CIBC Asset Management

MARKET SPOTLIGHT

February 2020

Global Markets

Celebrating the new year and a partial resolution of U.S.-China trade issues, investors moved in to buy equities in early January. However, the Coronavirus emerged later in the month, inviting comparisons to previous pandemics where economic growth was affected (2003 SARS is perhaps the best-known recent example). This threw a scare into investors as the month drew to a close and global equity markets fell -0.6% (USD) but gained 1.4% (CAD), as the Canadian dollar weakened.

U.S. broad equity markets were fractionally lower (-0.3%) with the Nasdaq 100 up 3%. U.S. manufacturing data improved in January—to the highest level since July—and consumer confidence also rose significantly. Quarterly earnings results, especially from technology companies, have been strong, beating expectations in many cases.

International developed equity markets lost 2.1% (USD), with Japanese equities lower by -1.4% (USD). The U.K. made its formal split from the European Union but trade negotiations will continue over the next 11 months. At its second meeting under Christine Lagarde, the ECB left interest rates unchanged, but announced a comprehensive review of monetary policy strategy.

Emerging markets lost 4.7% (USD), while China fell 4.8% (USD). As the Coronavirus has originated in China, its economy and those of surrounding countries are most likely to feel the biggest initial impact. To support continued growth, the Chinese central bank announced several monetary measures, including an injection of liquidity and a cut in short-term interest rates.

The view from our Chief Investment Strategist:

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Understanding where you're coming from helps you know where you're going

In 2020, we see three developments that could be critical for financial market returns: 1. the economic cycle has stabilized; 2. for the most part, markets have already priced in this nascent recovery; 3. secular headwinds will limit the potential strength of the recovery.

On the positive side, political uncertainty has recently abated. First, the U.K. came to an agreement (signed in January) with the European Union about their divorce. This followed general elections where Boris Johnson, the incumbent Prime Minister, won a significant majority. This should lead to a market-friendly outcome for the remaining negotiations. Second, the U.S. and China signed a phase-one trade deal. While there are outstanding issues still unresolved, both the U.S. and China have incentives to put their differences aside for the foreseeable future.

All else being equal, a stabilization of the economic cycle should be positive for the equity market, although it seems some of this cycle has already been priced in. With increases in the P/E ratio driving most of 2019's strong returns, our analysis shows there may not be much upside left to the equity market. However, while the main equity indices performed well, other segments of the market did not fare as well. Technology, consumer and rate-sensitive equities were very strong but small caps and highly cyclical sectors lagged and could still benefit if the cycle further improves. We can also point to commodity prices and cyclical currencies as examples of markets that have not moved up decisively.

Fixed Income

Yields moved sharply lower as news emerged that a new Coronavirus was spreading in China. The reaction in financial markets was mixed. Bond yields plunged due to concerns that global growth would slow materially enough to raise the odds for rate cuts from the Bank of Canada and Federal Reserve later this year. Equity markets saw a lesser impact, however, as the potential drag on stock prices was countered by higher odds that central banks could ride to the rescue yet again.

Canadian Equity

Canadian equities gained 1.7% in January, moving against the general trend in global markets. The Bank of Canada (BoC) met in late January and kept interest rates on hold, but conceded that there's a risk of economic sluggishness ahead. This could indicate they are open to cutting rates this spring, an event that would keep the Canadian dollar under pressure and potentially benefit Canadian exporters. Any economic fallout from the Coronavirus could also tip the balance in favour of a cut at the BoC March or April meeting.

Sound Bites

Dan Greenspan
Senior Equity Analyst–Mining & Materials

Gold is often strong in times of increased fear, reflecting a flight to safety.

Gold has been on a hot streak lately, appreciating by around 25% over the past eight months. The move was driven by falling interest rates and increased fears around trade wars between the U.S. and China. Middle East tensions between the U.S. and Iran and, recently, the Coronavirus outbreak in China also contributed.

Gold tends to do well in times of uncertainty. Going back to 2008, gold started the year around $800[1] an ounce and moved to $1,100 an ounce by the end of 2009, a move driven by the onset and follow-through of the global financial crisis. Gold hit an all-time high, almost $1,900 an ounce, in late 2011 when interest rates bottomed, quantitative easing expanded, and the U.S. dollar weakened.

Last year and now in 2020, equity market volatility has increased, lower interest rates have returned and gold has found its footing again. The price took off in the second half of 2019 and further strengthened into January. In addition, December and January are usually quite good months for gold, and that's continued into this year.

We believe there's a compelling case to be made to stay long gold in the medium term. We think increased uncertainty over the global economic outlook remains high. We see a higher risk of further interest rate cuts to help support global growth, and we're seeing negative real interest rates around the world. All these factors are supportive for gold in the coming quarters.

In the very near term, there is potential for some downside risk to the commodity price if fears around the Coronavirus subside. We think there's a premium baked into the gold price right now as a result of virus fears that is not fundamentally justified by the market. If we do see a calmer market, we could see a bit of a retreat in the gold price in the very near term. That said, we think that with real interest rates where they are, the gold price is fundamentally supported this year. With that in mind, we're comfortable staying overweight gold in a number of our funds. We generally view exposure to gold as a good hedge against global macro risks and a good diversifier. We think that gold tends to react counter-cyclically, and therefore it has a good place in our portfolios.

[1] All gold prices in USD

568