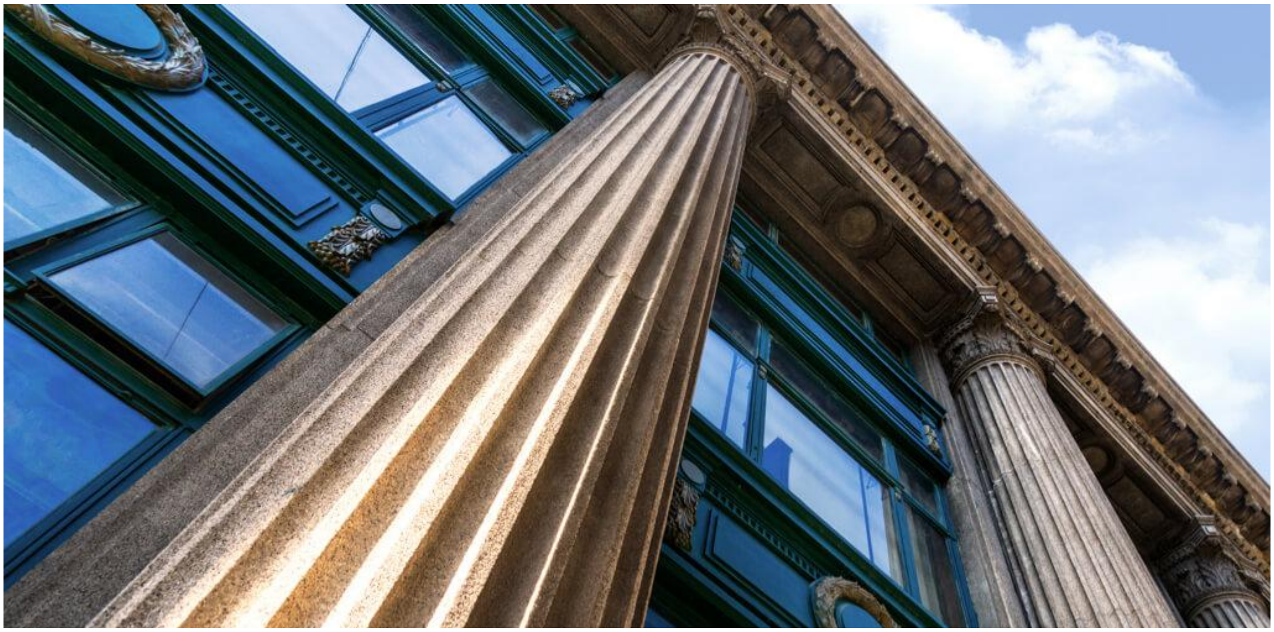
July 2022 market update

Will inflation peak soon, or could we be in for more?

August 9, 2022



Introduction

After falling significantly during the first half of the year, global equity markets started the second half by posting a positive return over the month of July. Despite ongoing aggressive monetary tightening, a slowdown in economic activity heightened expectations global central banks might need to ease their interest-rate increases. The U.S. Federal Reserve Board ("Fed") raised the target range of its federal funds rate by 75 basis points ("bps"), while the Bank of Canada ("BoC") lifted its key interest rate by 100 bps to 2.50%. In Europe, the European Central Bank ("ECB") announced its first interest rate increase since 2011, raising its main refinancing rate by 50 bps to 0.50%. Despite the BoC and Fed rate hikes, the yield on 10-year government bonds in Canada and the U.S. fell largely in response to recessionary concerns.

In Canada, the S&P/TSX Composite Index posted a positive return, led by the Industrials and Information Technology sectors. In the U.S., the S&P 500 Index also advanced, with gains in all 11 sectors. The tech-heavy NASDAQ Composite Index posted a monthly return of over 12%. Oil and gold prices declined over July.

The ECB joins in on the action

As stated at its previous meeting, the ECB began to raise its key interest rate at its July meeting. The central bank raised its main refinancing rate by 50 basis points ("bps") to 0.50%, from 0.00%, which was more than the 25-bps rate increase economists expected. It was the ECB's first rate increase since 2011. After concluding its asset purchase program, the ECB started lifting rates citing surging inflation, which reached a record 8.6% in June. The ECB joins other major central banks that have stepped up efforts to combat inflation by raising rates. In Canada, the BoC also surprised economists by lifting its benchmark overnight interest rate by 100 bps to 2.50%, the largest increase since 1998. In the U.S., the Fed also maintained an aggressive approach, raising the target range of its federal funds rate by 75 bps to 2.25% - 2.50%. Central banks are clearly committed to taming inflation and have noted they will continue to raise rates to bring inflation back to its targets.

