2021 capital markets mid-year in review

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2021 YTD – Market review

Regional equity indices	Index level		2021 YTD		2020 Total return
	31-Dec-20	30-Jun-21	Price return	Total return	
S&P/TSX	17,433	20,166	15.7%	17.3%	5.6%
S&P/TSX Small Cap	655	778	18.7%	19.8%	12.9%
Dow Jones Industrial	30,606	34,503	12.7%	13.8%	9.7%
S&P 500	3,756	4,298	14.4%	15.2%	18.4%
Russell 2000	1,975	2,311	17.0%	17.5%	19.9%
Nasdaq	12,888	14,504	12.5%	12.9%	45.1%
MSCI All Country World	646	720	11.4%	12.5%	16.9%
MSCI Europe	132	150	13.6%	15.8%	-2.8%
MSCI EAFE	2,148	2,305	7.3%	9.2%	8.4%
MSCI Emerging Markets Index	1,291	1,375	6.5%	7.4%	18.8%

Fixed income indices	Index level		2021 YTD total return	2020 Total return
	31-Dec-20	30-Jun-21		
FTSE Canada Universe Bond	1,221	1,179	-3.5%	8.7%
FTSE Canada All Corporate Bond	1,397	1,365	-2.3%	8.7%
Bloomberg Canada High Yield	158	165	4.5%	7.2%

Currencies	31-Dec-20	30-Jun-21	% change
CAD/USD	0.79	0.81	2.7%
CAD/EUR	0.64	0.68	5.8%
EUR/USD	1.22	1.19	-2.9%
GBP/USD	1.37	1.38	1.2%
USD/JPY	103.25	111.11	7.6%

Bond yields	31-Dec-20	30-Jun-21	bps change
10 yr Canada Govt.	0.68%	1.39%	71
10 yr US Treasury	0.91%	1.47%	55
10 yr Germany Govt.	(0.57)%	(0.21)%	36
10 yr Japan Govt.	0.02%	0.06%	4
30 yr Canada Govt.	1.21%	1.84%	63
30 yr US Treasury	1.64%	2.09%	44

Commodities	31-Dec-20	30-Jun-21	% change
Gold US$/oz.	1,898	1,770	-6.8%
Oil US$/bbl.	49	73	51.4%

Source: Bloomberg June 30, 2021. Index returns are in local currency. *Total return is price return plus re-investment of dividends
All figures quoted in the text are price only return, local currency, unless otherwise noted

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The healing has begun

This year opened with high hopes and even higher expectations. As vaccines rolled out globally, a handful of countries (US and UK most notably) dashed ahead of faltering vaccine campaigns in Canada, Europe, and parts of Asia, while the less-developed world saw a horrific surge of the virus. Buoyed by the success of the vaccines in the US and UK, anticipating similar success across the world in due time, equity markets rocketed to new all-time highs, with many notching half-year gains in the mid-teens. Bond yields bolted higher, rushing to price in a widening global economic recovery, along with the expectation of higher inflation – albeit with a view that inflation will prove transitory. The speed and magnitude of the move in sovereign yields in the first quarter brought the worst quarterly loss on record for Canadian bond investors before some reprieve in the second quarter as yields retreated slightly. Credit spreads tightened, softening the blow for investment-grade credit and high yield bonds, with the latter managing a decent mid-single-digit return. The development of variants of concern did little to stop stocks and bond yields from moving higher. Capital markets pinned their hopes on vaccine efficacy holding up, and that renewed lockdowns (especially in Europe and Canada) only meant a shift in timing, not derailment – for now (and fingers crossed), markets appear to be correct.

There was plenty of support for stock prices during this uncertainty around the virus, variants, and vaccine rollout. Central bankers around the world pledged to keep the easy money flowing. Pent-up business and consumer spending showed signs of release in areas ahead in the reopening timeline (China and US in particular). All the while, corporate earnings across a wide swath of industries blew away expectations, giving stocks a feeling of invincibility. The government measures deployed to bridge businesses and households through the pandemic appear to have worked (with little regard for the tab rung up). Those companies that thrived in the work-, play-, and stay-at-home environment are exiting the pandemic strengthened and hopeful that their businesses will see lasting benefits from a permanent shift or acceleration in consumer behaviour. For many of the hardest-hit companies (airlines, hotels, car rental, hospitality), first, simply managing to survive was an upside surprise. Then came the reopening trade, as share prices rose from the ashes on early signs that once reopening is allowed, a robust recovery in leisure and hospitality follows (at least for some period) as the public returns in earnest to make up for lost time.

