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2022 capital markets mid-year in review

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2022 YTD – Market review

Regional Equity Indices	Index Level		YTD		2021
	Dec. 31, 2021	Jun. 30, 2022	Price Return	Total Return	Total Return
S&P/TSX	17,433	21,223	-11.1%	-9.8%	25.2%
S&P/TSX Small Cap	655	774	-15.0%	-13.9%	20.3%
Dow Jones Industrial	30,606	36,338	-15.3%	-14.4%	20.9%
S&P 500	3,756	4,766	-20.6%	-20.0%	28.7%
Russell 2000	1,975	2,245	-23.9%	-23.4%	14.8%
Nasdaq	12,888	15,645	-29.5%	-29.2%	22.2%
MSCI All Country World	646	755	-20.9%	-20.0%	19.0%
MSCI Europe	132	162	-15.5%	-13.4%	25.8%
MSCI EAFE	2,148	2,336	-21.0%	-19.2%	11.9%
MSCI Emerging Markets	1,291	1,232	-18.8%	-17.6%	-2.3%

Fixed Income Indices	Index Level		YTD	2021
	Dec. 31, 2021	Jun. 30, 2022	Total Return	Total Return
FTSE Can. Universe Bond	1,190	1,045	-12.2%	-2.5%
FTSE Can. All Corp. Bond	1,378	1,227	-11.0%	-1.3%
Bloomberg Can. High Yield	167	155	-6.9%	5.6%

Currencies	Dec. 31, 2021	Jun. 30, 2022	% change
CAD/USD	79.12	77.68	-1.8%
CAD/EUR	69.54	74.09	6.5%
EUR/USD	1.14	1.05	-7.8%
GBP/USD	1.35	1.22	-10.0%
USD/JPY	115.08	135.72	17.9%

Bond Yields (%)	Dec. 31, 2021	Jun. 30, 2022	bps change
10-yr Canada Govt.	1.43	3.22	180
10-yr U.S. Treasury	1.51	3.01	150
10-yr Germany Govt.	-0.18	1.34	151
10-yr Japan Govt.	0.07	0.23	16
30-yr Canada Govt.	1.68	3.14	146
30-yr U.S. Treasury	1.90	3.18	128

Commodities	Dec. 31, 2021	Jun. 30, 2022	% change
Gold USD/oz.	1,829.20	1,807.27	-1.2%
Oil USD/bbl.	75.21	105.76	40.6%
German Nat. Gas EUR/MWh	65.85	144.15	118.9%
Copper USD/lb.	446.35	371.45	-16.8%

Source: Bloomberg June 30, 2022. Index returns are in local currency. *Total return is price return plus reinvestment of dividends.
All figures quoted in the text are price only return, local currency, unless otherwise noted

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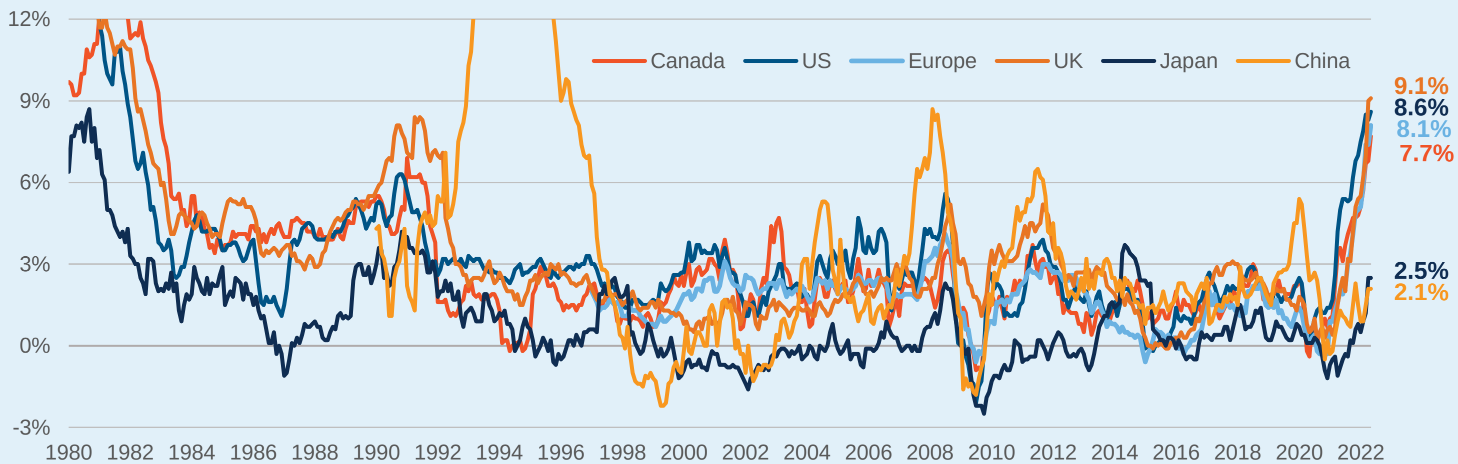
A rude awakening for markets

