Monthly Market Monitor

May 2021

NEI

HIGHLIGHTS

Supply constraints driving inflation
Incoming inflation data and rising commodity prices reflect a rebounding global economy, leading to higher input prices mainly driven by supply constraints.

Cases surging in India
The surge of COVID-19 in India has grown to crisis proportions, with cases now exceeding 350,000 per day and record deaths. The country's economic recovery is in jeopardy, though equities were flat over the past month.

Now that stimulus has passed, taxes are being planned
U.S. President Joe Biden's first 100 days have delivered the strongest post-election U.S. equity returns in at least 75 years on the back of record stimulus. Naturally, the focus is turning to how all of it will be paid for.

ASSET ALLOCATION OUTLOOK SUMMARY

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

This month / Last month

This table illustrates the short-term outlook of NEI's Asset Allocation Team on various equity and fixed income asset classes as of April 30, 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.

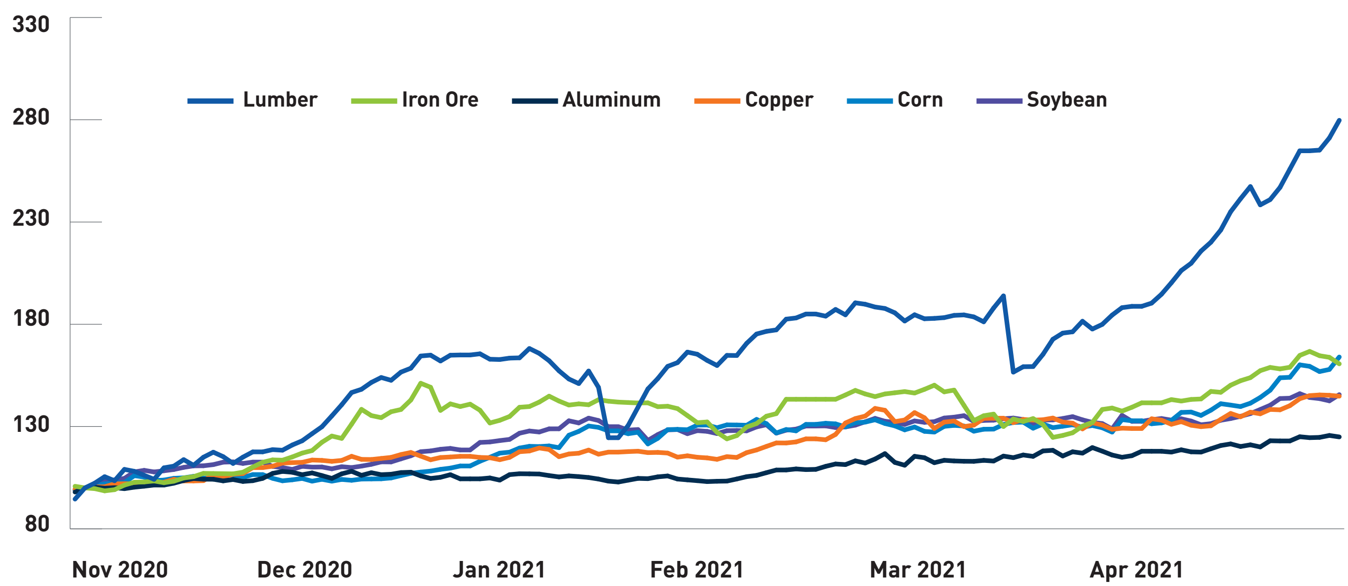
OVERVIEW

Global stock markets continued to rally in April on positive economic news and in the face of rising fears of a new wave of COVID-19 infections. Vaccine distribution has been encouraging and it appears it will be effective in stopping the virus once everyone has access. In the U.S., individuals over 65 have been prioritized, and in turn their case counts and hospital admissions have been significantly lower than the rest of the population.

Despite higher commodity prices and strong inflation data, global bond markets consolidated last month. Bond yields did not rise as incoming economic data merely confirmed the economic rebound, implying the bar for inflation surprises is set very high. Going forward it will be important to watch whether supply constraints or increased demand are driving inflation readings higher. We remain positive on equities on the back of rebounding economic growth and are underweight bonds in our asset allocation solutions as inflation is expected to rise into year-end.