Flooded with liquidity, stock markets took on an air of euphoria. There were tell-tale signs that sentiment toward equities was running high (to put it mildly). The capital markets landscape is also changing. There are commission-free trading platforms accessible in the palm of one’s hand and the greater use of complex trading tools like options and shorting by a wider array of investors. Social media offers tutorials on the fly from newly minted ‘experts.’ These themes brought Special Purpose Acquisition Corporations (SPACs), cryptos and meme stocks, aka the BANG complex (Blackberry, AMC Entertainment, Nokia and GameStop) into the daily lexicon. The media (perhaps starved for excitement since Washington DC became a tad less sensational) fanned the flames.

SPACs raised copious amounts of money (with celebrities hopping on the bandwagon); share prices rose and then fell as the bloom came off the rose.

A similar path played out for cryptocurrencies, initially buoyed by some recognition and high-profile endorsements by Tesla, Blackrock, BNY Mellon, and Mastercard, only to see some of those same players (Elon Musk) pull the rug out on social media. Central bankers and regulators piled on with China imposing curbs and US and European officials citing money laundering, drug trafficking and terrorism as reasons for regulation.

None of the aforementioned saw more spectacular volatility than the Reddit-fueled meme/BANG craze. These businesses, whose fortunes appear challenged, became a David vs. Goliath narrative. The heavily shorted stocks were sniffed out by a community of everyday market participants, some savvy enough to know what a short squeeze can do if it squeezed hard enough (short-sellers face the theoretical prospect of unlimited losses). The share prices went on roller-coaster rides of volatility measured in the hundreds and thousands of percent moves. At one point, shares of AMC were up 2,800% YTD and GameStop 1,700%.

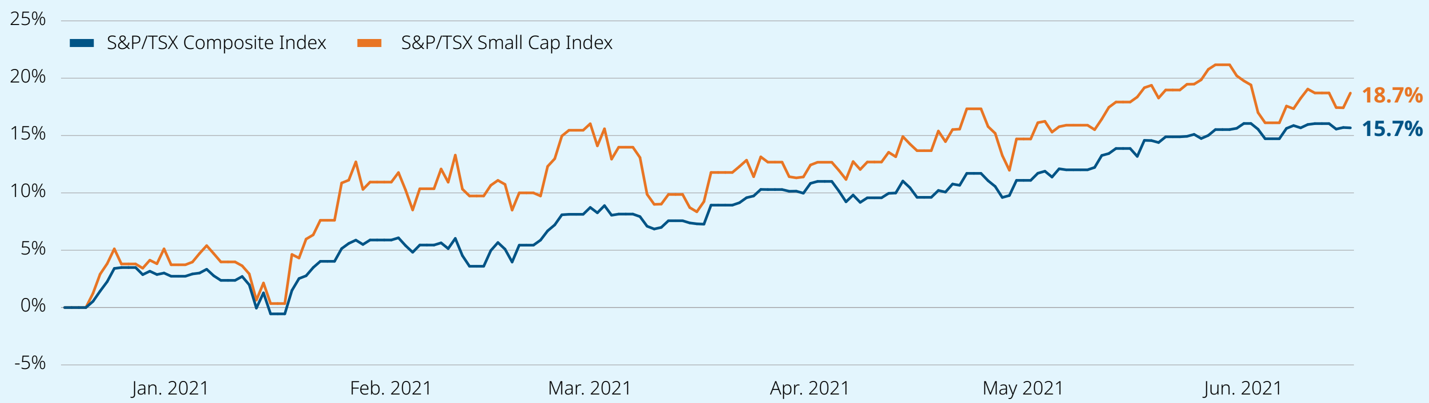
Among many narratives surrounding these incidents is one notion with which we take great exception – that capital markets are nothing more than glorified casinos. While participation in both comes with the risk of losing money, unlike casinos, capital markets provide a valuable contribution to society – they facilitate capitalism. Capitalism facilitates innovation. Innovation improves our lives – indeed, it can save lives (thank you, Pfizer, Moderna et al.)! Capital markets connect those with excess savings to those in need of money to fund good ideas. But what makes a good idea is often difficult to identify in advance. Hence the need for risks and rewards to discipline the allocation of capital so that the cream rises to the top. In capitalism, good ideas and strong companies thrive. While bad ideas or no longer useful companies are removed, freeing up resources best deployed elsewhere. SPACs and cryptocurrencies being a part of the capital markets, are in the proper arena to test whether these entities have usefulness and staying power – time and capital market driven price discovery will tell. As for the BANG's, options and short selling are tools of the trade. They help capital markets fulfill their essential role of price discovery. This is not to say that these are perfect tools or aren't hazardous. A knife is an indispensable kitchen utensil, but it can cause harm if not used properly. No system is perfect, and the best systems should grow and learn from their mistakes. Capital markets price risk; one needs to be careful when contemplating removing risks from a system where the risk of loss disciplines the participants.