This year began with the world facing the rapid spread of the Covid-19 omicron variant, renewing concerns of another pandemic-induced slowdown. After the variant thankfully proved to be less lethal than its predecessors, optimism towards the economy reopening was restored, albeit for the time being. Although central banks tightening monetary policy would be a headwind for the economy and markets, the path towards normalization was widely expected to be gradual, given the sensitivity of a global economy still healing from the effects of the pandemic. Investors had many positives to point to that would support the global expansion. Consumers were still armed with their war chest of excess savings accumulated over the pandemic, allowing the spending spree to continue. In turn, strong consumer spending would spur additional business investment. Broadly speaking, consumer and business balance sheets remained solid and were well-positioned to weather any slowdown that was to materialize. Earnings growth was still expected to grow alongside above-trend global GDP growth. Lastly, China was primed to emerge as a pivotal ballast to global growth, as many anticipated policymakers to begin easing financial conditions to meet the Party's 5.5% real GDP growth target for 2022. However, just as the economy looked to be picking up steam, news of Russia invading Ukraine sent shockwaves around the world. Although Russia and Ukraine make up a relatively negligible portion of global GDP, their footprint in the commodity complex was vast. Crude oil prices surged, up 41% to US$106/bbl, after more than doubling last year, natural gas prices rallied 48% in the US and 120% in Europe, and agriculture prices were up across the board. At the same time, China's Dynamic Zero COVID policy and resultant lockdowns in the key manufacturing and export hub of Shanghai put the world's second-largest economic growth target in jeopardy alongside further aggravating global supply chains.

With commodity prices soaring, inflation zoomed to multi-decade highs across the globe, forcing central bankers to swiftly shift their timeline forward in normalizing monetary policy. After two years of implementing a patient and data-driven approach, acknowledging the sensitivity of an economy still recovering from the effects of the pandemic, central banks now find themselves behind the curve on inflation. Alongside broad interest rate hikes, they have also begun reducing their swollen balance sheets (quantitative tightening). Markets are now questioning how well the economy will fare in an environment where they can no longer rely on central banks bailing them out with the proverbial 'Fed Put' (see more below).

Global CPI inflation (%)



Source: Bloomberg May 2022

The cascading effects of soaring inflation led to a sharp sell off in fixed-income, with the FTSE Canada Universe Bond Index and the Bloomberg Global-Aggregate Bond Index falling into correction territory (-10%). Bond yields jolted higher across the yield curve, led by the shorter end. This caused inversions across many parts of the curve (including the most-oft cited spread between the US 10-year and 2-year Treasury yields), flashing warning signs of a slowing economy and a potential looming recession.

The upward shift in bond yields has driven a material compression in equity valuations. The forward P/E multiple for the S&P 500 fell from ~23x earnings earlier in the year to just above the 10-year average at ~17x, underpinning the worst half since 1970 for the S&P 500. The index is now in bear market territory, having fallen 21% from its all-time-high set in early January. The declines were more acute in the speculative, growth areas of the market. The tech-heavy NASDAQ was down 30%, Cathie Wood's ARK ETF dropped nearly 60%, while the price of Bitcoin collapsed to US$18,731 (-60%). One of the only places to hide this year was in energy stocks, which benefitted from rising oil and natural gas prices. At the same time, a shift towards defensives ensued, shielding investors from some of the sizeable losses seen in other sectors.

The end of an era?

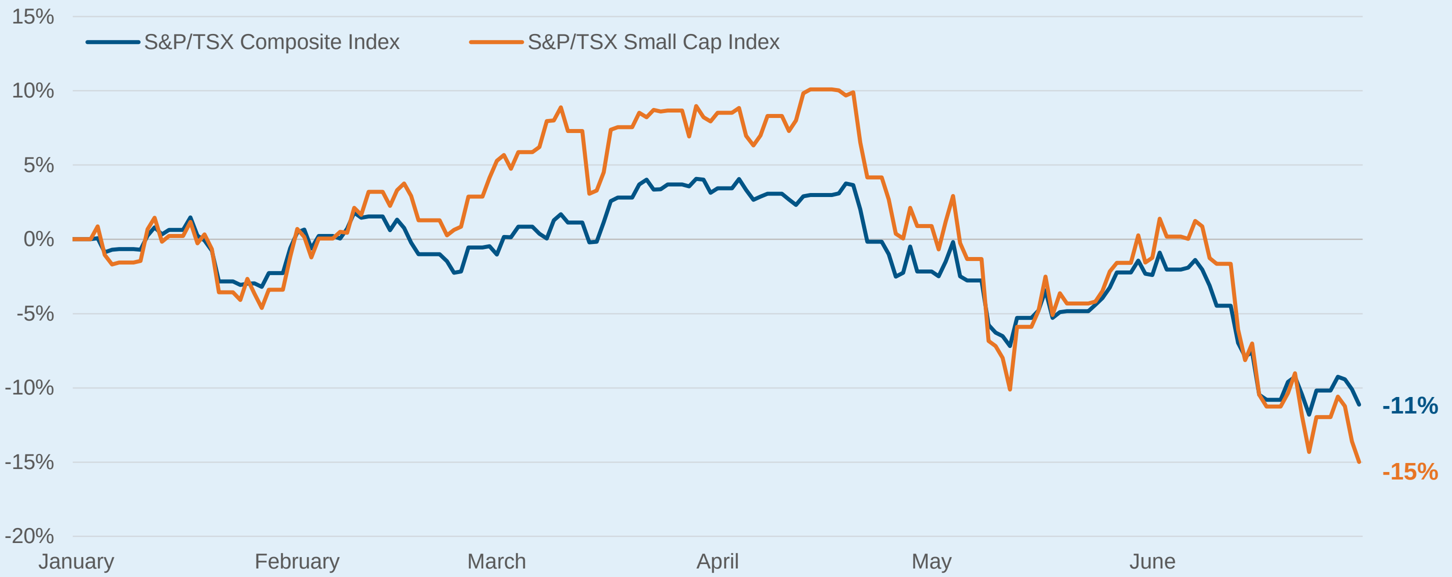
For more than a decade following the Great Financial Crisis, market participants have enjoyed an unprecedented tailwind from the proverbial 'Fed Put' that has backstopped risk assets and propelled equities to all-time-highs. This phenomenon revolves around the idea that the US Federal Reserve (Fed) would swoop in and save the day, accelerating their bond purchases (quantitative easing) and cutting interest rates if the economy or the stock market were to show any signs of weakness. Now that inflation has risen to multi-decade highs, the Fed and other central banks alike are playing catch up, rushing to normalize policy. The concern is that central banks will be forced to ratchet up rates deep into restrictive territory to tame inflation, pushing the economy into a recession in its wake. This has effectively removed the so-called 'Fed Put', leading to a downward rerating in stocks and bonds thus far this year. The question now is if the Fed will blink in the upcoming quarters as it embarks deeper into its campaign to rein in inflation, particularly considering the recent inklings of slowing economic growth. If they do moderate their pace of rate hikes or deliver an outright pause, markets should react positively as this could be seen as a reinstatement of the 'Fed Put'. The path forward for central banks will be heavily swayed by where inflation heads next. Importantly, long-term inflation expectations have remained slightly above the 2% target for inflation, indicating that markets still believe upward pressure on prices will moderate. However, if expectations become unanchored from current levels, the Fed will likely be forced to raise rates more aggressively. This scenario would spell bad news for the economy and the stock market.

