MACKENZIE Investments

Monthly Market Matters

Summary for April 2022

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Highlights

Stocks extend declines on a sharp rise in bond yields. Bond sell off continues amid hawkish US Federal Reserve

Geopolitical, economic growth concerns, and diverging global monetary policy push the US dollar up to 20-year high.

Q1 earnings results better than expected, but markets focused on shaky forward guidance and ongoing macro risks

US CPI inflation accelerates, but the core figure moderates, potentially marking a peak in core inflation

Nowhere to hide

Global equity markets saw its worth month since the start of the pandemic in March 2020. The main headwind for risk assets was a sharp back up in bond yields, punishing stocks and deepening the sell off in bonds. The FTSE Canada Universe Bond Index fell another 3.5%, entering correction territory year to date. The move higher in yields was particularly jarring for growth stocks. The tech-heavy Nasdaq Composite Index plunged 13%, making April the worst month for the index since the Great Financial Crisis in October 2008. Markets are now pricing in 50 basis point hikes for the US Federal Reserve's (Fed) next four meetings after numerous hawkish remarks from Fed Committee members. The rise in interest rates, alongside the ongoing geopolitical and growth concerns have market volatility ratcheting higher. The VIX Index broke through the 30-point level for the first time in a year.

Earnings moved to the back burner

We are past the midway point in S&P 500 Q1 earnings season, and the results continue to come in solidly, with 81% beating their estimates by an average of 3.1% thus far. However, investors are shrugging off the better-than-expected results and instead focusing on shaky forward guidance and the laundry list of macro risks present. The Q1 results for the once market darling FAANG stocks were much-anticipated going into this reporting season. However, even the once seemingly invincible tech giants could not evade the carnage in equity markets. Aside from Meta, forward guidance has been dreary, particularly from Amazon. The stock fell 15% after the company reported rising cost pressures and projected sluggish Q2 sales growth due to slower online sales. Apple, which has fared the best of the bunch in this year's FAANG sell-off, fell lower despite delivering record earnings and revenue results. The company warning of a possible US$8 billion hit from the current supply chain challenges, driven by the lockdowns in China, dragged the stock lower. With the Fed quickly turning from ally to foe for these interest rate sensitive, long duration technology stocks, this year's sluggish start indicates that investors are placing more emphasis on underlying fundamentals before placing a bid.

Rising Real Yields threaten TINA

The yield on the 10-year US Treasury inflation-protected bonds (TIPS) turned positive for the first time since the outbreak of the

Canadian Fixed Income	Level	Month	YTD
FTSE Canada Universe Bond	1,069	-3.5%	-10.2%
FTSE Canada All Corporate Bond	1,248	-3.2%	-9.4%
Bloomberg Canada High Yield	160	-1.5%	-4.0%
Global Equities	**Level**	**Month**	**YTD**
S&P/TSX Composite	20,762	-5.2%	-2.2%
S&P/TSX Small Cap	781	-6.5%	0.9%
S&P 500	4,132	-8.8%	-13.3%
NASDAQ	12,335	-13.3%	-21.2%
Russell 2000	1,864	-10.0%	-17.0%
UK FTSE 100	7,545	0.4%	2.2%
Euro Stoxx 50	3,803	-2.6%	-11.5%
Nikkei 225	26,848	-3.5%	-6.8%
MSCI China (USD)	69	-4.1%	-17.7%
MSCI EM Index (USD)	1,076	-5.7%	-12.6%
Currencies and Commodities	**Level**	**Month**	**YTD**
CDN $	$0.778	-2.8%	-1.7%
US Dollar Index	102.96	4.7%	7.6%
Oil (West Texas)	$104.69	4.4%	36.0%
Natural Gas	$7.24	27.1%	102.4%
Gold	$1,897	-2.1%	3.7%
Copper	$4.41	-7.3%	-0.8%
Canadian Interest Rates	**Level**	**Month**	**YTD**
3-month T-bill	1.39	79	123
GOC bonds 2-yr	2.62	33	167
GOC bonds 10-yr	2.86	46	144
GOC bonds 30-yr	2.80	42	112
Canadian Sector Performance		**Month**	**YTD**
Energy		2.7%	30.8%
Materials		-4.8%	13.9%
Industrials		-8.0%	-4.7%
Cons. Disc.		-2.9%	-10.8%
Info Tech		-19.9%	-48.3%
Health Care		-17.8%	-24.9%
Financials		-6.7%	-5.4%
Cons. Staples		0.4%	5.4%
Comm. Services		-1.4%	6.2%
Utilities		-1.5%	2.4%
Real Estate		-6.3%	-11.4%