Adding to the excitement that growth and spending will be robust was the better-late-than-never stimulus package in the US and longer-term fiscal spending announcements in many countries pledging to build back better. After more than a year of eye-popping numbers and ballooning figures in just about every corner of society, the public and capital markets have become desensitized to the terms 'billions' and 'trillions' – they fail to elicit any response, let alone fear or a mild cringe. Governments have picked up on this 'free-pass' to spend and are embarking on generational, transformational spending on healthcare, infrastructure, social safety nets, and social equality and injustice – all laudable causes, but should we completely abandon all notions of fiscal prudence, prioritization and cost-benefit analysis? Companies will be happy to soak up the government's largess. Should the bond market vigilantes come out of hibernation and push yields too high, the wake-up call could be rude. Indeed, what may placate the bond market (higher taxes) won't be welcomed by stocks. This combo could deliver a checkback for bond yields and remind investors that the safety aspect of high-quality fixed income is not only alive but necessary for portfolios to be called 'balanced.'

Canadian equity

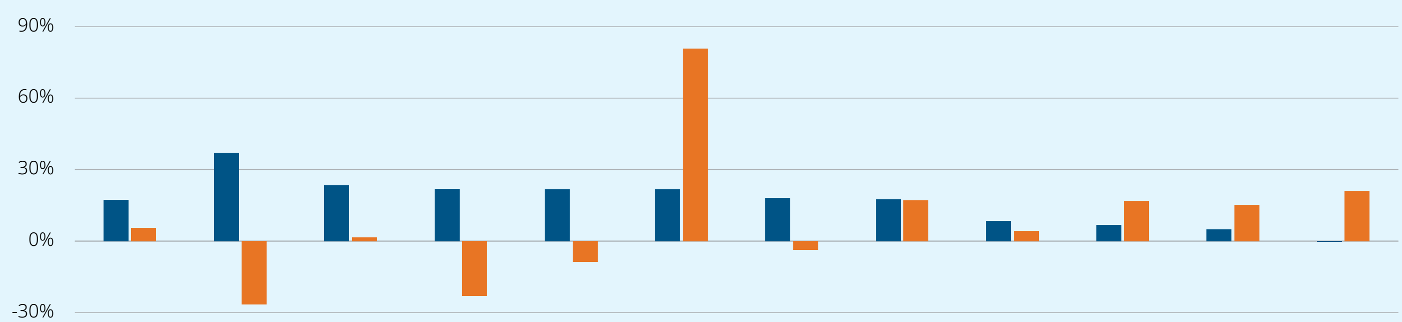
Canadian equities ranked amongst the top-performing equity indices, with the S&P/TSX Composite surging 17.3% year-to-date on a total return basis. The stellar performance follows the solid 5.6% advance in 2020. Investors looking to capitalize on a firming rotation from high-flying growth stocks into cyclical and value-oriented sectors poured money into Canadian equities. Foreign inflows into Canadian equities through the first four months of 2021 totalled $28.6 billion. If this pace continues, it will mark the highest figure since 2017. Gains for the TSX were broad-based with materials the lone sector in negative territory, weighed down by the gold miners. The heavyweight financial and energy sectors largely drove the move higher, powered by record earnings beats. Financials were bolstered by a release of the massive loan-loss provisions set aside last year, while energy stocks benefitted from a 50% spike in oil prices. The 26% rally coming from market darling Shopify helped anchor the 22% gain from the information technology sector.

S&P/TSX Composite & S&P/TSX Small Cap - 2021 YTD performance



Source: Bloomberg June 30, 2021

S&P/TSX sector total returns (%)



	S&P/TSX Composite Index	Energy	Financials	Health care	Real estate	IT	Telecom services	Consumer disc.	Consumer staples	Industrials	Utilities	Materials
YTD	17.3%	37.0%	23.4%	22.0%	21.7%	21.7%	18.2%	17.6%	8.5%	6.8%	4.9%	-0.4%
2020	5.6%	-26.6%	1.6%	-23.0%	-8.7%	80.7%	-3.7%	17.1%	4.3%	17.0%	15.3%	21.2%