Looking at the incoming inflation data it is clear the global economy is rebounding, which is leading to higher input prices mainly driven by supply constraints. The latest ISM Manufacturing survey showed the prices paid component hit 89.6, one of the highest readings in the survey's history. The prices paid component has only been above 90 once since the 1970s. Higher demand and prices can also be seen in the housing market as new home sales and housing starts in the U.S. reached the highest levels since 2006. Additionally, the number of homes available for sale has fallen to the lowest level since the 1970s. Low interest rates have driven strong demand for housing, which combined with tight supply, has pushed lumber prices up significantly. The chart below shows the massive rise in lumber prices over the last six months as well as other important raw materials. Supply bottlenecks in raw materials and transportation are supporting commodity prices.

Commodity Prices Past 6 Months



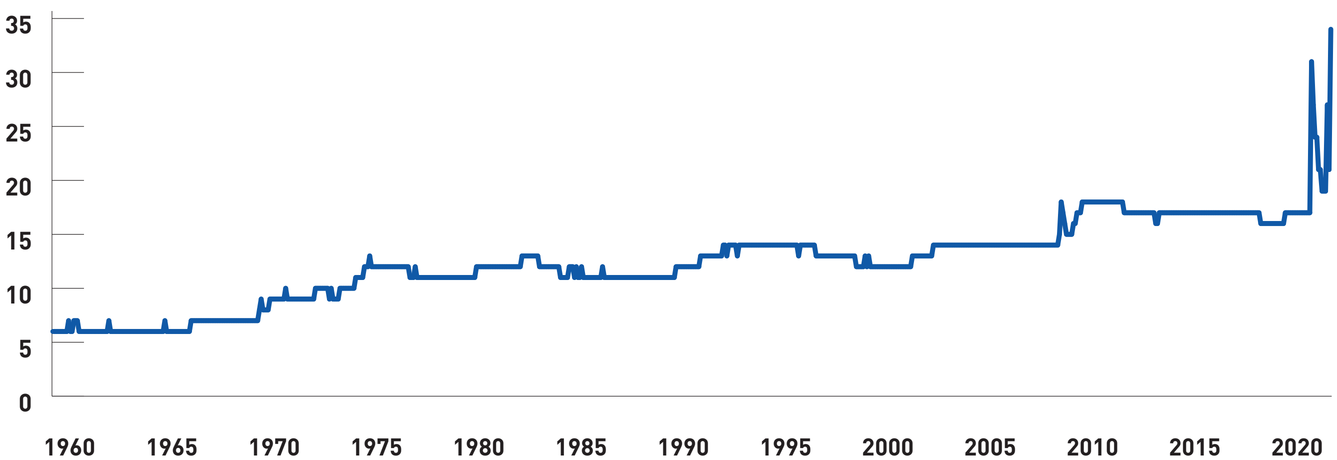
Prices rebased to 100 as of November 3, 2020. Source: Bloomberg. Data as of April 30, 2021.

U.S.

U.S. President Joe Biden delivered his State of the Union address to Congress and laid out his progressive economic agenda. The plan includes a massive US$4 trillion in infrastructure and social spending, which is expected to be funded by taxes on corporations and the wealthy. Biden appealed to senators for the country to unite, however, most of the proposals are not expected to receive Republican support.

The size and impact of the latest stimulus package is showing up in U.S. economic data releases. In March, government transfer payments as a percentage of personal income hit a new high, accounting for 34% of personal income, as shown in the chart below.

U.S. Government Transfer Payments As % of Personal Income



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

According to JP Morgan, Biden's first 100 days have delivered the strongest post-election equity returns in at least 75 years. Since Biden's election and the Georgia Senate victory, investors have driven stock prices higher on the back of record stimulus. Now that the major stimulus measures have been passed, the conversation is naturally turning to how it will all be paid for it. Biden has proposed a new tax plan with three major elements:

1) Increasing the corporate tax rate from 21% to 28%

2) A minimum global corporate tax for the G20

3) Almost doubling the capital gains tax rate from 20% to 39.6% for those who make more than US$1 million

A recent study by Goldman Sachs analyzed past capital gains tax changes and found that capital gains tax hikes would reduce household equity allocations driven by the wealthiest 1%. However, the trend of net equity selling after a capital gains tax has usually been short lived and reversed during subsequent quarters.

