Monthly Market Monitor

April 2021

HIGHLIGHTS

Inflation to run hot
Rising global inflation is a primary concern for investors. Fiscal stimulus, excess savings, supply constraints, and the U.S. Federal Reserve's policy stance are all supportive of inflation running hot this year.

U.S. Fed committed to new inflation framework
The Fed has confirmed it will allow inflation to go over its long-term 2% target, showing it is committed to its new inflation framework known as the "flexible form of average inflation targeting," or FAIT.

Rotation into economically sensitive assets continues
The outlook for global economic growth continues to be upgraded due to the massive amount of stimulus and the pace of vaccine distributions. The rotation into stocks with high beta to economic growth such as cyclical and value stocks continues.

ASSET ALLOCATION OUTLOOK SUMMARY

This month
Last month

	Negative		Neutral	Positive	
Equity					
Canada Equity				This month	
U.S. Equity			Last month	This month	
International Equity			This month		
EM Equity			This month	Last month	
Fixed Income					
Government Bonds		This month			
Corporate Bonds			This month		
High Yield Bonds			This month		
Overall equity				This month	
Overall fixed income		This month			

This table illustrates the short-term outlook of NEI's Asset Allocation Team on various equity and fixed income asset classes as of March 31, 2021. If an asset class has a blue box in its row and no green box, it means this month's outlook is the same as the prior month's.

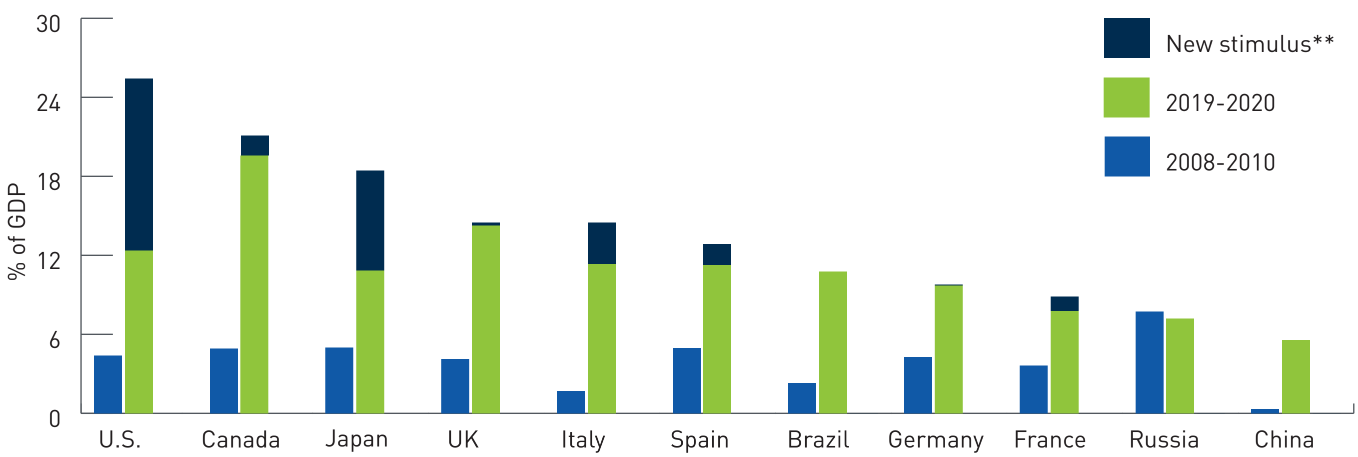
OVERVIEW

Global markets consolidated throughout March as investors processed the implications of better global growth, higher inflation, and the sharp jump in yields seen in February. Global stock indices excluding emerging markets were up moderately during the last month, with the rotation from growth and technology stocks to cyclical and value stocks continuing under the surface. The highly anticipated Federal Reserve decision in March confirmed the central bank is committed to allowing inflation to run over the 2% target, setting the stage for yields to continue to climb higher.

Rising U.S. yields helped the broad U.S. dollar index rise, putting in a counter-trend rally against the downward trend in place since March 2020. Commodity prices fell due to the rising U.S. dollar and extended bullish positioning. Economically sensitive commodities like oil and copper, which had a strong run this year, took a breather, while gold has continued its selloff.

