January 2022 market update

Volatility and inflation on the rise as central banks prepare for spring hike.

Feb. 8, 2022

Introduction

The restrictions put in place to contain the rapid spread of the COVID-19 Omicron variant continued to weigh on global economic activity in January. The service sector experienced a significant decline. While economic activity slowed, inflation continued its march higher through the period, raising new questions about the stability of the economic recovery. Despite rising inflation, the major central banks – including the Bank of Canada ("BoC") and the U.S. Federal Reserve Board ("Fed") – opted to wait a little longer before starting to tighten monetary policy.

The spread of Omicron, geopolitical tensions and inflation all contributed to a heavy bout of volatility on the global markets over the month. In Canada, the S&P/TSX Composite Index posted a decline, hindered by weakness in the Information Technology and Health Care sectors. In the U.S., high-growth technology stocks were particularly volatile as expectations for rising interest rates gave rise to questions about their valuations. The NASDAQ Composite Index dropped over 8% during the month. Meanwhile, the S&P 500 Index was dragged lower by the Consumer Discretionary sector. The yield on 10-year government bonds in Canada and the U.S. both rose over the quarter. The price of oil advanced over the month. Conversely, the price of gold fell.

Tightening brings on volatility

Late in 2021, global central banks, including the BoC and Fed, began signalling their intentions to start tightening policy by raising their key policy rates in 2022. In preparation, investors reconsidered valuations and equity prices with interest rates expected to rise, contributing to some extreme volatility on the equity markets in January. The volatility was particularly acute in high-growth technology stocks. The CBOE Volatility Index ("VIX"), which represents expected volatility in the S&P 500 Index, rose to its highest level since January 2021 during the quarter.

While economists expected the BoC to raise rates at its first meeting of the year to tame inflation, ongoing uncertainty created by the new lockdown restrictions prompted the central bank to hold its benchmark overnight interest rate steady at 0.25% at its January meeting. However, the BoC did note economic slack has been absorbed, opening the doors for an interest rate hike at its March meeting. It was much the same in the U.S. The Fed kept the target range for its federal funds rate unchanged at 0.00% to 0.25%. Following that decision, the Fed acknowledged that consumer prices continue to surge higher, which may warrant an interest rate increase 'soon,' raising expectations of a March interest rate increase.

Prices continue to surge higher

In another sign that rising interest rates are on the horizon, Canada's inflation rate surged to its highest level since 1981. In December, inflation reached 4.8% year-over-year, as strong demand combined with supply chain disruptions continue to push up prices. Rising prices for gasoline, automotive vehicles and home and mortgage costs also contributed to the increase. This was also the 10th consecutive month Canada's inflation rate has been above the BoC's target of 2%. Meanwhile, producer prices rose by 16.1% year-over-year in December, adding further upward pressure to consumer prices. The elevated inflation rate is expected to persist through the first half of this year. With the BoC now telegraphing that it's ready to lift interest rates, attention turns to Canadians carrying a large amount of debt, both credit and mortgage debt. In its most recent Consumer Debt Index, MNP found that 45% of Canadians are not confident in their ability to pay for basic living expenses this year.

China eases monetary policy while others tighten

While most global central banks are preparing to tighten monetary policy, the People's Bank of China ("PBOC") has been heading in the opposite direction in response to challenges facing China's economy. China's economy expanded 4.0% year-over-year in the fourth quarter of 2021, slowing from the 4.9% expansion in the third quarter. This was the third straight quarter of slowing economic growth. Strict COVID-19 lockdown restrictions, persistent supply chain disruptions and financial challenges linked to the property sector all weighed on the country's growth. To counter those pressures and help ease debt struggles in the property market, the PBOC lowered its key policy rate, the one-year medium-term lending facility rate, by 10 basis points ("bps") to 2.85%. Later in the month, the PBOC lowered its one-year loan prime rate ("LPR") by 10 bps to 3.70%, and its five-year LPR to 4.60%, from 4.65%. The PBOC is committed to help support China's economy and speed up its pace of growth.

Consumers put their wallets away

While economists were expecting a decline in spending in December as Americans started their holiday shopping early amid concerns around supply chain challenges and product shortages, the decline was larger than forecast. Retail sales in the U.S. fell by 1.9% versus the 0.1% decline expected by economists. This was the biggest drop in sales since July. Lower sales for furniture, sporting goods and clothing contributed to December's decline. E-commerce sales also fell, suggesting higher prices and concerns about product selection have affected the entire retail sector. Another key gauge of spending activity in the U.S., personal spending, fell by 0.6% in December, which was the first monthly decline since February, while personal income rose during the month. U.S. consumer demand has helped drive the U.S. economic recovery from the deep losses suffered at the onset of the pandemic. A continued slowdown in spending may hinder further progress in the economic recovery.

Market performance - as at January 31, 2022

Equity Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
S&P/TSX Composite Index C$	21,098.29	-0.59%	**-0.59%**	-0.59%	**-0.59%**	21.69%	**21.69%**
S&P 500 Index US$	4,515.55	-5.26%	**-4.89%**	-5.26%	**-4.89%**	21.57%	**20.58%**
Dow Jones Industrial Average US$	35,131.86	-3.32%	**-2.95%**	-3.32%	**-2.95%**	17.17%	**16.21%**
MSCI EAFE Index US$	2,222.45	-4.86%	**-4.50%**	-4.86%	**-4.50%**	4.63%	**3.77%**
MSCI Emerging Markets Index US$	1,208.23	-1.93%	**-1.55%**	-1.93%	**-1.55%**	-9.13%	**-9.87%**
MSCI Europe	1,996.54	-4.62%	**-4.25%**	-4.62%	**-4.25%**	10.14%	**9.23%**

Index US$							
MSCI AC Asia Pacific Index US$	184.71	-4.35%	**-3.98%**	-4.35%	**-3.98%**	-9.38%	**-10.13%**

Fixed Income Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
FTSE Canada Universe Bond Index C$	1,149.75	-3.40%	**-3.40%**	-3.40%	**-3.40%**	-4.80%	**-4.80%**
FTSE World Investment Grade Bond Index US$	238.55	-2.25%	**-1.87%**	-2.25%	**-1.87%**	-6.38%	**-7.34%**

Currencies	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
CAD/USD	0.7869	-0.54%	-	-0.54%	-	0.54%	-

Commodities	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
West Texas	88.15	17.21%	-	17.21%	-	68.87%	-

Intermediate (US$/bbl)							
Gold (US$/oz)	1,797.11	-1.75%	-	-1.75%	-	-2.74%	-