The next shoe to potentially drop for equity markets is corporate earnings. Q1 earnings held in well, coming in ahead of expectations but with commodity prices rising, tight labour markets and ongoing supply chain bottlenecks, record corporate profit margins set last year are at risk of falling. The focus is shifting toward what will come in the year's second half. Forward guidance has begun to deteriorate, with several high-profile US retailers lowering earnings guidance due to excess inventory levels and an inability to pass on higher costs to consumers. However, analysts' forward earnings estimates for the broader market have yet to be revised lower despite elevated risks to the outlook. If we begin to see downward revisions, it could put further pressure on equities as we progress through the second half of the year.

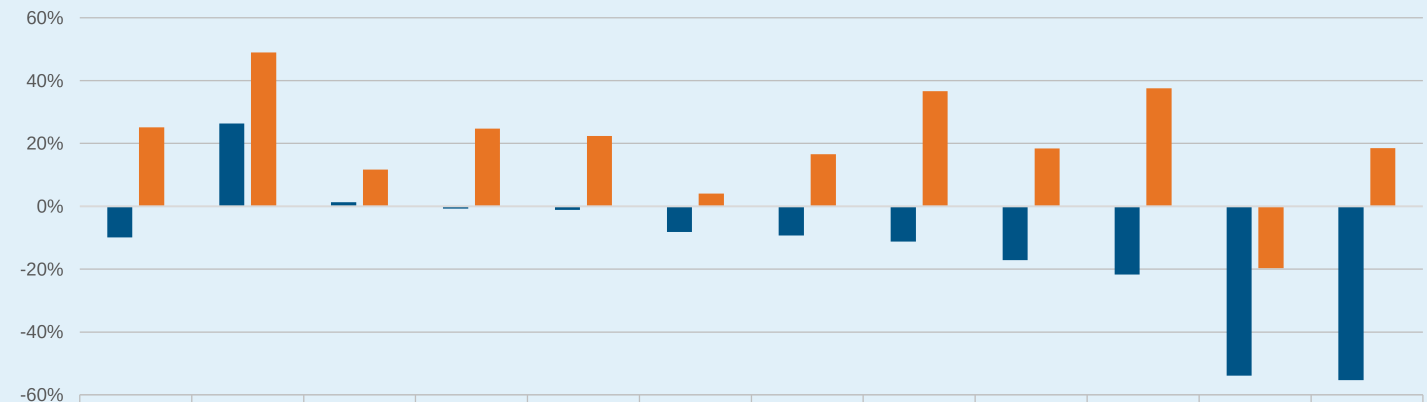
Canadian equity

Although Canadian equities could not avoid the losses seen globally, they did rank amongst the top-performing equity indices, with the S&P/TSX Composite down 9.9% on a total return basis. Energy stocks were one of the few places to hide this year. Accordingly, the index's ~15% weight helped mitigate the sizeable losses seen in virtually every other sector. The ~30% gain in the energy sector was more than offset by the double-digit losses seen in information technology (IT), health care, real estate, consumer discretionary, and financials. IT losses were hefty (-55%), as sharply rising interest rates triggered a massive rerating in equity prices, particularly for long-duration names such as Shopify (-77%). Amid the deteriorating backdrop, a shift into defensive names ensued. The utilities sector (+1.3%) was the lone sector outside of energy to contribute positively to performance.