Lastly, the Federal Reserve kept monetary policy unchanged at the April meeting, reinforcing its commitment to average inflation targeting. The Fed recognizes the strengthening economy and believes the recent rise in inflation is transitory. Fed Chair Jerome Powell reiterated it was not yet time to begin thinking about tapering and said the Fed would communicate such decisions "well in advance."

CANADA

A new wave of COVID-19 cases has led to further lockdowns and restriction. On April 16 Ontario Premier Doug Ford extended an emergency stay-at-home order and implemented strict measures to limit the movement of people. Lockdowns are no doubt making their impact, but perhaps more important to note is that vaccination efforts have significantly ramped up. The latest vaccination data from Our World in Data shows that 32.7% of Canadians have received at least 1 dose, having more than doubled from 13.3% in March.

Economic data has been solid and the Bank of Canada is beginning to recognize the underlying strength and resilience of the economy. The central bank's forecasts for 2021 GDP growth and inflation were revised up to 6.5% and 2.3% respectively. The central bank also cut its bond purchases to $3B a week from $4B. Markets are looking past lockdowns as the consensus is that a successful rollout of vaccines will result in a speedier economic recovery.

EUROPE

Roughly a quarter of the European population has received their first dose of the vaccine and data show that case counts are beginning to peak. Eurozone GDP fell by 0.6% in Q1, following the 0.7% decline in Q4 2020, as the region struggled to contain COVID variants by implementing lockdowns. Manufacturing surveys across Europe remain strong with the Germany ifo Business Climate Index rising to 96.8 in April from 96.6 in March, back above pre-covid levels. Strong expectations are not translating into hard economic data however, with incoming industrial production activity still weak.

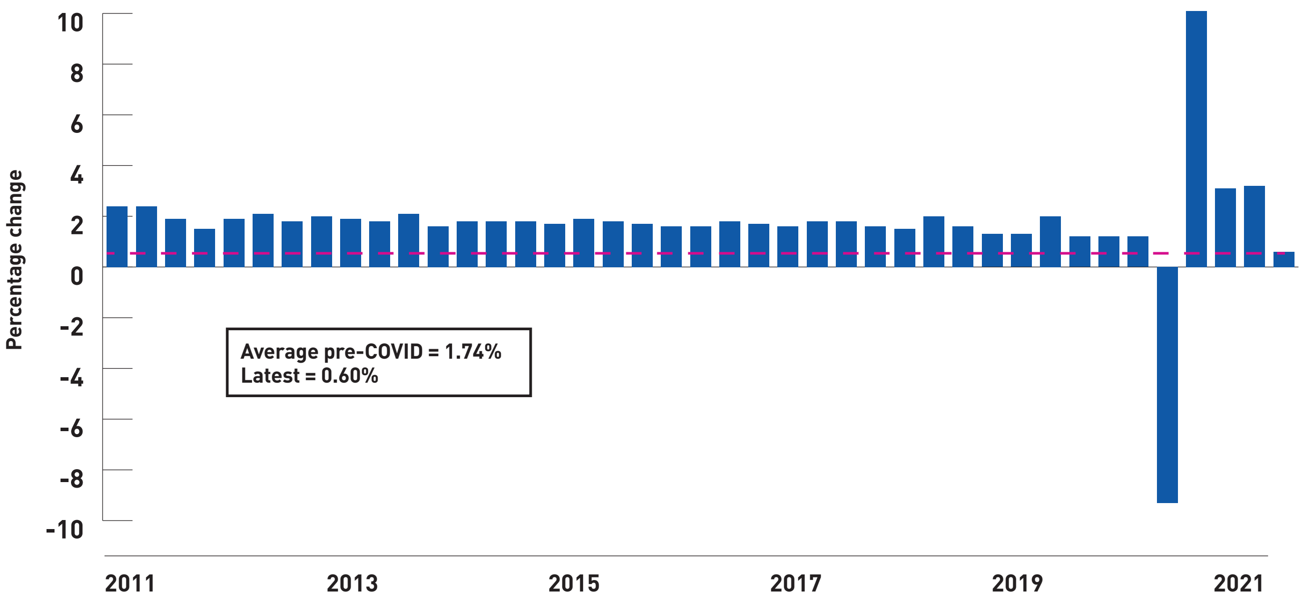
The global semiconductor shortage is hurting auto production as manufacturers must delay production and deal with higher input costs. Manufacturing firms have noted high demand and rising capacity utilization, but a large portion of companies are reporting supply bottlenecks. Supply constraints should ease into the rest of the year which should benefit Europe.