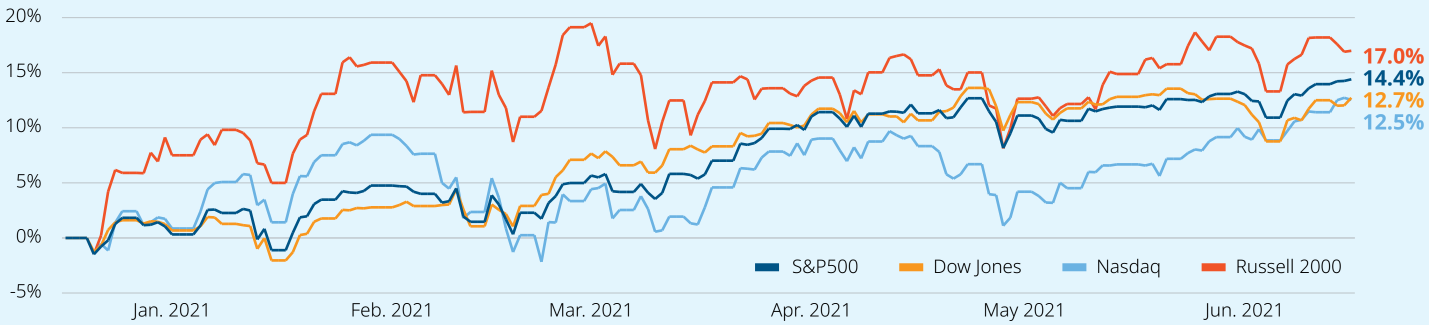
Source: Bloomberg June 30, 2021

US equity

All major large and small-cap US equity benchmarks recorded double-digit returns (S&P 500, DOW, NASDAQ and Russell 2000), extending the remarkable rebound from the depths of March of last year. The S&P 500 roared ahead with a 15.2% total return. The few setbacks were brief and mild, nothing greater than 5%, extending the correction-free (>10% decline) run that dates back to the March 23, 2020 bottom.

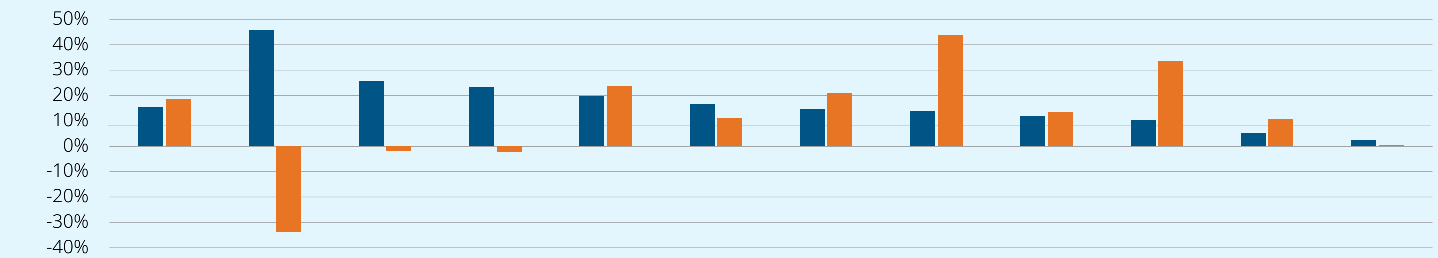
Gains in the S&P 500 were broad-based, with all 11 GICS sectors finishing in the green. The energy sector was the standout performer, returning over 40% as Americans began returning to the roads and airports. The heavily weighted information technology sector suffered a setback in the first quarter, as investors favoured cyclical names poised to benefit from the economy reopening. In addition, bond yields shot up violently earlier in the year, which stifled the long-duration, hyper-growth, mega-cap new economy, and technology stocks, whose valuations ballooned from the 2020 and earlier downward trend in yields. The sharp rise in yields was quickly arrested in the second quarter, sparking a rebound in the new economy and technology stocks. Financials were the second-best sector. Banks benefited from the release of enormous loan-loss provisions set aside last year and the loosening of regulations that paved the way for the resumption of share buybacks and dividend increases.

US equity indices – 2021 YTD performance



Source: Bloomberg June 30, 2021

S&P 500 sector total returns (%)



	S&P500	Energy	Financials	Real estate	Telecom services	Industrials	Materials	IT	Health care	Consumer disc.	Consumer staples	Utilities
■ YTD	15.2%	45.6%	25.6%	23.3%	19.7%	16.4%	14.5%	13.8%	11.9%	10.3%	5.0%	2.4%
■ 2020	18.4%	-33.7%	-1.8%	-2.2%	23.6%	11.1%	20.7%	43.9%	13.4%	33.3%	10.7%	0.5%