S&P/TSX Composite and S&P/TSX Small Cap - 2022 YTD performance



S&P/TSX sector total returns (%)



	S&P/TSX Composite Index	Energy	Utilities	Comm. Serv.	Consumer Staples	Materials	Industrials	Financials	Consumer Disc.	Real Estate	Health Care	IT
YTD	-9.8	26.3	1.3	-0.7	-1.1	-8.2	-9.3	-11.2	-17.1	-21.7	-53.9	-55.3
2021	25.2	49.0	11.6	24.7	22.4	4.1	16.5	36.6	18.4	37.5	-19.6	18.5

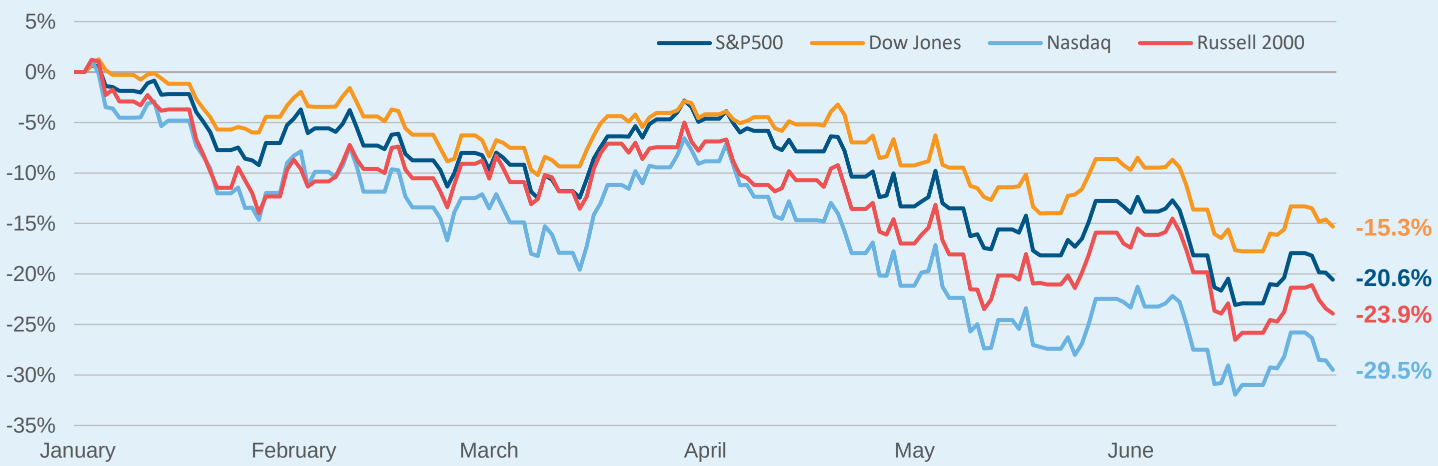
Source: Bloomberg June 30, 2022

US Equity

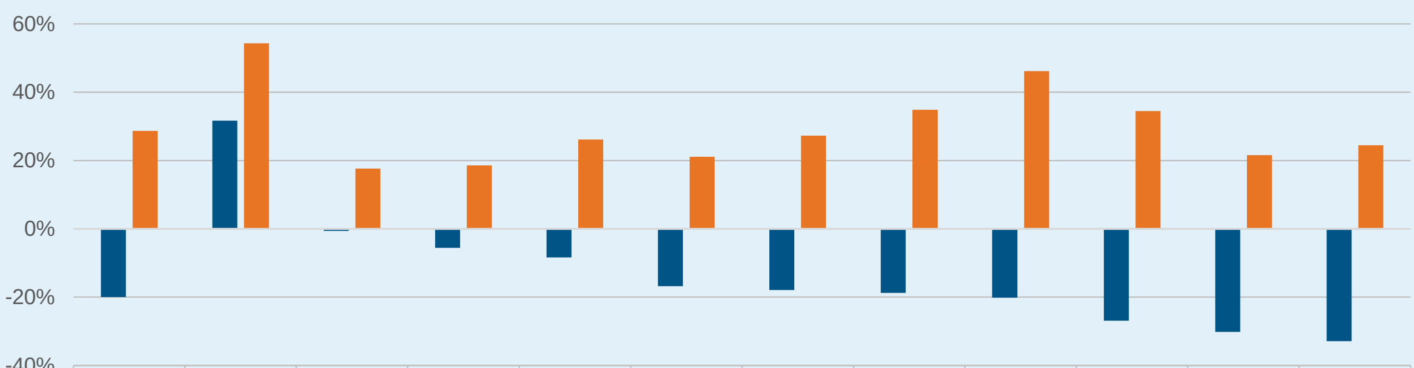
Rising interest rates took a massive bite out of US equities this year, ending their recent dominance as they performed the worst amongst all major equity indices. All major large and small-cap US equity benchmarks recorded losses of at least 15% (S&P 500, DOW, NASDAQ and Russell 2000). The S&P 500 recorded its worst half since 1970, plunging 21% from its all-time-high into bear market territory. The growth-oriented NASDAQ Composite fared even worse, plummeting 30%. Sharply rising bond yields dragged equity valuations back down to earth. The forward P/E ratio for the S&P 500 fell from ~23x at the beginning of the year to slightly above the 10-year historical average of ~17x.

Aside from energy, all sectors in the S&P 500 finished in negative territory. The heavily-weighted information technology (IT) sector was the largest detractor amid the spike in bond yields. Consumers shifting away from spending on goods to services weighed on the consumer discretionary sector, while the communication services sector was hauled down by massive losses in Meta (-52%) and Netflix (-71%). Economic growth concerns outweighed the positive effects of rising interest rates for financials (-19%). The energy sector was the standout performer, as the Ukraine war and lockdowns in China added to the ongoing commodity supply shock from the reopening of the global economy, powering commodity prices higher.