The outlook for global economic growth continues to be upgraded due to the massive amount of stimulus (see chart below from BCA Research) and the pace of vaccine distributions. Based on data from Goldman Sachs[1], the distribution of vaccines has taken on 2 speeds as of the end of March. In the U.S. 28.9% of the population has received their first shot, while in Europe roughly 11.0% have received their first shot (11.8% in France, 11.3% in Italy, 11.2% in Germany, 10.9% in Spain and 45.2% in the UK). Europe is behind on vaccines and is now battling a new wave of COVID-19 cases. With the end of the pandemic in sight, policymakers have tightened social distancing rules to prevent another wave before the vaccine can be distributed. The U.S. economy is expected to outperform in the beginning of the year, with economic momentum swinging to the rest of the world later this year.

Fiscal Stimulus* (% of GDP)



* Calculated as the absolute value of the change in overall balance (net lending/borrowing as % of GDP). Excluding loan guarantees and quasi-fiscal stimulus.

** New stimulus plans (all in US$) revealed after October 2020, including: the U.S. $2800B omnibus bill and Biden rescue plan; Japan's third relief package with $385B in direct fiscal spending; Canada's proposed $78B stimulus plan over the next 3 years (assuming spend evenly); the UK's $6.2B new lockdown stimulus; Italy's $53.9B business aid and stimulus; Spain's $13B small businesses aid; Brazil's $8B extended federal cash transfer program; and France's $24.3B business aid plan. Additionally, Italy, Spain, Germany and France's new stimulus include commitments from the EU recovery grants (excluding loans).

Source: IMF fiscal monitor (October 2020) and BCA Research Inc. calculations. For more information please visit: https://www.bcaresearch.com/

[1] Combined data from: Our World in Data, Johns Hopkins University Centers for Civic Impact, Goldman Sachs Global Investment Research.

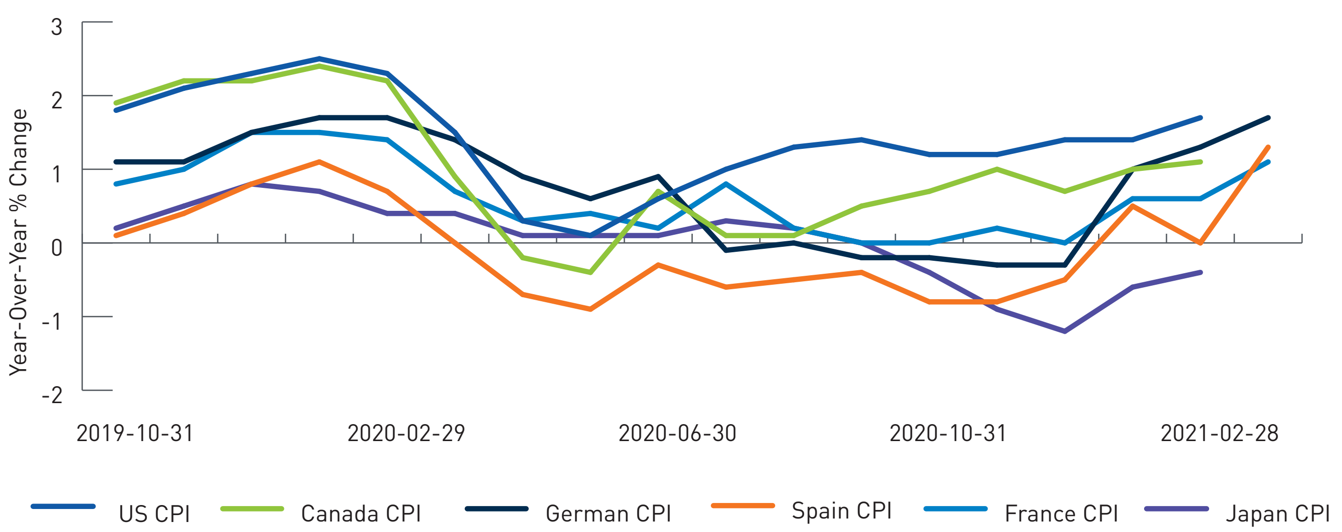
According to Bank of America's monthly survey of global asset managers, rising global inflation is the number one risk to markets, replacing COVID-19 concerns for the first time since the pandemic started. Fiscal stimulus, excess savings, supply constraints, and the Federal Reserve's policy stance are all supportive of higher prices and inflation running hot this year.

Lockdowns have prevented people from spending and fiscal stimulus has increased incomes, allowing consumers to accumulate significant excess savings. As economies begin to open there is plenty of pent-up demand which should drive consumption for the rest of the year. The global supply-side of economies has seen many bottlenecks due to lockdowns, causing shortages and higher prices for goods. Market participants are trying to anticipate how much the additional pent-up demand will increase inflation.