EMERGING MARKETS

The surge of COVID-19 in India has grown to crisis proportions, with cases now exceeding 350,000 per day and record deaths. The country's economic recovery is in jeopardy, though equities were flat over the past month. Despite the dire situation, markets appear to be looking past the pandemic, and similar to most regions around the world, we are watching developments closely.

In our asset allocation solutions, we remain neutral on emerging markets with a negative tilt toward China. China Q1 GDP surged a record 18.5% year-over-year. But due to base effects, the reading may appear stronger than it actually is. To determine the direction of economic momentum we need to focus on higher frequency data. China's quarter-over-quarter GDP rose 0.6% in Q1, which was the lowest in the last decade, and down from 3.2% in Q4 2020. The service industry suffered, but March retail sales data indicate this may be temporary. The manufacturing sector held up in the first quarter.

Real China GDP Q/Q, Seasonally Adjusted



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

The Chinese economy may be slowing, but the strong performance to date has raised concerns over policy tightening. Prior to the pandemic, Chinese policymakers were focused on reducing leverage in the system, and as the rest of the world stimulates global growth, Chinese policymakers are looking to normalize credit growth. The quarterly slowdown may reflect a shift in China's policy priorities in favor of containing financial market excesses rather than stimulating growth at all costs.

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	0.03	-3.87	-3.71	-4.92	-2.23	4.02	2.76	3.86
Bloomberg Barclays Global Aggregate ($C Hdg)	0.25	-1.70	-1.44	-2.24	0.02	4.02	2.85	4.02
Bloomberg Barclays US HY 2% Issuer Cap ($C Hdg)	1.06	1.57	7.76	1.90	19.10	5.91	6.62	6.18
Equities								
MSCI World (Developed Markets)	2.43	6.80	19.11	6.03	28.72	12.54	13.62	12.82
MSCI World Growth	4.05	3.63	14.39	2.90	32.08	18.87	18.11	15.61
MSCI World Value	0.96	9.95	24.19	9.13	24.55	5.88	8.86	9.84
MSCI Canada	2.20	11.39	24.40	10.49	31.10	8.76	8.76	5.42
MSCI USA	3.18	8.00	18.95	7.26	30.87	17.10	16.79	16.63
MSCI EAFE	0.82	3.76	18.87	2.93	23.89	4.82	8.48	7.99
MSCI Europe	2.33	6.33	23.00	5.07	26.70	4.80	8.23	7.49
MSCI Japan	-3.61	-2.71	8.09	-3.42	15.64	4.10	8.74	9.82
MSCI Pacific Ex Japan	2.01	4.27	21.47	5.28	27.20	6.04	9.62	7.70
MSCI EM (Emerging Markets)	0.32	-2.05	13.44	1.23	31.72	6.05	12.09	6.32
World Currencies (relative to CAD)								
US Dollar	-2.12	-3.70	-7.74	-3.44	-11.43	-1.36	-0.36	2.63
Euro	0.25	-4.58	-4.65	-5.00	-2.66	-1.48	0.64	0.51
Pound Sterling	-1.78	-2.90	-1.20	-2.19	-2.78	-1.19	-1.48	0.74
Yen	-1.05	-7.76	-11.76	-8.79	-13.35	-1.33	-0.78	-0.38

Source: Morningstar. Data as of April 30, 2021.

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