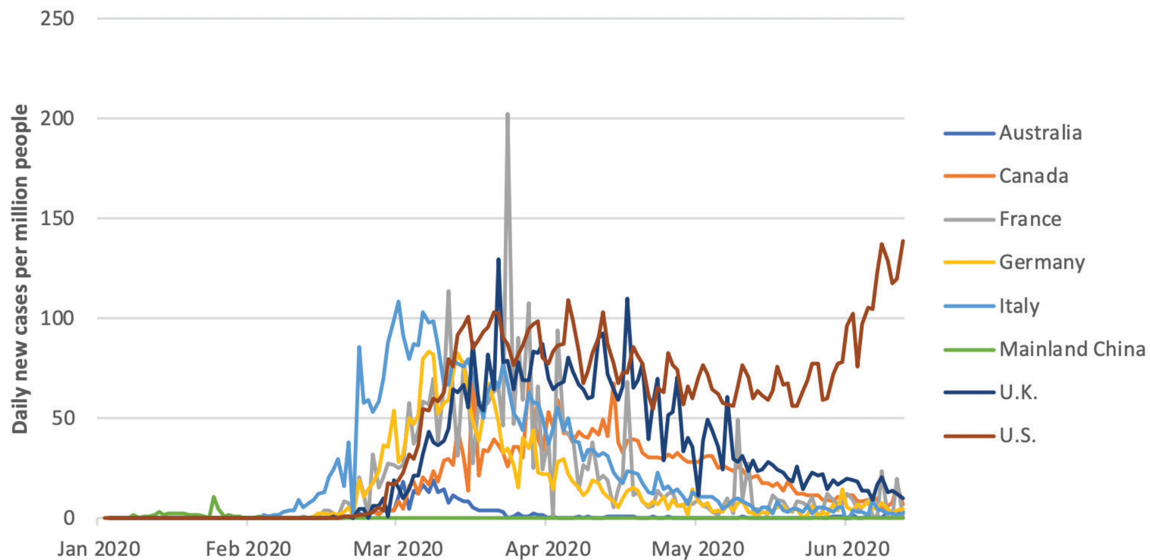
Upturn in the U.S economy



Source: Bloomberg. Data as of June 30, 2020.

Investor sentiment then quickly turned negative as a wave of anti-racism protests spread across the U.S. and around the world. In addition, a much dreaded but somewhat expected development: a resurgence of new coronavirus cases in certain U.S. states as they reopened, prompting governors to quickly reverse some of the reopening measures. This was our primary concern last month, given the U.S. administration's poor track record of managing the pandemic.

U.S. new coronavirus cases reach record highs



Source: Bloomberg. Data as of June 30, 2020.

If we were to see a second wave in new coronavirus cases, economies will likely face further delays in reopening, resulting in a longer path to recovery. In turn, this could lead to more equity market volatility in the short- to medium-term, but we would not expect to see another global lockdown. The last few months gave world governments a much-needed preparation window. Until a vaccine is developed, the virus is not going away, and infections will continue. Today, healthcare systems have a greater capacity to deal with the pandemic than they did back in March, which could make all the difference. Again, as we are facing a global health crisis, there will be always some degree of uncertainty as events unfold.

The International Monetary Fund revised their 2020 real GDP growth estimate to -4.9% from -3.0% in April, and instead of 5.8% growth in 2021, they now expect growth of 5.4%. Given the extreme uncertainty surrounding this pandemic it was not surprising that we'd see revisions to economic forecasts. Markets have been incredibly eager to price in the eventual recovery – perhaps a bit too eager. Despite signs of global growth turning positive, it is clear there is a long road ahead of us.

On balance, our tactical positioning within our asset allocation solutions remains neutral. There are a number of reasons for caution heading into the summer months: second waves, escalating U.S.-China tensions, and of course U.S. elections in November. That said, with record amounts of institutional cash on the sidelines, central banks standing by to intervene, and optimistic retail investors, it may be difficult for equity markets to correct significantly from these levels.