US equity indices - 2022 YTD performance



S&P 500 sector 2022 YTD total returns (%)



	S&P 500	Energy	Utilities	Consumer Staples	Health Care	Industrials	Materials	Financials	Real Estate	IT	Comm. Serv.	Consumer Disc.
■ YTD	-20.0	31.6	-0.6	-5.6	-8.3	-16.8	-17.9	-18.7	-20.1	-26.9	-30.2	-32.8
■ 2021	28.7	54.4	17.7	18.6	26.1	21.1	27.3	34.9	46.1	34.5	21.6	24.4

Source: Bloomberg June 30, 2022

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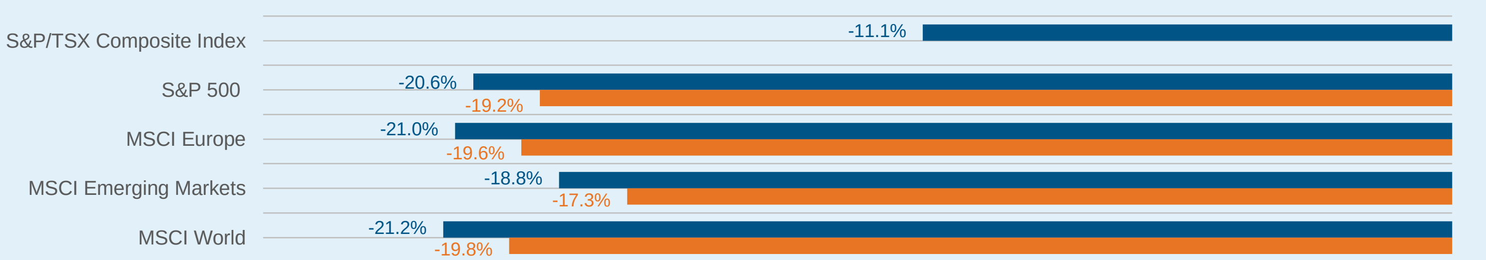
International Equities

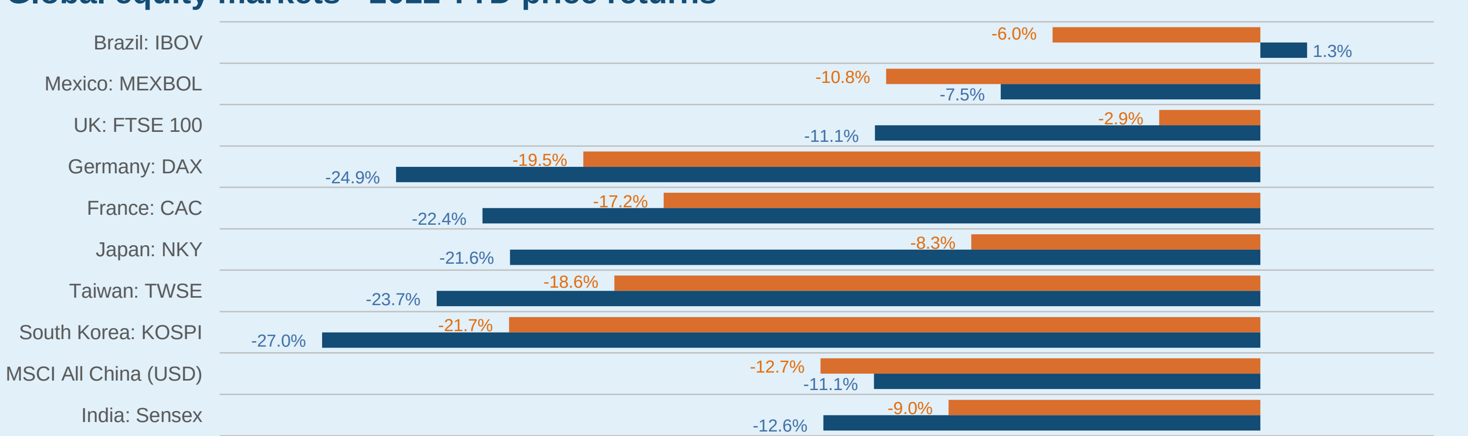
International equities tumbled lower, with the MSCI EAFE Index seeing a 19.6% loss (total return). Europe is acutely vulnerable to the situation in Ukraine, given they rely on Russia to source nearly half of its natural gas needs. Alongside announcing numerous sanctions on Russia, European policymakers announced a partial embargo on Russian energy, worsening an already dire situation. The combined effects have led to an enormous jump in inflation across the continent. Eurozone headline CPI inflation has rapidly eclipsed the 8 percent handle as oil and natural gas prices surge. Soaring inflation prints have the European Central Bank pivoting hawkish, with the first rate hike widely expected at their next meeting in July. Meanwhile, Japanese stocks held up remarkably well, with the Nikkei 225 falling 8.3%. As nearly every other global central bank turns hawkish, the Bank of Japan has stubbornly held onto its dovish policy by keeping interest rates low and holding on to its yield curve control measures. The divergence in policy from other central banks has punished the Japanese yen, which would traditionally benefit from a risk-off environment like this year. The yen has fallen to the lowest level against the US dollar since the late 1990s. Although the UK economy struggles with its cost of living crisis (UK headline CPI accelerated to 9.1% y/y in May) the stock market has ranked amongst the best in the world this year, with The FTSE 100 Index managing a relatively modest loss of -2.9%. Similar to its Canadian counterparts, a significant energy weighting in the index offset the losses in other sectors. In addition, the outsized gains in AstraZeneca (+27%), which holds an ~8% weight in the index, lifted the health care sector.