Additionally, on March 23, a giant container ship blocked the Suez Canal, one of the world's most critical trade routes accounting for about 12% of global trade. Based on rough estimates the blockage held up around $5.1 billion a day in westbound traffic and approximately $4.5 billion a day in eastbound traffic. After 6 days the ship was freed, and efforts are under way to restart shipping with more than 450 vessels waiting near the canal. The unexpected trade route blockage adds pressure to supply-side shortages and inflation.

Over the next few months, we expect to see price pressures on the supply-side show up in the inflation data. Also due to the significant drop in inflation last March, the base effects for year-over-year data will cause higher inflation readings. We are already seeing the beginning of inflation turn up in developed economies (see chart below). There is a high probability that U.S. inflation data between March and May will be over 2%, which should support rising yields. We expect the trend of rising bond yields to continue and are underweight bonds in our asset allocation solutions.

Global Inflation Data



Source: Bloomberg. Data as of March 31, 2021.

The incoming positive news on global growth, vaccine distribution and the magnitude of fiscal stimulus packages makes it difficult to articulate a bearish thesis on global stocks. However, being overly bullish given all the positive news makes it easy to become complacent. We remain overweight stocks in our asset allocation solutions, but we are watching for excessive bullish sentiment in markets.

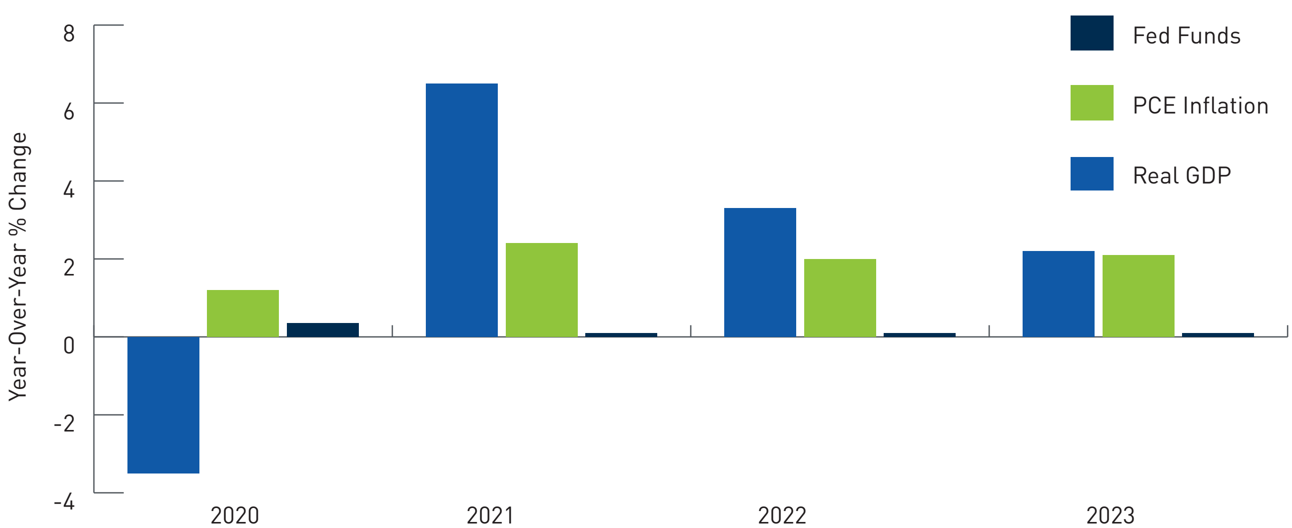
U.S.

The Federal Reserve has confirmed it will allow inflation to go over its long-term 2% target, showing it is committed to its new inflation framework.

Generally, when inflation reaches 2%, the Fed begins to tighten monetary conditions by raising interest rates to reduce inflation. In August 2020, the Fed changed its inflation framework noting it "will likely aim to achieve inflation moderately above 2% for some time" after periods of persistently low inflation. This new strategy is called the "flexible form of average inflation targeting," or FAIT.

The Fed's March economic projections show expected real GDP growth of 6.5% in 2021 and inflation of 2.4%. That means the Fed expects nominal GDP to grow 8.9% in 2021. The Fed is expected to keep interest rates at zero for the next three years despite strong growth and inflation.

Federal Reserve - Median Economic Projections



Source: Bloomberg, U.S. Federal Reserve. Data as of March 17, 2021.