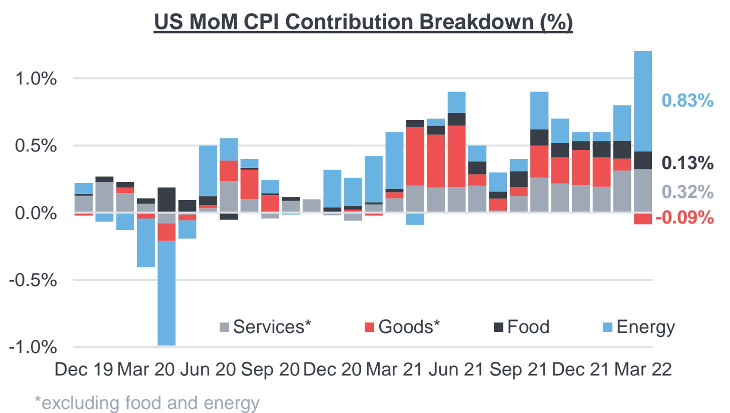
Source: Bloomberg & FactSet April 30, 2022 – local currency unless noted, equity price only returns, bonds total return

pandemic two years ago. This measure is also known as the real yield since it measures the true cost of borrowing for corporations after you back out expected inflation. Growth stocks are particularly vulnerable to rising real yields given their lofty valuations rely on favourably low discount rates. Traders adding to their bets for the US Federal Reserve (Fed) to hike rates 'expeditiously' has sparked the ~1% move higher in real yields in just six weeks and has the nominal 10-year US Treasury yield approaching 3%. The spike in real yields is substantial because it threatens to topple the 'There Is No Alternative' (TINA) narrative, a critical pillar of support for risk assets that has underpinned the strong inflows into equities. When real rates are negative, investors avoid investing in cash or sovereign bonds as they would lock in a negative return after adjusting for inflation. As we have seen over the last decade, historically low real yields have forced investors further out on the risk spectrum, hence the term TINA. According to the Fed's most recent Summary of Projections, the Committee sees the neutral rate for the Fed Funds Rate at ~2.4%. Current market expectations of almost ten rate hikes imply that the Fed will be forced to raise interest rates ~50 basis points above neutral by the end of this year to quell inflation. As a reminder to our readers, interest rates currently sit at just 0.25%-0.50%! We still believe that the US Federal Reserve will have trouble reaching that level without something breaking in the financial system, given the mountain of debt at the consumer, corporate and government levels. Recall that during the 2015-18 hiking cycle, after getting interest rates to ~2.5%, Powell capitulated to external pressures and lowered interest rates at the first sign of softening in the economy. Admittedly, the key difference today is inflation. However, the March US CPI report (see chart in focus) makes us more optimistic that core inflation will peak in the next few months. This should warrant at least a pause from the Fed in the second half of this year, offering some relief for battered fixed-income and growth investors.

Surging US dollar adds to global growth concerns

The US dollar has been steadily strengthening against every major currency since the start of March, with the US Dollar Index climbing 8% in 2022 to reach the highest level in twenty years. The obvious explanation for the strength is rising US bond yields during the Fed's quest to tame inflation. However, foreign monetary policy and growth fears have also driven the move higher, while simultaneously cementing the dollar's safe-haven status in the process. The Euro, Japanese yen and Chinese yuan have weakened significantly against the dollar. All three have one thing in common: their central banks are tilting dovish. This reinforces the divergence of global monetary policy narrative that is playing out. The central banks that continue to hold a dovish stance will likely see their currency punished against the greenback, as the Fed continues to push interest rates higher. If the strength in the dollar persists, this adds yet another headwind for global growth, particularly for emerging market economies that often rely on dollar-issued debt. Indeed, one could surmise that the strength of the dollar is overextended. Perhaps that is the case. However, recall that for every currency trade, two transactions effectively occur: you buy one currency while simultaneously selling another. Even if one is bearish on the dollar, a viable alternative is currently missing. The Chinese yuan is being penalized by the country's economic woes, the prospects for the Euro will continue to be dampened as long as the war in Ukraine persists, and as alluded to above, the yen weakness will likely endure unless the Bank of Japan capitulates on its dovish stance. This points to further dollar strength in the short term.

Chart in focus: Watch for second-order effects



*excluding food and energy

US headline CPI inflation came in at a scorching 8.5% y/y in March, a tick higher than expectations and up from its 7.9% y/y pace. The acceleration validates the numerous issues still plaguing the global economy. However, parsing through the data left us and markets slightly more constructive on the inflation outlook (S&P 500 was initially up ~0.75% after the release). As our chart illustrates, the bulk of the monthly gains concentrated in energy (+11.0% m/m) – gasoline prices (+18.3% m/m) accounted for over half of the monthly advance. Core inflation (excludes food and energy) came in lower than expected at just 0.3% m/m, while goods inflation outright declined (-0.1% m/m). Pandemic-related goods that have driven a significant portion of the increase in the annual inflation figure appear to be cooling. For example, used car and truck prices, contributing ~1% to the annualized inflation figure, dropped sharply this month (-3.8% m/m). Coupling this with declining shipping costs, evidence of supply chain pressures easing, and hints of demand destruction due to higher prices, the first-order effects from the pandemic appear to be fading, and the peak for core inflation is perhaps behind us. Now, lockdowns in China, the war in Ukraine, and second-order effects related to the economy reopening are the key risks that could keep inflation elevated. Prices for services account for over half the CPI basket and have begun to shift higher, a wage price spiral is a possibility given the tightness in the labour market, and shelter (+5.0% y/y) remains a significant concern, given it accounts for almost a third of the CPI basket. If these second-order effects are held in check, inflation could moderate and increase the probability of the US Federal Reserve achieving a soft landing.