Emerging market (EM) equities continued to struggle, with the MSCI Emerging Market Index (USD) falling 17.6% (total return). The primary detractors were Taiwan, South Korea, China, and Russian equities. EM stocks were battered by the overall risk-off environment in the first half of this year. The two primary events that have hampered the growth outlook were the Ukraine war and the lockdowns in China, as a spike in Covid-19 cases forced the renewed lockdown measures across the country. The Chinese government's zero-tolerance policy toward Covid threatens the lofty 5.5% 2022 real GDP growth target that Chinese policymakers set for this year. The problems were not only seen domestically. Chinese factory shutdowns further strained global supply chains, leading to longer delays and congestion at major shipping ports. A sharply rising US dollar (+9%) also weighed on the outlook for EM economies, given many countries typically rely on dollar-issued debt to fund their initiatives. China's government and their central bank (PBoC) have begun easing monetary policy and still have ample room to do more. The magnitude of their support will be imperative for the global economic outlook in the back half of the year.

Major global equity indices - 2022 YTD price returns



Global equity markets - 2022 YTD price returns



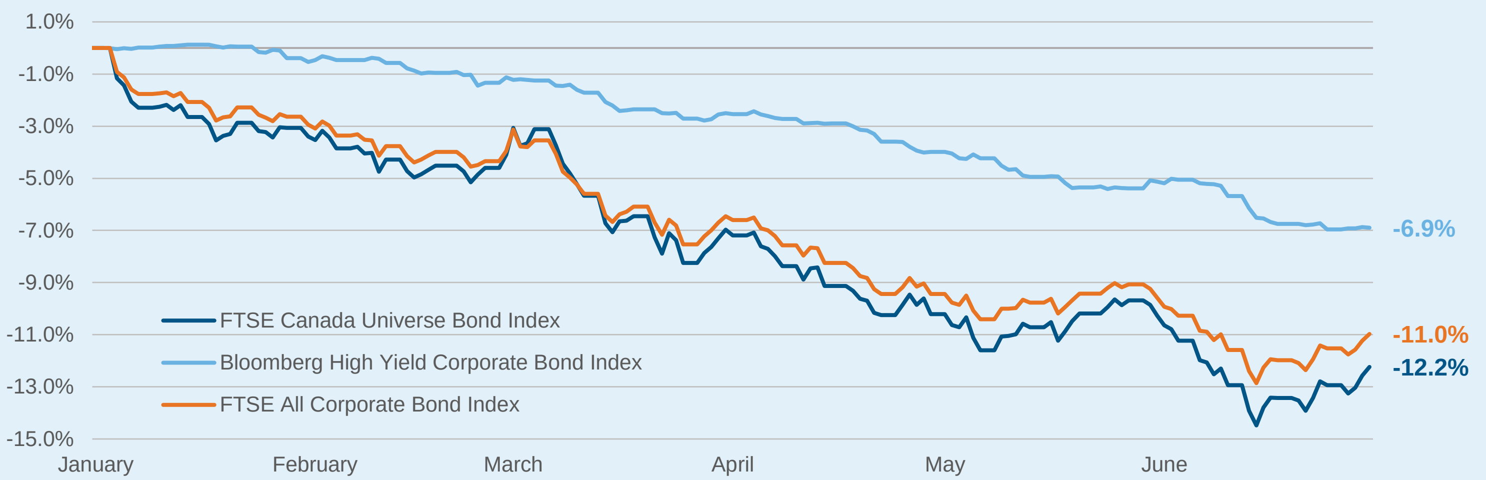
Source: Bloomberg June 30, 2022

Canadian fixed income

The tumultuous past year for Canadian fixed income investors carried into 2022, as bond yields spiked higher on hawkish global central bank policy reacting to the highest inflation in nearly four decades. The FTSE Canada Universe Bond Index fell 12.2%, with the Government of Canada 10-year bond yield jolting 180 basis points (bps) higher to 3.2%, the highest level in over a decade**.** The overall rise in yields led to shorter-duration bonds significantly outperforming longer-term instruments. The FTSE Canada Long Term Overall Bond Index fell 22.1%, while the FTSE Canada Short Term Index was down a lesser 4.4%.

