TD Wealth

Investor Newsletter

Summer 2021

Adding to the continued concerns of vaccine roll-out and COVID-19 variants, increased demand for certain commodities and supply chain disruptions have brought increased risks of inflation to the forefront of investor mindsets. Debate remains whether changes in demand and supply chain struggles will be transitory or sustained, or even how long is "transitory." Despite a couple of hiccups related to those concerns, North American markets continued their early 2021 trend in the second quarter (Q2) by outpacing most other global equity markets and extended strong year-to-date gains: S&P/TSX Composite Index 17.28%, S&P 500 12.19%, U.K. London FTSE 9.2%, German DAX 6.86%, MSCI Japan -1.24%, China Shanghai Comp 1.76%, MSCI EAFE 8.59%, MSCI Emerging Markets 4.73%, and MSCI World Index ex-USA 7.34% (year-to-date 2021 returns adjusted to the Canadian dollar).[1] While a rally in oil prices contributed to Canada's relative equity outperformance, its impact on the Canadian dollar created a drag for U.S. and Non-North American market performance on a currency adjusted basis. The returns by sector for Canada's S&P/TSX Composite Index was broad based with just the cannabis heavy healthcare sector posting a negative return and 8 of the remaining 11 sectors gaining more than 5% in Q2. The performance by sector was even more consistent for the S&P 500, as the weakest performer was the relatively small utilities sector that declined by just 0.4%. The technology and energy sectors led on both sides of the border. Divergence occurred within the emerging market group, with commodity focused markets (Brazil and Russia) out-pacing a Chinese market facing internal anti-competitive actions that focused on its tech sector.

The Bank of Canada (BoC) has continued down the tapering path, reducing the amount of weekly bond purchases following their July meeting. The BoC remains confident in the long-term recovery of the Canadian economy despite slower than expected gains in the first half of 2021. They increased their GDP estimate by 0.9% for 2022 to 4.6% in their Monetary Policy Report released after the meeting. While they'll likely continue to taper, possibly ending the quantitative easing program by year-end, any changes to the overnight rate remain on the horizon. The BoC is very much in the transitory camp despite revisions to their inflation expectations. They now expect consumer inflation (CPI) to average 3% over the course of 2021, with a peak year-over-year rate of 3.9% during the third quarter. Maintaining that much of this increase in CPI is the result of temporary factors, they expect the supply chain bottlenecks to ease later this year and CPI to normalize around their targeted rate of 2% in the fourth quarter.

The U.S. Federal Reserve Open Market Committee (FOMC) is electing to take an even more patient approach, with Chairman Jerome (Jay) Powell only acknowledging that the planning process for tapering has begun. They continue to be vague with their communication that "substantial further progress is required" and we don't expect an actual announcement to taper until December.[2] Like the BoC, Chairman Powell and the FOMC are downplaying the sustainability of recent inflation data despite also increasing the 2021 forecast of their favoured inflation measurement, the PCE deflator, from 2.4% to 3.4%. Their view is that we're experiencing a re-basing following last year's significant decline in prices. That said, they are also fighting the perception that inflation will remain elevated as there is a self-perpetuating component to increased inflation expectations.

Ottawa Wealth Advisory Group
TD Wealth Private Investment Advice
360 Albert St., Suite 1600, Ottawa ON K1R 7X7
T: 613 783 4000 | Toll-Free: 1 877 275 5953 | F: 613 783 4075

After a tough start to the year, bonds rallied as long-term interest rates broadly came off their early 2021 highs as the market seems to be more comfortable with transitory inflation conversation. The move hasn't been enough to get the FTSE Canada Universe Bond Index into positive year-to-date territory, as it trades at -2.58% as of July 28.[3] With little changed for short-term rates, the move has resulted in a flatter yield with the difference between the Canadian 2 and 10-year treasuries narrowing to 0.71%, as of July 28, from 1.25% in mid-March.[4] As the Canadian preferred share market rate-reset structure is tied to the shorter term 5-year treasury bonds, it held up well as its yield declined much less than the 10-year's. Further supporting preferred shares was the continued shrinking of the available pool of securities, with Q2 redemptions of $3.9 billion bringing the 2021 total to $6 billion. With more expected in the second half, we believe the supply/demand equation to be supportive of the remaining securities.

Though Canada experienced a slower vaccine roll out and an accompanying impact in economic growth compared to the U.S., a rally in commodity prices, especially oil, helped push the Canadian dollar (CAD) to its highest level relative to the U.S. dollar since 2015 in mid-July. That faded since the end of May and the CAD is back to early 2021 levels at $1.252 per USD as of July 29, with oil dropping nearly 10% after OPEC+'s agreement to expand production in August and increased concerns about the economic impact of the Delta variant.[5] We expect energy prices to stabilize and, combined with a slightly more hawkish central bank, the CAD/USD exchange rate to find support at these levels.

While concerns about COVID-19 variants remain, especially in areas where vaccination rates have stagnated, we expect economic recovery to continue through the summer and into the fall. The market seems to be pricing that as the base case and, with very strong early Q2 financial results being met with a muted market response, we expect that returns should moderate in the second half while volatility ticks higher. Regardless, we believe equities remain the financial market's preferred destination for capital and that said volatility be met with a bid with investors looking to deploy significant amounts of uninvested cash.

Sources:
1. Bloomberg Finance L.P. as at June 30, 2021. Total Index returns. Index returns calculated in C$.
2. House Financial Services Committee Hearing. U.S. Federal Reserve Chair Jerome Powell. July 14, 2021
3. Morningstar Inc. July 28, 2021
4. Refinitiv 2021. July 28, 2021
5. Refinitiv 2021. July 28, 2021

Interest Rates as of July 28, 2021

Fixed Income Securities	1 year	2 years	3 years	5 years	10 years	20 Years	30 Years
GICs**	0.80%	1.10%	1.45%	1.50%			
Canadian Treasury Bonds*	0.30%	0.46%	0.55%	0.78%	1.17%	1.60%	1.75%
U.S. Treasury Bonds*	0.07%	0.21%	0.38%	0.73%	1.27%	1.84%	1.92%

* Rates provided by Refinitiv 2021
** Rates provided by TD Wealth

Chris Martin
Vice President & Investment Advisor

Dan Soublière
Vice President & Investment Advisor

Alex Anderson, CFA
Vice President & Portfolio Manager

Dawn Cameron
Associate Investment Advisor

Carol Williams
Associate Investment Advisor

Lesley Gover
Client Service Associate

Gloria Stewart
Client Service Associate

Ottawa Wealth Advisory Group

TD Wealth Private Investment Advice
360 Albert St., Suite 1600, Ottawa ON K1R 7X7
T: 613 783 4000 | Toll-Free: 1 877 275 5953 | F: 613 783 4075