Source: Bloomberg June 30, 2021

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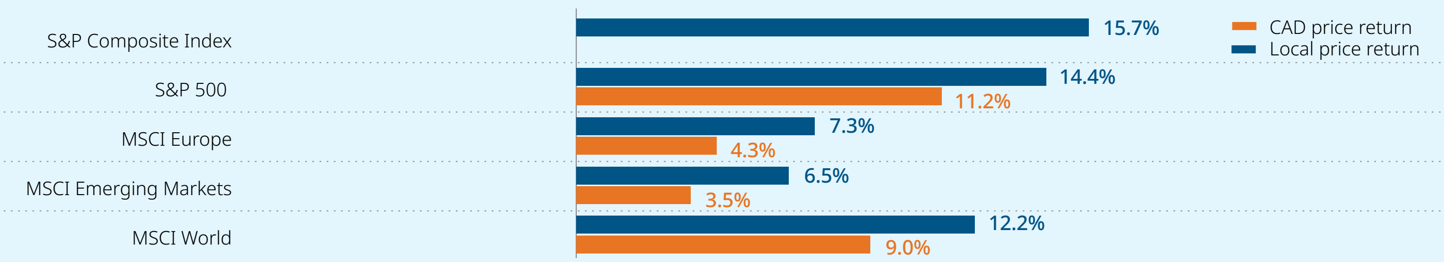
International equities

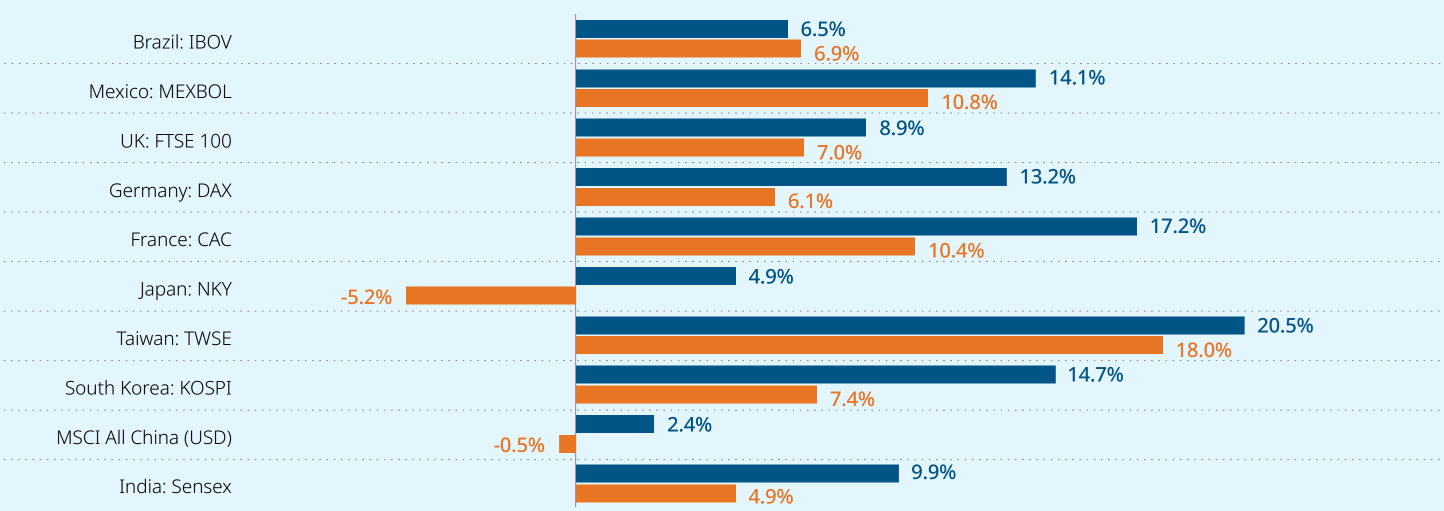
International equities benefited from similar sector tailwinds as Canada, with the value-oriented MSCI EAFE Index delivering a 6.9% total return. Despite COVID variants forcing fresh lockdowns in the UK and Europe, major European indices recorded double-digit returns as many countries were eventually able to loosen lockdown restrictions as vaccination ramped up. Vaccine rollout in Japan has lagged considerably, leading to sporadic reopening. Exporter-heavy Japanese equity indices managed modest gains, with the slowing pace of Chinese growth also weighing, the Nikkei 225 Index gained 4.9%. After Japanese stocks were one of 2020's best performers, the modest gains thus far in 2021 are a relative performance drag compared to the double-digit returns coming from the broader EAFE index.

Emerging market (EM) equities lagged their developed market counterparts. The MSCI Emerging Market Index (USD) produced a 7.9% total return. Emerging markets are sensitive to Chinese credit growth and economic conditions. Additionally, US dollar strength and broader global monetary conditions remain an influence. EM equities continued to rally on the value-rotation, reflation trade in the very early part of 2021. However, signs of peaking Chinese growth and Chinese authorities moving to tighten monetary conditions by mid-February precipitated a 10.8% correction to the MSCI EM Index. A combination of surprise strength for the US dollar, some EM central banks outside of China raising interest rates, and developed market central banks shifting slightly hawkish also weighed. EM markets consolidated the correction from March through May and are beginning to show signs of recovery, ending the second quarter near their post-correction highs.