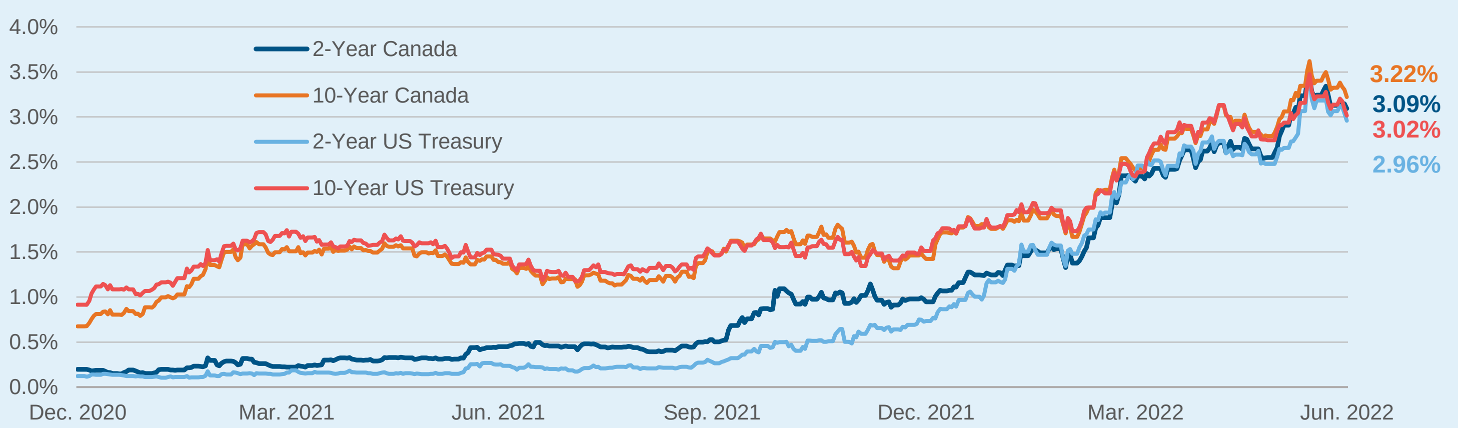
Central bankers shifted more hawkish amid rising and persistent inflation and inflation expectations. Global central banks (excluding Japan and China) have begun increasing interest rates, quickly maneuvering towards a more neutral stance while shifting their monetary policy from quantitative easing to quantitative tightening. In June, the Fed raised its policy rate by 75bps, the single largest hike since 1994. The Bank of Canada is expected to follow suit with a 75 bps increase of their own in July. Credit spreads have started to widen, but the additional yield pick-up in investment-grade corporate bonds helped mitigate the rise in bond yields, allowing credit to overperform government bonds slightly. Still, government, investment-grade corporate, and high yield bonds all delivered double-digit losses. Within the government sector, federal bonds outpaced provincial and municipal bonds.

Canadian fixed income indices - 2022 YTD total returns



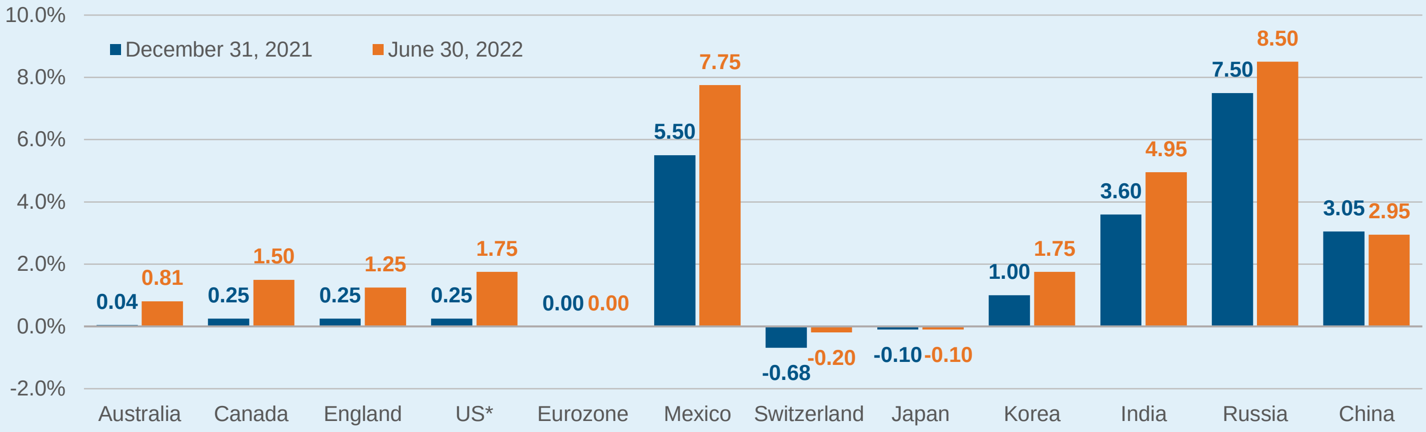
Source: Bloomberg June 30, 2022

2-Year and 10-Year government bond yields



Source: Bloomberg June 30, 2022

Global central bank rates (%)



Source: Bloomberg June 30, 2022
*upper range

Commodities

Commodities were one of the few places to hide this year. The commodity supply shock from the rapid reopening of the economy was exacerbated by the war in Ukraine and the lockdowns in China. Although supply chain pressures appear to be easing (evidenced by declining shipping costs and lower delivery times), they are still wreaking havoc across global supply chains, leading to shortages in various parts of the world**.** Energy prices moved notably higher, with WTI crude oil up 41% to US$105.76/bbl, while natural gas prices ballooned in both the US (+48%) and Europe (+120%). OPEC+ has gradually picked up its pace in restoring its oil production output after the record cuts at the beginning of the pandemic. Despite pressures for more supply, US shale companies are showing restraint, with production still ~1 million bbl/day lower than pre-pandemic levels. US refinery capacity is also near capacity (94%), pushing gasoline prices to record highs. After surging to an all-time high last year, copper prices (a bellwether for global economic activity) have dropped sharply (-17%) amid fears over a global economic slowdown.

Bloomberg commodity index

Source: Bloomberg June 30, 2022

WTI crude oil (US$/bbl)

Source: Bloomberg June 30, 2022

Investors betting on gold as a hedge against inflation were left disappointed. Despite the highest inflation in decades, gold prices fell (-1.2%), ending the first half of the year at US$1,807/oz. Gold prices are negatively correlated to real bond yields, which have risen sharply on increasingly hawkish central bank policy. After spending the last two years deep in negative territory, The US 10-year Treasury Inflation-Protected Securities (TIPS) yield has skyrocketed 180 bps to 0.67%. The other headwind for gold bugs was a strongly appreciating US dollar.