CANADA

Following a 7.5% drop in March, April monthly GDP fell 11.6% with weakness across all sectors. That said, with a surprise 290,000 jobs added in May and most major cities re-opening, we should see growth start to pick up. As per the IMF's updated outlook, Canada's economy is expected to shrink 8.4% this year, worse than the 8.0% decline projected for all advanced economies. Despite a recent rebound in crude oil prices, the energy sector faces a slump in global demand which could last well into year-end.

A sustained recovery for Canada also depends largely on the demand side of the economy. Highly levered households are more vulnerable to economic shocks, and at 181% Canada has one of the highest household debt-to-disposable income ratios across developed nations according to the OECD (in comparison, the U.S. stands at 105%). Taken in consideration along with headwinds in the energy sector, it may be difficult for Canadian equities to outperform the broad global market in the near term.

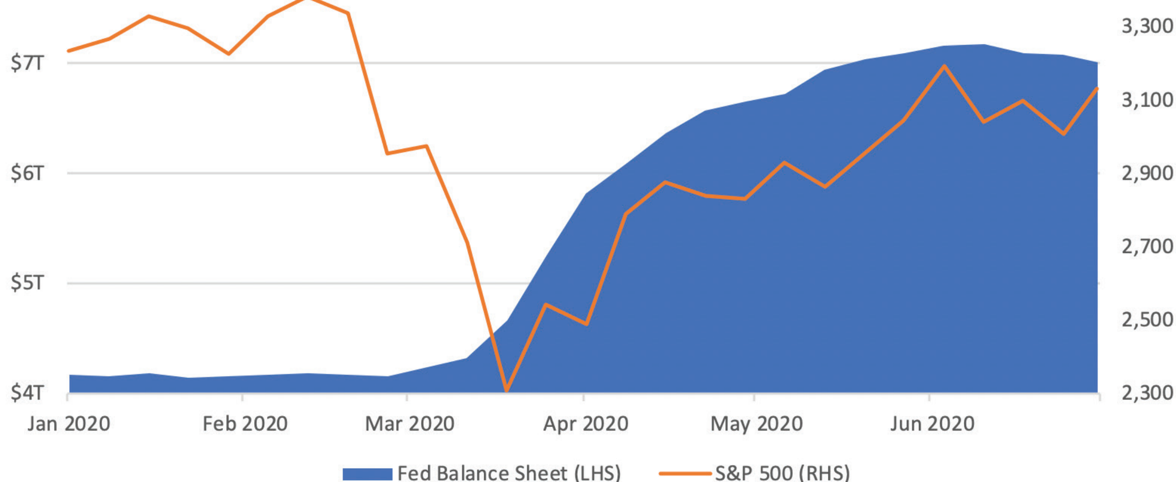
The Canadian Emergency Response Benefit has been extended another 8 weeks, and it's likely more government stimulus will be needed after that. Tiff Macklem, taking over as Bank of Canada Governor in late June, noted in his first speech that "it will be a very long period before we start discussions about removing stimulus."

While households are highly indebted, we have previously noted that the Government of Canada has the lowest net debt to GDP ratio across the G7. Despite a credit rating downgrade by Fitch to AA+, our balance sheet has ample room for additional fiscal response. Within fixed income, we continue to favour investment grade corporate over government bonds, with an overall benchmark neutral duration.

U.S.

In mid-June, the Fed announced they will be purchasing debt from individual corporate issuers, on top of their existing purchases in corporate bond ETFs. Since the pandemic, the Fed's balance sheet has swelled from US$4.3 trillion to over US$7.0 trillion and counting. With policy rates anchored until at least 2022, the Fed appears to be prepared to use as much stimulus as necessary. At the June FOMC meeting Fed Chair Jerome Powell gave investors a dovish yet grim reminder of the current economic reality, saying they are "not even thinking about thinking about [a rate hike]."