Economic growth slips in Q2

Surging inflation, geopolitical uncertainty and monetary tightening have all raised concerns about a slowdown in global economic activity. Second quarter data from the world's two largest economies show signs of this slowdown. In China, the economy contracted by 2.6% over the second quarter of 2022. On a year-over-year basis, the economy expanded by 0.4%, a marked slowdown from the 4.8% year-over-year increase in the first quarter. Much of the blame for the weakness in China's economic growth over the quarter was placed on its ongoing lockdown restrictions, which weighed on domestic demand and its key manufacturing sector. In the U.S., an advanced estimate showed the economy shrinking by 0.9%, annualized, in the second quarter of 2022. This would put the U.S. economy into a technical recession after falling 1.6% in the first quarter. A drop in real estate investment, government spending and business investment, which offset gains in net trade, weighed on the U.S. economy. Consumer spending, a key component of U.S. GDP, advanced at a slower pace in the second quarter over the previous one. The slowdown in economic activity in these large economies likely suggests slowing activity around the world.

Has it peaked yet?

Many nations and regions across the globe continued to report either multi-decade or record-high levels of inflation in June, prompting investors to question whether inflation has finally peaked. There were some signs in July that it may indeed have peaked. In Canada, the annual inflation rate reached 8.1% in June, its highest level since 1983. Europe posted a record rate of inflation of 8.6%, while the U.K., China and Japan saw inflation rates of 9.4%, 2.5% and 2.4%, respectively. In the U.S., inflation hit its highest level since 1981 at 9.1%, but the core inflation rate, which excludes more volatile energy and food prices, slowed to 5.9% from 6.0%, its third consecutive monthly drop. While this suggests inflation is broad based, it also indicates that energy and food have been major contributors to price growth. In July, oil prices dropped over 10%, providing some relief for consumers at gas pumps. Some commodity prices fell during July, most notably wheat, which experienced a relatively sharp drop. While inflation may not have yet peaked, declining commodity prices and tightening monetary policy may be helping to slow consumer price growth.

Euro hits parity with dollar

In July, the euro fell and briefly reached parity with the U.S. dollar. The drop marked the first time the two currencies have been equal in 20 years. As economic uncertainty around the world mounts, investors have flocked to the U.S. dollar looking for a safe haven asset. While the euro has dropped relative to the U.S. dollar for several years, there was a marked decline over 2022 as the conflict in Ukraine, inflation and fears over a recession heightened among investors. While it lagged some of its global peers in tightening policy, ECB monetary action also weighed on the value of the euro. In July, the ECB raised its main refinancing rate for the first time since 2011, lifting it to 0.50%. This is significantly behind the Fed at 2.50%. According to a flash estimate, the European economy expanded by 0.7% in the second quarter of 2022. However, economic growth is expected to slow, particularly as major economies, including Germany, deal with the energy crisis. The weakening euro, which will raise import costs and add to inflationary pressures, may add further pressure to the European economy.

Market performance - as at July 31, 2022

Equity Markets	**Level**	**Month to date**	**Month to date (C$)**	**Year to date**	**Year to date (C$)**	**1 year**	**1 year (C$)**
S&P/TSX Composite Index C$	19,692.92	4.41%	**4.41%**	-7.21%	**-7.21%**	-3.05%	**-3.05%**
S&P 500 Index US$	4,130.29	9.11%	**8.60%**	-13.34%	**-12.22%**	-6.54%	**-3.77%**
Dow Jones Industrial Average US$	32,845.13	6.73%	**6.23%**	-9.61%	**-8.45%**	-6.38%	**-3.61%**
MSCI EAFE Index US$	1,937.26	4.93%	**4.44%**	-17.07%	**-16.00%**	-17.28%	**-14.83%**
MSCI Emerging Markets Index US$	993.78	-0.69%	**-1.15%**	-19.34%	**-18.30%**	-23.28%	**-21.02%**
MSCI Europe	1,705.59	4.87%	**4.38%**	-18.52%	**-17.47%**	-17.88%	**-15.46%**

Index US$							
MSCI AC Asia Pacific Index US$	160.34	1.47%	**1.00%**	-16.97%	**-15.90%**	-19.75%	**-17.37%**

Fixed Income Markets	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
FTSE Canada Universe Bond Index C$	1,085.42	3.90%	**3.90%**	-8.81%	**-8.81%**	-8.97%	**-8.97%**
FTSE World Investment Grade Bond Index US$	213.52	2.15%	**1.67%**	-12.50%	**-11.38%**	-15.36%	**-13.08%**

Currencies	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
CAD/USD	0.7815	0.52%	-	-1.33%	-	-2.81%	-

Commodities	Level	Month to date	Month to date (C$)	Year to date	Year to date (C$)	1 year	1 year (C$)
West Texas	98.62	-6.75%	-	31.13%	-	33.96%	-

Intermediate (US$/bbl)							
Gold (US$/oz)	1,765.94	-2.29%	-	-3.46%	-	-3.40%	-