MACKENZIE Investments

Monthly Market Matters

Summary for August 2021

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Highlights

A see-saw month where fears over the delta variant sank bond yields and stock prices, only to largely stage a full recovery as fears abated and US fiscal and monetary policies took on greater clarity.

The rapidly spreading delta variant brought renewed lockdowns in Asia and Oceania, supply chain disruptions ensued.

Corporate earnings continue to exceed expectations, once again buttressing equity markets.

Valuations have improved. Stellar recoveries in earnings have helped to chip away at nose-bleed equity market valuations.

Market summary

It was a see-saw month for most asset prices. A late-month rally saw most global equity indices make gains on the back of solid earnings growth; other assets were little changed to lower. Prices of all assets generally followed the same see-saw path. Some had a quick start, but all suffered a mid-month risk-off swoon, followed by a late-month rally. The ebb and flow of the COVID-19 delta variant is primarily to blame for the mid-month decline. Fears over vaccine efficacy, renewed restrictions, and even subdued activity amongst the highly vaccinated brought a risk-off tone that saw bond yields test six-month lows before the late month reversal that saw equities, commodities and bond yields rise again. The turnaround came from an improvement in Covid case counts (in China, daily new cases have fallen close to zero since Aug 16, and there are signs that the fourth wave may be rolling over in the US, UK and Europe), the US FDA's full approval (versus the emergency use authorization) of the Pfizer vaccine, and talk of booster shots in the US and elsewhere. The risk-on tone was further bolstered by progress on US fiscal spending legislation and dovish signals from the US and European central banks.

Covid flare-ups tap the brakes on global growth

The virus is bringing varied impacts worldwide depending on vaccination levels, activity restrictions, and timing of the fourth wave. In general, there has been a slowdown in global activity under the delta variant. Even jurisdictions with few restrictions in place, like the US and the UK, saw sharp declines in their August services sector Purchasing Manager Indices and retail sales figures. This underscores that individual choice to curb activity is happening whether government restrictions are in place or not. Canadian economic activity that proved to be slower than expected in the heavy lockdown months of Q2 will also likely see softening in July and perhaps August (the StatsCan preliminary GDP estimate for July is -0.4% m/m). Canadian payroll numbers disappointed for July. These disappointments, combined with the Federal election date (Mackenzie Federal election insights), and uncertainty over the delta variant, may lead the Bank of Canada to pause its asset purchase tapering. As such, Canadian bond yields were softer on the month versus their US counterparts, and

Canadian Fixed Income	Level	Month	YTD
FTSE Canada Universe Bond Index	1,190	-0.1%	-2.6%
FTSE Canada All Corporate Bond Index	1,378	0.0%	-1.3%
Bloomberg Canada High Yield Index	166	0.1%	5.4%
Global Equities	**Level**	**Month**	**YTD**
S&P/TSX Composite	20,583	1.5%	18.1%
S&P/TSX Small Cap	757	0.1%	15.5%
S&P 500	4,523	2.9%	20.4%
NASDAQ	15,259	4.0%	18.4%
Russell 2000	2,274	2.1%	15.1%
UK FTSE 100	7,120	1.2%	10.2%
Euro Stoxx 50	4,196	2.6%	18.1%
Nikkei 225	28,090	3.0%	2.4%
MSCI China (USD)	94	-0.1%	-13.3%
MSCI EM Index (USD)	1,309	2.4%	1.3%
Currencies and Commodities	**Level**	**Month**	**YTD**
CDN $	$0.793	-1.1%	0.9%
US Dollar Index	92.63	0.5%	3.0%
Oil (West Texas)	$68.50	-7.4%	41.2%
Natural Gas	$4.38	11.7%	59.7%
Gold	$1,814	0.0%	-4.5%
Copper	$4.38	-1.8%	24.1%
Canadian Interest Rates	**Level**	**Month**	**YTD**
3-month T-bill	0.17	0	11
GOC bonds 2-yr	0.42	-3	22
GOC bonds 10-yr	1.21	1	54
GOC bonds 30-yr	1.77	2	56
Canadian Sector Performance		**Month**	**YTD**
Energy		-0.9%	25.7%
Materials		-3.0%	-1.3%
Industrials		3.7%	13.2%
Cons. Disc.		-1.5%	13.3%
Info Tech		5.8%	32.5%
Health Care		1.0%	9.3%
Financials		1.7%	22.9%
Cons. Staples		1.9%	17.5%
Comm. Services		3.8%	19.9%
Utilities		0.6%	6.4%
Real Estate		1.8%	27.1%

Source: Bloomberg & FactSet August 31, 2021 – local currency unless noted, equity price only returns, bonds total return

the loonie's wings were clipped (oil prices skidding 7.4% didn't help the Canadian dollar either).

In addition to the virus disrupting local activities, the global supply chain impacts continue to fester. Zero-tolerance policies in China, Taiwan and Australia bring low cases but severe economic disruptions. Meanwhile, global supply chain heavyweights such as India, Malaysia, Japan, Thailand, Philippines, Vietnam, Mexico, and Indonesia sit in the top 15 of global daily new Covid cases, bringing work stoppages at factories and ports. The bottom line is learning to live with Covid remains for the foreseeable future. The fact that highly vaccinated advanced economies have experienced a sharp rise in new cases due to the delta variant underscores that true herd immunity will likely prove elusive.

