Global Markets Commentary

“*I’m safe on Mars. Perseverance will get you anywhere.*”

*Tweet from NASA’s Perseverance Mars Rover*

Almost seven months after its launch from Cape Canaveral, Florida, and a journey of 470 million kilometres through space, on February 18 NASA’s Perseverance rover landed on Mars. The primary focus of the project, which began in 2013, is to search for signs of ancient microbial life. Behind the mission is the age-old quest to learn whether we are alone in this universe.

Perseverance touched down near Jezero Crater, an area scientists believe was once covered by rivers of water, essential to life. The robot is collecting samples of the red planet’s geological and atmospheric environments for analysis back on Earth.

Perseverance has a sidekick – a tiny helicopter called Ingenuity, which has already phoned home. If all goes well, this spring it will become the first craft to fly on another planet. Ingenuity will provide a fuller understanding of other atmospheres and help guide future solar-system missions.

Meanwhile, back on Earth we remain mired in a pandemic that has taken more than 2.5 million lives worldwide and caused economic chaos. Yet, the astonishingly fast development of COVID-19 vaccines is itself an inspiration. As people around the globe are inoculated, however slowly, we have hope that widespread reopenings and a strong economic rebound are within sight.

Like the “seven minutes of terror” (as scientists dubbed the interval between the rover’s fiery plunge through Martian skies and landing on solid ground), February was anything but smooth for both equity and fixed income markets.

Although most equity markets finished in positive territory, they had quite a bumpy ride. The latter half of February saw a pullback driven by spikes in government bond yields. Market watchers were concerned about an overheating economy, given better-than-expected earnings results, business reopenings and massive amounts of fiscal stimulus still to come. This, in turn, caused equities to decline, particularly in the sizzling technology sector.

**Canada – A soft landing**

February brought encouraging signs of declining COVID-19 cases across Canada. In early March, new vaccines from AstraZeneca and Johnson & Johnson were approved for use, adding to the existing Pfizer and Moderna vaccines. Although Canada’s vaccination rate lags significantly behind the rates of other developed nations, Canada will have received a total of eight million vaccine doses by the end of March, providing new confidence that this pandemic may soon fade to a painful memory.

Our equity market trended higher in February; the S&P/TSX Index returned 4.03% for the month. In a recent Reuter’s survey, portfolio managers expressed renewed optimism about Canada’s economic recovery, anticipating the index will climb higher by year’s end. A variety of commodities, including oil, saw a significant price boost as February ended. Copper topped US$9000 a ton, climbing to an eight-year high. Although Western Canadian Select (WCS) continues to trade at a discount compared to West Texas Intermediate (WTI), the latter inched close to US$64 a barrel. Strength in commodities and oil helped energy and mining companies such as Whitecap Resources and Franco Nevada become leading S&P/TSX movers.

Earnings at all Canadian banks across the board beat market expectations. Both energy and financials contributed to the index’s solid performance. Technology seems to be falling out of favour with investors. Shopify made headlines again, only this time as a leading detractor to index performance. Utilities and materials continue to struggle. Gold prices fell against a backdrop of rising bond yields and a stronger dollar.
The Canadian 10-year bond yield picked up, causing the yield curve to steepen. While a boost in yield supported a strong Canadian dollar, it also exacerbated growing concerns about high valuations in the technology sector.

Canada’s housing market continues to break records. Bank of Canada Governor Tiff Macklem noted the Canadian housing market might be showing early signs of “excess exuberance,” and reminded buyers that prices will not continue their meteoric rise indefinitely. Despite a red-hot housing market, we expect our central bank to maintain its current interest rate of 25 basis points until unemployment numbers improve from 9.4%, and core inflation edges closer to its 2% target.

On March 2, Statistics Canada released a flash estimate that indicated GDP rose by about 0.5% in January, a strong measure of Canada’s economic resilience.

United States – Exploring optimism

February brought volatility to financial markets and extreme weather across the U.S. Equity indices surged early in the month after emerging from a Reddit-induced pullback at January’s end. While markets rose, temperatures across the South plummeted. Winter storms and prolonged cold left many states, especially Texas, without power. Natural gas prices soared and crude prices climbed above US$60 to reach pre-pandemic levels.

The technology-led rally came to a screeching halt when yields on U.S. treasury bonds skyrocketed on prospects for a rapid economic recovery. Rising yields are signs of optimism about the economy’s outlook, but can also indicate that inflation is likely to nose up, which would prompt central banks to hike interest rates. This has a negative effect on equity prices, and an outsized impact on technology companies in particular thanks to their higher valuation multiples.

February’s rapid technology sell-off fizzled after U.S Federal Reserve Chairman Jerome Powell allayed fears that the Fed would raise rates. He said inflation, output and employment remain well below Fed targets. Although the U.S. Government 10-year Treasury rate rose to 1.37%, its highest level in a year, this isn’t likely to trigger a rotation out of equities into fixed income.

