June 2021 market update

U.S. Fed signals rate tightening, the chip shortage continues to stall the automotive industry and Canada's recovery sputters.

July 9, 2021

Introduction

The global economic recovery continued in June, but some regions experienced a slowdown in conditions as lockdowns impacted some parts of the world. Manufacturing activity across the globe was relatively strong. The service sector, particularly in Europe, also picked up during the month. Consumer and business optimism appeared to be rising, which may bode well for the overall health of the global economy. Many global central banks raised their outlooks, and some, including the U.S. Federal Reserve Board ("Fed"), signaled key policy rates might rise sooner than expected.

In Canada, the S&P/TSX Composite Index reached a new high in June, surpassing the 20,000 level for the first time. The Information Technology and Energy sectors led Canada's main equity index higher. South of the border, U.S. equities finished higher, with the S&P 500 Index and NASDAQ Composite Index reaching fresh record closing prices in June. Global equities, as measured by the MSCI ACWI Index, ended the month slightly higher. The yield on 10-year government bonds in both Canada and the U.S. fell in June. Expectations for higher global demand pushed oil prices above US$70 for the first time since 2018. Gold prices dropped during the month.

Tightening coming soon

After concluding its June meeting, the U.S. Federal Reserve Board ("Fed") announced it was holding the target range for its federal funds rate at 0.00% to 0.25% and maintaining its bond purchases at US$120 billion per month. The Fed raised its outlook for the U.S. economy and inflation, thereby signaling to markets it may tighten policy by raising its key policy rate ahead of earlier expectations. The Fed also noted it had initiated conversations to reduce its bond purchases. Out of 18 officials, 11 expected two rate hikes by the end of 2023, while seven believed there might be one rate increase in 2022. This surprized markets, immediately sending equities and long-term government bond yields down.

Equities and bond yields settled as the Fed tried to ease concerns. Fed Chair Jerome Powell reiterated the Fed's stance that inflation was transitory. The President of the New York Fed noted that talks about raising its policy rate were still some time away. It appears policy tightening is on the mind of Fed officials amid a recovering economy, an improving labour market and rising inflation.

Stalling recovery

Statistics Canada reported Canada's gross domestic product shrank 0.3% in April. This is the first decline in 12 months and is reflective of slowing growth amid new lockdown restrictions. The closure of non-essential businesses also impacted the labour market. The unemployment rate ticked higher as Canada's economy lost jobs in April and May.

Business closures impacted the Canadian consumer. Retail sales dropped 5.7% in April, the first decline since January. Most economists had predicted the economic recovery would be uneven on its way to a full recovery. And the setback appears to be temporary. Major markets across the country began reopening efforts in June as a result of the ongoing vaccine rollout. While challenges may still lie ahead, optimism among businesses and consumers is rising.

No chips, no production

There is a global shortage of semiconductor chips, the impact of which is spilling over to several other industries, including the automotive industry. As lockdowns began last year, many automotive manufacturers halted their orders for chips, expecting car purchases to remain muted for some time. As a result, manufacturers of computers and phones bought the chips given the surge in demand as more people were forced to stay at, and work from, home. As lockdowns eased, car sales increased and car manufacturers struggled to secure chips. Now, millions of cars across North America remain on parking lots waiting for chips before they can be delivered. This has put upward pressure on the prices of chips and automobiles. The rise in automobile prices, both new and used, have risen substantially and contributed to the higher inflation rate in Canada and the U.S. Despite much uncertainty as to when automobile companies will be able to offload their growing inventory, automobile manufacturers on the S&P 500 Index rose over June.

Full demand recovery expected next year

With more reopenings taking place around the world, markets expected global oil demand to climb higher. In its June 2021 Oil Market Report, the International Energy Agency ("IEA") expects global oil demand to return to pre-pandemic levels by the end of 2022. The IEA projects global demand to increase by 5 million barrels of oil per day this year, then another 3.1 million barrels of oil per day in 2022. In the shorter term, household and business demand will likely increase. As the summer approaches, households may travel more, using more gasoline. On the business side, production increases will require more oil usage. As demand and use of oil increases and current supplies deplete, the Organization of the Petroleum Exporting Countries and Russia ("OPEC+") announced it would extend its production increases into July. While rising oil demand may support oil prices, rising supply may put a ceiling on prices in the short term. Oil prices moved higher in June and finished at US$73.47 per barrel.

Market performance - as at June 30, 2021

Equity Markets	Level	Month to date	Year to date	One year
S&P/TSX Composite Index C$	20,165.58	2.20%	15.67%	29.97%
S&P 500 Index US$	4,297.50	2.22%	14.41%	38.62%
Dow Jones Industrial Average US$	34,502.51	-0.08%	12.73%	33.66%
MSCI EAFE Index US$	2,304.92	-1.25%	7.33%	29.45%
MSCI Emerging Markets Index US$	1,374.64	-0.11%	6.46%	38.14%

Fixed Income Markets	Level	Month to date	Year to date	One year
FTSE Canada Universe Bond Index C$	1,178.96	0.96%	-3.46%	-2.43%
FTSE World Investment Grade Bond Index US$	248.96	-0.73%	-3.51%	1.98%

Currencies	Level	Month to date	Year to date	One year
CAD/USD	0.8066	-2.72%	2.62%	9.48%

Commodities	Level	Month to date	Year to date	One year

West Texas Intermediate (US$/bbl)	73.47	10.83%	51.48%	87.17%
Gold (US$/oz)	1,770.11	-7.17%	-6.76%	-0.61%