Fed stimulus continues to boost equities



Source: Bloomberg. Data as of June 30, 2020.

As long as the Fed runs the money printer, we should see support for equity and credit markets. It also helps that U.S. economic data has turned positive as indicated by surprise improvement in the labour market, a record gain in pending home sales, and an uptick in PMI. The personal savings rate remains high (still nearly triple pre-COVID levels), which should bode well for consumer spending once lockdown measures are lifted. This does not necessarily mean we're more positive on the U.S. economy, it just means the economy is now catching up with the stock market rally. We remain overweight U.S. equities on a tactical basis but will look to take profits over the coming months.

INTERNATIONAL

The eurozone saw the largest downward revision from the latest IMF forecasts. GDP is expected to contract 10.2% this year, compared to the initial estimate of -7.5% in March. With key rates unchanged, the European Central Bank increased the Pandemic Emergency Purchase Programme by 600 billion euros, bringing the total to 1,350 billion. The purchase horizon of the program was extended to June 2021 and maturing payments will be reinvested to the end of 2022.

The eurozone is set to reopen its international borders in July and whether it can be done without triggering large second waves will be critical to its recovery. According to the European Parliament as of 2018, tourism accounts for 10.3% of GDP and 11.7% of total employment, several times higher than North America. On a tactical basis we continue to have a slight underweight to international equities.

Meanwhile, China continues to lead the economic recovery. PMI indicators are back above 50, industrial profits rose in May, and automobile traffic in major cities is approaching pre-COVID levels (Shanghai is already back). Beijing's passing of the Hong Kong national security legislation will no doubt ruffle feathers with Western countries. With talks of sanctions and other forms of retaliation, we can expect increased U.S.-China tensions ahead.

MARKET PERFORMANCE

Percent return in Canadian dollars

	1 Mo	3 Mo	6 Mo	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
Bonds								
Bloomberg Barclays Canada Aggregate	1.60	5.67	7.42	7.42	7.73	5.25	4.11	4.58
Bloomberg Barclays Global Aggregate (CAD Hdg)	0.49	2.33	3.75	3.75	5.67	4.51	4.01	4.29
Bloomberg Barclays US High Yield 2% Issuer Cap (CAD Hdg)	0.95	9.97	-4.81	-4.81	-1.33	2.23	3.94	6.48
Equities								
MSCI World (Developed Markets)	1.15	14.21	-1.03	-1.03	7.19	8.41	8.78	12.72
MSCI World Growth	3.00	20.13	11.82	11.82	22.47	15.93	13.36	15.72
MSCI World Value	-0.78	7.73	-13.64	-13.64	-7.57	0.77	4.00	9.56
MSCI Canada	2.10	14.99	-8.53	-8.53	-4.36	2.75	3.39	5.29
MSCI USA	0.74	16.34	2.46	2.46	12.35	12.16	12.03	16.25
MSCI EAFE	1.89	9.93	-6.88	-6.88	-1.12	2.42	3.85	8.39
MSCI Europe	2.55	10.29	-8.40	-8.40	-2.84	1.60	3.24	8.31
MSCI Japan	-1.48	6.80	-2.45	-2.45	7.46	4.61	5.27	8.76
MSCI Pacific Ex Japan	6.43	15.01	-8.60	-8.60	-9.05	2.43	4.48	8.30
MSCI EM (Emerging Markets)	5.78	12.99	-5.24	-5.24	0.70	3.53	4.67	5.87
World currencies (relative to CAD)								
US Dollar	-1.46	-4.31	5.03	5.03	4.23	1.60	1.76	2.51
Euro	-0.50	-2.05	5.09	5.09	2.80	1.08	1.92	1.63
Pound Sterling	-1.52	-4.65	-2.04	-2.04	1.19	-0.08	-3.04	0.57
Yen	-1.60	-4.25	5.80	5.80	4.09	2.98	4.35	0.50

Source: Morningstar. Data as of June 30, 2020.

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