Following the spike in bond yields in February, markets were expecting the Fed to hint at some sort of support to keep yields low through either yield curve control, "operation twist," or a hint at monetary tightening. The Fed went against these expectations by reaffirming its intent to keep rates at zero until 2023, stating that they believe the rise in inflation is temporary. By keeping monetary policy easy, the Fed is letting the economy run hot. We expect strong economic growth and higher inflation to force yields to rise further, causing us to remain underweight bonds and overweight cyclical stocks in our asset allocation solutions.

CANADA

The main concern in Canada has been the slow distribution of vaccines and the possibility of a third wave of virus cases. According to Bloomberg, a total of 5.43 million doses of the vaccine have been administered averaging 176,873 doses per day. At this rate, it will take an estimated 9 months to cover 75% of the population with 2 doses. In addition to vaccine supply issues, health officials have recommended a pause on the AstraZeneca vaccine to people under 55 because of a risk of blood clots. This further extends the timeline for Canada to vaccinate its population.

Despite the logistical issues with vaccine distribution, we still maintain a positive view on Canadian stocks. Tight supply conditions in commodity markets should sustain momentum in the energy and materials sectors over the coming quarters. As global growth returns throughout the year, Canada should benefit from the continued upturn in cyclicals and the commodity rally.

INTERNATIONAL

Within our asset allocation solutions we are neutral on international equity; however, we are beginning to shift toward a positive view on Europe. Investors continue to rotate into indices with high beta to economic growth.

Europe is still dealing with vaccine distribution issues and new virus cases, but equity markets are beginning to look attractive. PMI data show the service sector may have turned the corner, and the manufacturing sector remains strong with the euro area manufacturing PMI hitting all-time highs. Additionally, the European Central Bank has decided to increase the pace of its bond purchases over the next quarter. This should keep rates low in Europe and put downward pressure on the euro, which would support exporters. European stock markets have a higher weighting to banks and economically sensitive cyclical sectors, which stand to benefit in the current environment.

Our view on emerging markets is neutral, and we are tilting toward a negative stance on China. China's credit impulse leads growth by about 6 months and it peaked late last year. Debt growth is an important driver of economic activity through lending to consumers and businesses. The credit impulse is a simple measure of the flow of credit into the economy. Specifically, the credit impulse is the change in the growth rate of credit which correlates closely with private demand. The monetary tailwinds in China have faded while the rising U.S. dollar and yields continue to add headwinds. The performance of emerging market indices has been driven by technology stocks, which we expect will suffer as interest rates rise, specifically the China-related software stocks.

MARKET PERFORMANCE

Percent return in Canadian dollars

	1 Mo	3 Mo	6 Mo	YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs
Fixed Income								
Bloomberg Barclays Canada Aggregate	-1.46	-4.95	-4.47	-4.95	1.36	3.69	2.74	3.94
Bloomberg Barclays Global Aggregate ($C Hdg)	-0.40	-2.48	-1.69	-2.48	1.32	3.79	2.83	4.09
Bloomberg Barclays US HY 2% Issuer Cap ($C Hdg)	0.15	0.83	7.14	0.83	23.05	5.74	7.19	6.23
Equities								
MSCI World (Developed Markets)	2.58	3.51	12.51	3.51	36.01	11.86	12.71	12.73
MSCI World Growth	0.10	-1.11	6.16	-1.11	39.69	17.47	16.59	15.36
MSCI World Value	4.95	8.09	19.31	8.09	30.93	5.81	8.49	9.91
MSCI Canada	4.18	8.12	17.47	8.12	40.64	8.64	9.00	5.05
MSCI USA	2.97	3.95	12.05	3.95	40.01	15.80	15.42	16.32
MSCI EAFE	1.56	2.09	12.99	2.09	27.66	5.13	8.23	8.26
MSCI Europe	2.34	2.68	13.22	2.68	27.99	4.75	7.56	7.81
MSCI Japan	0.33	0.20	10.15	0.20	23.39	5.42	9.84	9.99
MSCI Pacific Ex Japan	0.25	3.21	18.19	3.21	35.95	6.22	8.93	7.75
MSCI EM (Emerging Markets)	-2.22	0.91	15.20	0.91	39.86	5.58	11.43	6.34
World Currencies (relative to CAD)								
US Dollar	-0.72	-1.35	-5.91	-1.35	-11.70	-0.84	-0.57	2.60
Euro	-3.87	-5.24	-5.69	-5.24	-5.42	-2.33	0.04	0.68
Pound Sterling	-2.03	-0.43	0.42	-0.43	-1.75	-1.39	-1.38	1.07
Yen	-4.28	-7.82	-10.14	-7.82	-13.73	-2.10	-0.23	-0.31

Source: Morningstar. Data as of March 31, 2021.

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