Major global equity indices - 2021 YTD performance (price return) in local and Canadian currency



Global equity markets - 2021 YTD performance (price return) in local and Canadian currency



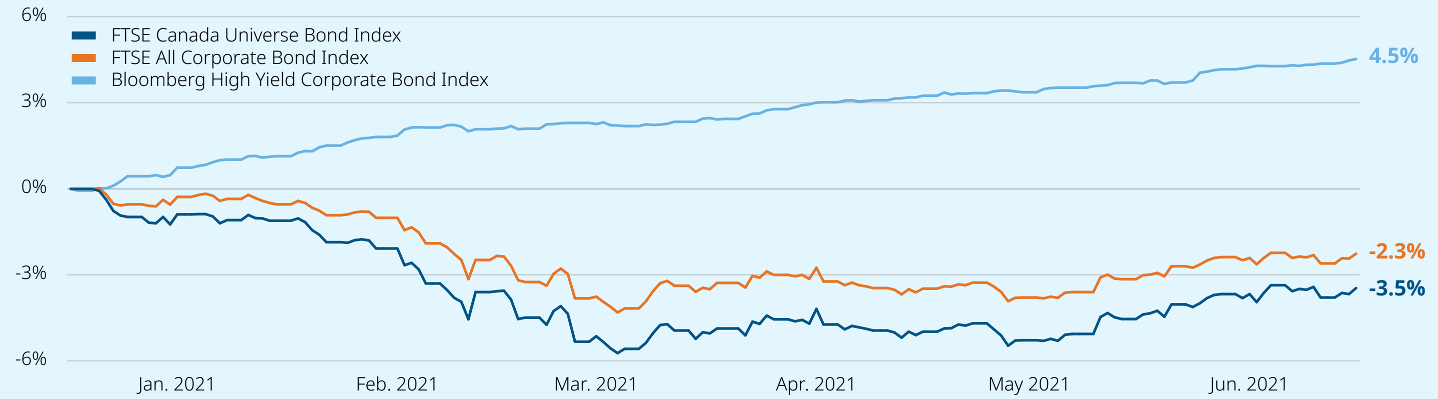
Source: Bloomberg June 30, 2021

Canadian fixed income

Canadian fixed income struggled in the first half of the year amid a sharp rise in bond yields. The FTSE Canada Universe Bond Index tumbled 3.5%, with all the damage occurring in the first quarter. Government of Canada 10-year bond yields jolted 88 bps higher in the first quarter, as accelerating global vaccinations fueled optimism for a reopening of the world economy. With central banks holding their accommodative stance steady (essentially anchoring the shorter end), the yield curve steepened sharply, leading to longer-term bonds underperforming shorter duration. The FTSE Canada Long-Term Overall Bond Index was down over 12% by mid-March, recovering less than half of that loss by June 30.

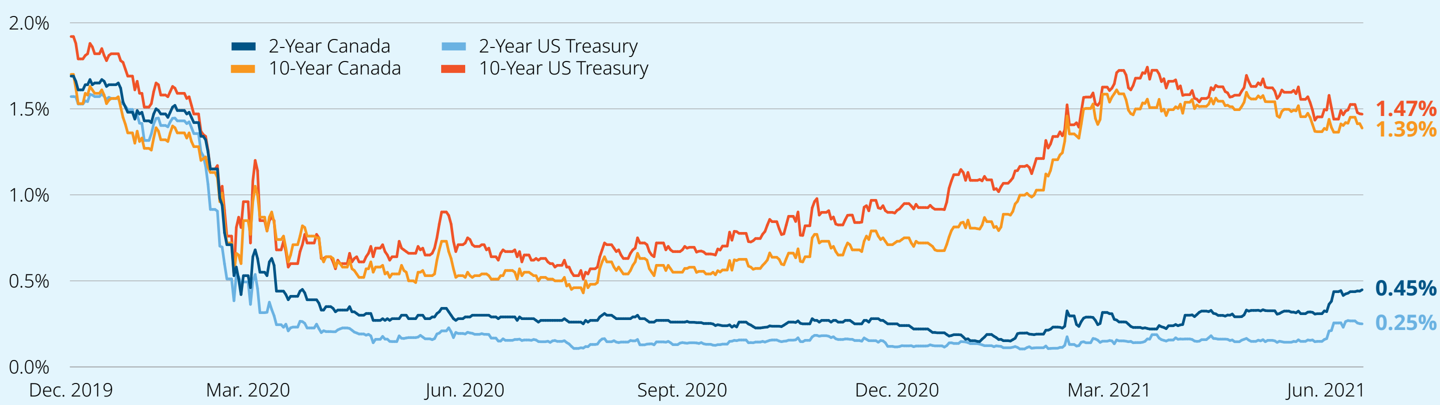
The Bank of Canada has begun to taper their quantitative easing programs and has moved up its timeline for raising its benchmark interest rate but is still purchasing $3 billion worth of government debt a week while keeping the overnight rate at 0.25%. Credit spreads continued to narrow, with investment-grade corporate bonds outperforming government bonds. High yield bonds were by far the best performer; the Bloomberg Canadian High Yield Corporate Bond Index produced a mid-single-digit return. Within the government sector, federal bonds outpaced provincial and municipal bonds.