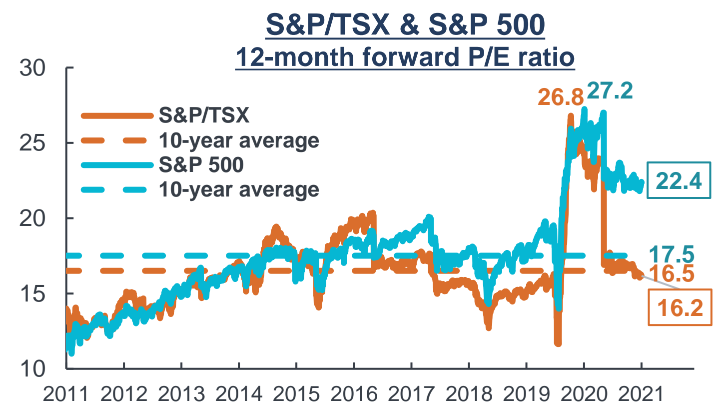
Consequently, society will need to adapt to the idea of a level of disease circulation and impact that keeps the health care system functioning for both the Covid-infected and all other procedures. For now, this leaves a simmering level of risk that outbreaks will occur. Capital markets are becoming used to this scenario and take comfort in the demonstrated ability of corporations to adapt (more below), and that flare-ups provide an opportunity for authorities to keep fiscal spigots open and central bank easy-money policies in place for longer.

Corporate earnings too good to ignore

While July saw the beginning of earnings season and little reaction on the part of share prices, the continuation of earnings surprises into August was too good to ignore, with many equity markets extending their string of all-time highs. The MSCI All Country World Index (+2.4% monthly gain in US$), the S&P 500 and the S&P/TSX all recorded their seventh monthly gain in a row. For some fun with stats, courtesy of Tony Dwyer at Canaccord Genuity: Since 1957, the S&P 500 has delivered 13 streaks of seven months or more, posting new highs. Historically, the streak continued to at least eight months 62% of the time (8/13). However, we are heading into the fall, which has historically been a seasonally weak period for stocks - so what does the streak say about drawdowns? Only two instances saw no drawdown at some point following the close of the seventh month. Therefore, 85% of the time, a buying opportunity arose. But it has never been a fire-sale; from the seven-month closing high, the median decline was 3.1%, and the worst decline was 6.4%. Every seven-month streak brought higher levels over the following six months, with a median gain of 10.8% to the six-month peak. The bottom line, statistically, this track record suggests a mild pullback is coming, and it should be bought.

Second-quarter 2021 earnings once again made a mockery of analyst predictions. With only a handful of companies left to report, the S&P 500 posted year-over-year earnings growth of 93%, with 86% beating their earnings estimates by an average surprise of 16%. Similarly, for the S&P/TSX, earnings are up 135% year-over-year, 61% beat their earnings estimates by an average of 13%. In fairness, the past year has seen many corporations suspended forward guidance due to the substantial uncertainty stemming from the pandemic. The has led analysts to be more conservative with their estimates. Markets also underestimated how well corporations have adapted to the new environment. While unprecedented fiscal and monetary policy has boosted growth. The transformational shifts (work from home, cloud services, and e-commerce) that have underpinned enhanced profitability and productivity are also at play. Companies have also successfully passed on their increased costs to customers, who have been quite forgiving to higher prices for the time being, as easing lockdown measures and elevated cash levels see the release of pent-up demand.

Chart in focus: Earnings growth outpaces price gains



Equity market valuations that were of particular concern at the beginning of the year have improved. The S&P 500 was trading at a forward price-to-earnings (P/E) ratio of ~27x, a level not seen since the lead-up to the 2000 dot-com bubble. As a result, consensus estimates called for muted stock market returns this year, yet, the S&P 500 has returned a stellar 20% YTD. Today, the S&P 500 trades at ~22x forward earnings. In other words, earnings have outpaced prices by a significant margin.

The story is even better in Canada, where very volatile swings in earnings in cyclical sectors like energy, materials, industrials, and financials are driving a triple-digit rebound in index earnings. Even though the S&P/TSX is also up smartly on the year (+18%), the multiple has fallen a snick below its 10-year average.

The outstanding corporate earnings results do have analysts scrambling to raise the bar. Historically, there has been a pattern to analyst forecasting. After earnings have taken a sharp hit, analysts have typically been shy with their recovery estimates. This eventually comes to an end. At some point, analysts will over-correct to this bias and likely become overly optimistic on their earnings projections. This will likely bring an end to the outsized positive surprises and curb the magnitude of equity market gains as well. We believe the backdrop remains one where earnings growth will support stock prices, but the added juice of positive surprises will have passed.

Source: Bloomberg & FactSet August 31, 2021 – local currency unless noted, equity price only returns, bonds total return

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