Progress continues on vanquishing COVID-19. Daily case numbers have been declining for six consecutive weeks and hospitalizations are at levels not seen since before American Thanksgiving. The U.S., along with the U.K., continues to lead among G7 nations in getting shots into arms and plans to speed up its inoculation rollout. At the end of February, the U.S. Food and Drug Administration granted emergency use authorization to Johnson & Johnson’s (J&J) single-dose vaccine, making it the third vaccine in the U.S. arsenal. The company began to ship doses just two days later. By the end of June, J&J is expected to provide 100 million doses to state and local governments.

Pandemic optimism spread to labour markets. The number of workers seeking unemployment benefits continued to fall. January’s unemployment rate improved from 6.7% in December to 6.3%. This trend is likely to continue as long as vaccines roll out smoothly.

Although it gave back some of its impressive early-month gains, the S&P 500 was up 1.71% at the end of February. While volatility is likely to remain, the market will look to President Joe Biden’s US$1.9 trillion stimulus package for further short-term support. There are some concerns, however, that this bold measure risks overheating the economy.

Europe and the U.K. – Launching stimulus

Europe’s economy enjoyed a strong rebound after lockdowns were eased, but has sputtered recently. The Euro Area Services Purchasing Managers’ Index remained below 50, a point that separates growth from contraction. The Manufacturing PMI continued to inch toward 55. Although vaccines are rolling out more slowly than in the U.S., it looks like inflation in the region will continue to gain steam, driven mainly by increased demand for exports.

The European Union demonstrated its continued support for the economy by launching its largest-ever stimulus package. The €750 billion (US$917 billion) Next Generation EU Fund aims to lift long-term growth and cushion the pandemic’s impact across member states.

With continued positive news of worldwide vaccinations and expectations of revived demand, the market was optimistic about this region. In February, the FTSE 100 (U.K. equity) and STOXX 50 (EU equity) rose by 0.78% and 2.65%, respectively.

China – Lunar New Year

Each January and February, Lunar New Year (LNY) festivities mark one of China’s most important holidays. In these two months, consumption and travel generally peak, which provides a useful snapshot of overall demand trends in a normal year. COVID-19 made LNY in 2020 and 2021 anything but normal. A harsh travel clampdown designed to prevent...
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virus spread reduced travel by 70% during 2021 celebrations to welcome the Year of the Ox. Despite restrictions, domestic consumption continued to recover, albeit at a slower pace than in previous years.

Production maintained strong growth as the country reopened for business well ahead of other nations, increasing demand for goods from China. This uneven economic recovery got Beijing’s attention. It has begun to take measures to prevent industrial and real estate markets from overheating.

The Shanghai Composite rose a moderate 1.04% for February.

Japan – A controlled landing

Japan’s most populated areas – Tokyo, Osaka and Kyoto – remained under a state of emergency. Prime Minister Yoshihide Suga decided to err on the side of caution and focus on virus containment in order to avoid declaring another emergency later.

China’s rapid recovery since mid-2020 has lifted export demand for Japan. Its GDP growth in Q4 2020 beat forecasts. The economy posted 12.7% annualized growth that approached pre-crisis levels and came despite a 4.8% full-year fall. Signs of slowdown remain, however, as December real GDP shrunk 0.4% from the previous month.

Overall, the market has largely focused on positive developments; the Nikkei 225 rose 5.59%.

Our strategy

Despite a spike in bond yields, we continue to favour equities over fixed income. From a historical perspective, yields remain low. We find the risk/reward equation for equities more compelling – even though this year’s volatility could persist thanks to elevated valuations.

Our preference for equities is focused on the U.S., where many of the companies that have benefitted from a new work-at-home, play-at-home pandemic culture are located.

Contributing to this positive outlook is very supportive fiscal and monetary policy. The steady and accelerating pace of vaccinations is also good news. It puts the U.S. in a global leadership position to reach herd immunity (although virus variants, plus manufacturing and distribution challenges, persist). Overall, we have confidence that the U.S. economy is positioned to rebound this summer.

While we have been overweight equities for some time, we remain vigilant of both valuation concerns and changes to opportunities in fixed income.

The last word

Uncertainty remains in bond and equity markets. There are concerns that very low interest rates, coupled with massive fiscal stimulus and high personal savings balances, could unleash consumer demand and lead to unchecked inflation. Central banks would then be forced to raise rates sooner than expected. Under current circumstances, the market would view higher rates as a negative. That said, we believe this is unlikely.

Other kinds of uncertainty remain as well. Vaccine rollouts, while very impressive as feats of resourcefulness and logistics, are slower than we had hoped. We don’t know whether remote working will wind down when it’s safe to go back to the office. Nor do we know whether consumers will shift from online shopping to bricks-and-mortar retail once the economy opens up again.

One thing is certain, however: Perseverance and ingenuity have propelled us close to the finish line in the global race to conquer the virus.

Please contact your BMO financial professional if you have any questions or would like to discuss your investments.

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