Canadian fixed income indices - 2021 YTD total return



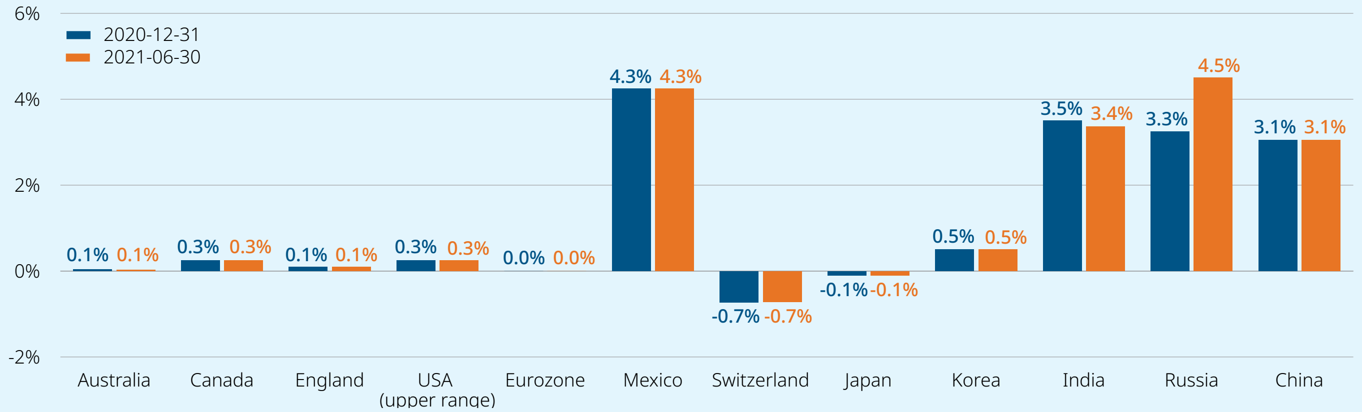
Source: Bloomberg June 30, 2021

2-year and 10-year Government bond yields



Source: Bloomberg June 30, 2021

Global central bank rates (%)



Source: Bloomberg June 30, 2021

Commodities

Commodities have been one of the most sought-after asset classes this year. The rapid reopening of the economy has led to disruptions in global supply chains and inventory shortages. Energy prices have moved notably higher with the price of WTI oil up 50% to US$73.5/bbl. OPEC+ members continue to cooperate to slowly restore their oil output after the record production cuts last year. US shale companies have also shown discipline by increasing production only gradually in response to the higher prices. Copper prices (a bellwether for global economic activity) surged to the highest level in almost a decade on the reopening trade. Copper received a further boost as more countries announced aggressive climate targets (copper being an input into electric vehicles and other climate technology).

Bloomberg Commodity Index

Source: Bloomberg June 30, 2021

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WTI crude oil (US$/bbl)

Source: Bloomberg June 30, 2021

Gold prices were dull, falling 6.8% to US$1770/oz after recording a blistering 25% return in 2020. The yellow metal's price began consolidating in the second half of last year, and that trend continued as investors looked to pile their money elsewhere in the risk-on environment. Higher global bond yields and a strengthening US dollar were also headwinds.

Gold spot (US$/oz)

Source: Bloomberg June 30, 2021

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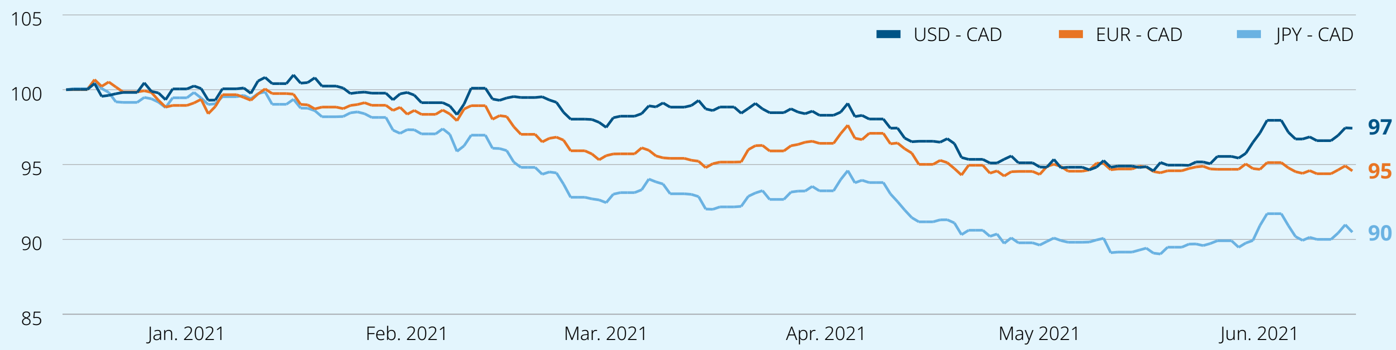
Currencies

