Monthly Market Insights

Data and opinions as of June 30, 2021

Tighter focus on job numbers amidst inflation watch

Markets continued their 2021 rally in June as vaccinations picked up speed globally and daily COVID-19 case counts stayed on a downward trend, particularly in Europe. Bonds and stocks benefitted as investors warmed to the idea that inflation may be transitory, despite high levels in the U.S. Employment data became the focus, with another disappointing release for May. Bond indices rose in response to falling longer-term interest rates. Growth stocks fared well as investor sentiment reflected expectations that economic growth may have peaked. Signs of higher inflation have caused concerns the U.S. Federal Reserve could raise rates at a faster pace. However, the Fed has a mandate of ensuring stable inflation and maximum sustainable employment, and employment is a long way off from full recovery.

The NEI perspective

Cyclical stocks drive TSX. Canadian equities had their best first half of a year in over a decade, as a strong global recovery and rising inflation expectations lifted cyclical sectors such as energy, materials, financials, and industrials.

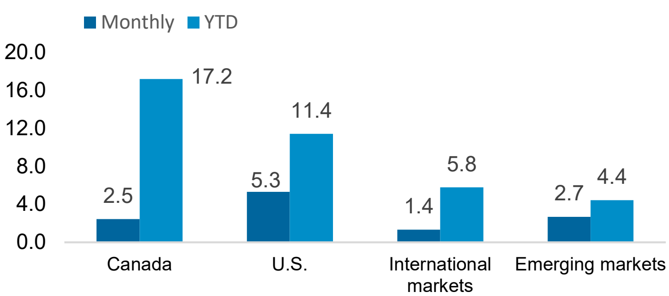
Fed rate expectations rise in 2023. The U.S. Federal Reserve acknowledged the rapidly recovering economy and rising inflation by accelerating the expected pace of interest rate hikes. The median forecast of the Federal Open Market Committee is now for two hikes in 2023.

Market cycle maturing. Rates of growth and inflation have likely peaked and are set to decelerate in coming quarters. This means markets may be entering a new phase of the cycle, with more muted returns driven by results and earnings.

From NEI's Monthly Market Monitor for July. Click here to get the full report.

Equity

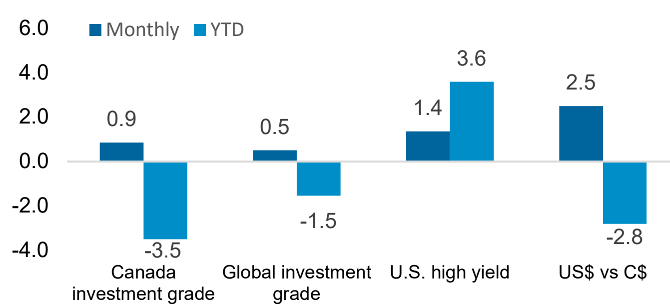
% return in C$



Canada: MSCI Canada; **U.S.:** MSCI USA; **International markets:** MSCI EAFE; **Emerging markets:** MSCI Emerging Markets. Source: Morningstar Direct.

Fixed income and currency

% return in C$



Canada investment grade: Bloomberg Barclays Canada Aggregate; **Global investment grade:** Bloomberg Barclays Global Aggregate; **U.S. high yield:** Bloomberg Barclays U.S. High Yield. Source: Morningstar Direct.

Balancing the Fed’s dual mandate

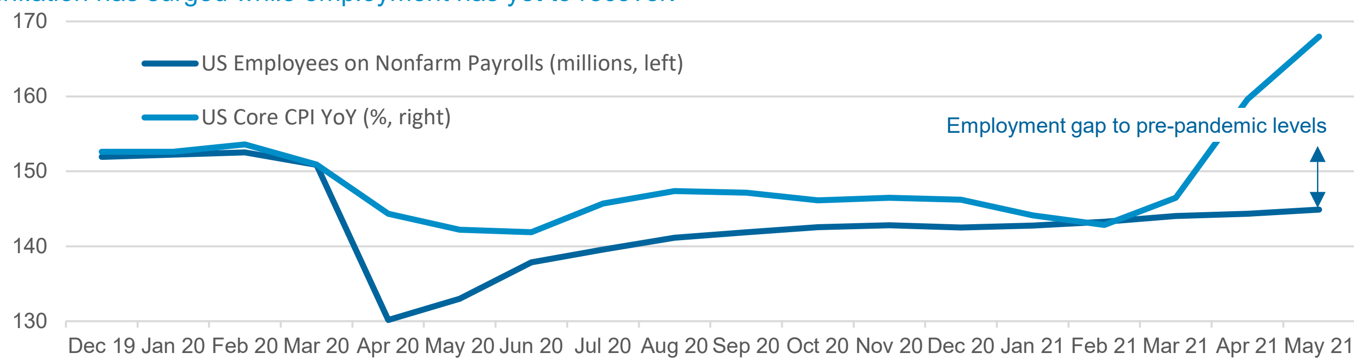
The Fed’s goals of price stability and maximum sustainable employment are collectively known as its “dual mandate.” These statutory mandates were adopted in the 1970s following an extended period of stagflation (high inflation and high unemployment). In the early years of this mandate, the Fed aggressively pursued policies to tame inflation, believing that stable prices would lead to stronger economic growth and increased employment. Eventually, these policies worked. By the mid-2000s core inflation stabilized at low levels, and unemployment rates were also low.

Then the 2007–2009 Global Financial Crisis hit. It was a severe recession that predictably led to a sharp increase in unemployment. Unlike the economy, jobless rates took nearly 10 years to return to pre-recession levels, thus earning the moniker of a “jobless recovery.” The 10-year recovery also led to a large increase in inequality, according to the Fed’s data on wealth distribution.

Fast forward to today, where the economy is recovering from a COVID-induced recession that was far more severe than the Global Financial Crisis. Strong demand, coupled with shortages in supplies, are causing inflation to spike at a time when millions of Americans remain unemployed more than a year after the onset of the crisis.

Employment and inflation

Inflation has surged while employment has yet to recover.



Source: Bloomberg, Statistics Canada. Data as of June 30, 2021.

The question remains as to how long the Fed can let inflation run higher to help increase employment, especially for population segments experiencing high unemployment (e.g., low-income workers and some racial minority groups). These labour market vulnerabilities, alongside rising food and resource prices, make the Fed’s dual mandate more challenging.