Gold spot (US$/oz)

Source: Bloomberg June 30, 2022

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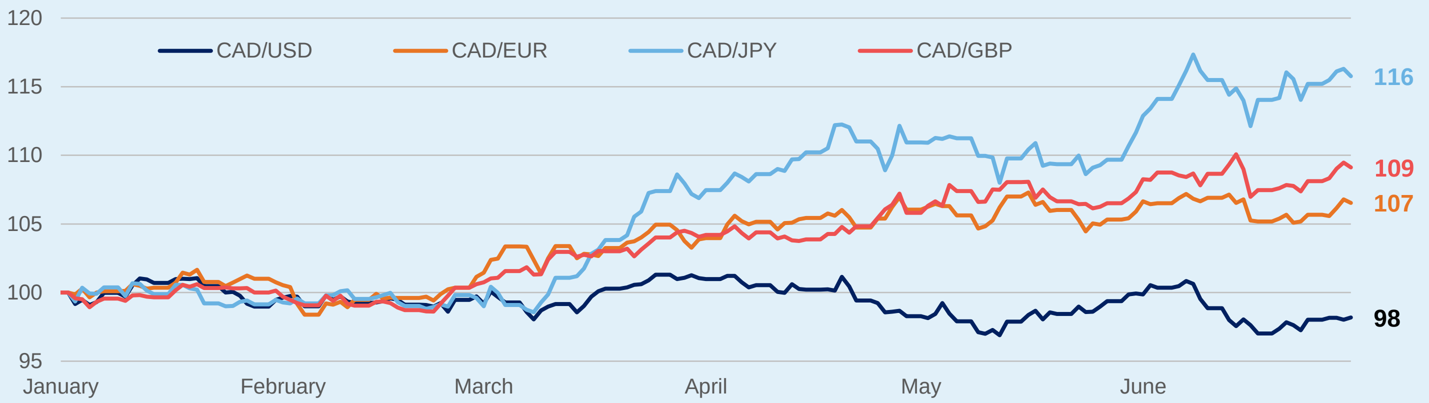
It was a tale of two cities for the Canadian dollar. Although the loonie depreciated against the US dollar, it strengthened against all the other major currencies. Against the greenback, it ended the first half of the year down 1.9% to CADUSD 0.78. The weakness of the CADUSD currency pair has more to do with the outright strength of the greenback, which has risen to the highest level in two decades. The earlier gap in short-term interest rate differentials relative to the US has narrowed further, removing the previous tailwind for the loonie. Conversely, the loonie rose significantly against every other major currency, bolstered by booming commodity prices and a hawkish Bank of Canada.

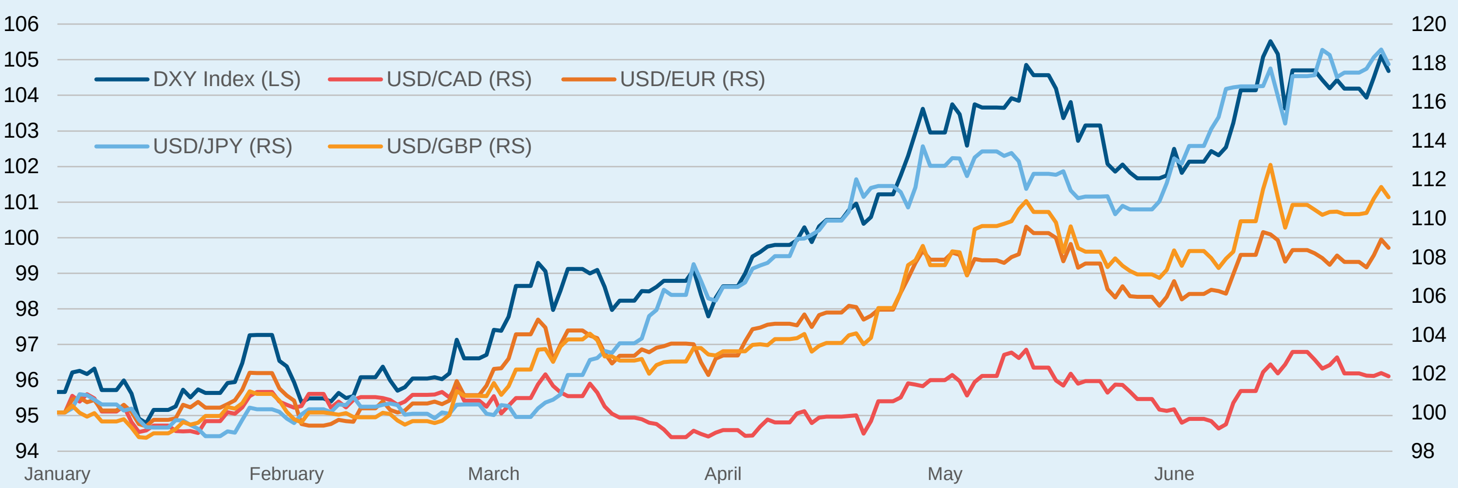
CAD performance vs. global currencies (indexed to 100)



Source: Bloomberg June 30, 2022

The US dollar jumped sharply in the first half of the year, with the DXY Index up 9.4%. The sudden hawkish shift from the US Federal Reserve (Fed) in reaction to the highest inflation in four decades has driven the move higher for the greenback. The Fed's most recent Summary of Economic Projections (dot plot) in June now estimates the Fed Funds Rate at 3.4% at the end of 2022, lightyears away from their 0.9% projection made at their December meeting.

CAD performance vs. global currencies (indexed 100)



Source: Bloomberg June 30, 2022

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