The Canadian dollar continued its climb, rising 2.7% to USD/CAD $0.81, CAD/USD $1.23. The loonie has soared higher after touching 68.9¢ in March of last year. The loonie is a typical beneficiary of global growth and a risk-on environment. The currency was fired up by the Bank of Canada's earlier than most move toward the slow removal of emergency monetary policy efforts. Additional support for the loonie came from the sizeable foreign investment flows into Canada thus far in 2021, along with favourable short-term interest rate differentials between Canada and the US, firming oil prices, and solid non-oil commodity prices. The loonie's ascent lost momentum in June as the US dollar strengthened on the slightly hawkish pivot from the US central bank.

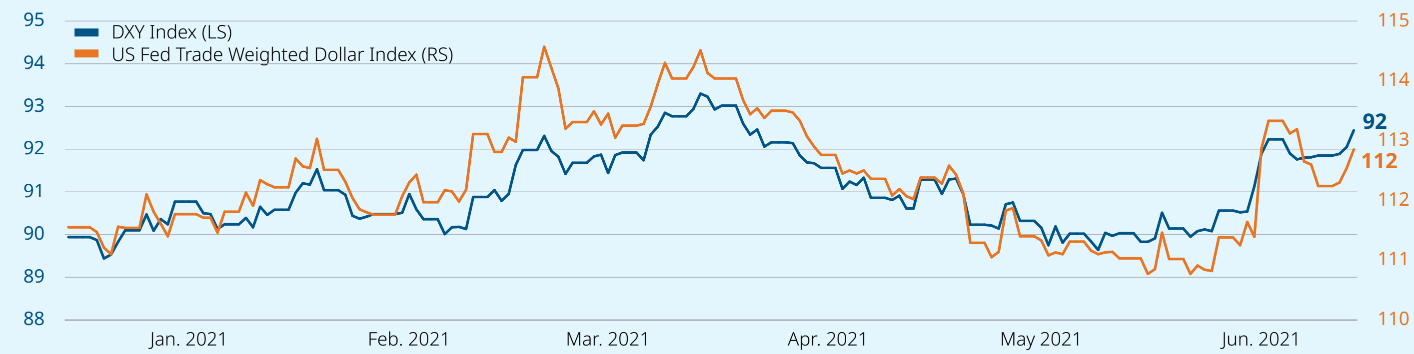
CAD Performance vs. Global Currencies (indexed to 100)



Source: Bloomberg June 30, 2021

The US dollar (DXY Index) was whipsawed throughout the first half of the year but managed to rebound from its worst year since 2017, up 2.8%. The US dollar bucked its sharp downward trend that began last year, moving higher alongside US bond yields. Feeding into the US dollar strength was a slightly more hawkish tone from a few Fed members. The greenback then seesawed, weakening through the spring on the improving vaccination rollout in Europe and Canada, and massive fiscal spending proposals from the White House. In June, the US dollar resumed its upward trend on the back of a surprise shift from the Fed, whereby markets are now expecting two interest rate hikes by the end of 2023.

US Dollar Index vs. US Fed Weighted Dollar Index



Source: Bloomberg June 30, 2021

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Bitcoin stole headlines earlier in the year when it surpassed a remarkable US$1 trillion market cap. By mid-April, the largest cryptocurrency had rallied over 100% to above US$60,000 amid increasing confidence that it could defy the odds and achieve mainstream adoption. Notable firms such as Tesla and Blackrock announced significant investments or some form of implementation. In addition, worries over the deterioration of the global financial system, in the form of higher than expected inflation, and fiat money in general, sent the digital coin skyrocketing. Bitcoin is also part of the broader speculative mania that has swept the market (SPACs and meme stocks), leading to large price swings. However, Bitcoin has been spiralling downward since peaking in April, losing almost half of its value and ending June at US$34,585. Tesla backtracked on its decision to accept Bitcoin as a form of payment, citing environmental concerns. At the same time, the People's Bank of China instituted curbs on cryptocurrencies and warned investors against speculative crypto trading while other central banks mused about regulation.

Bitcoin spot (XBT/USD)

Source: Bloomberg June 30, 2021

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