WHAT'S MOVING MARKETS?

May 19, 2022

Equities

Equity markets are starting to see the impacts of the U.S. Federal Reserve Board (Fed) increasing interest rates to fight inflation and slow the economy. This has added to volatility in equity prices. Current market volatility is in contrast to strong corporate results and a strong consumer. Employment levels are still very strong and consumers still flush with cash, ready to spend and drive the economy forward. Corporate results have been relatively solid overall in recent weeks, even though companies have said they're concerned by rising labor costs and lingering supply chain problems, which appear to be taking longer to resolve than markets expected.

Consumer companies reporting

Several large consumer companies released earnings results on Wednesday. The Canadian divisions of Walmart and Home Depot outperformed their U.S. divisions. Home Depot Canada's same-store sales were above the company's average, and management said: "our Canadian business is in terrific shape." Walmart's international division was led by Mexico and Canada, with Canadian same-store sales growing 7.7%. These corporate results support our belief that consumer spending in Canada has remained strong.

China and the war in Ukraine

China appears to be moving closer to a re-opening, which could alleviate global supply chain woes and help to dissipate inflation. China's recent Covid lockdowns have intensified lingering supply chain issues. The war in Ukraine is, we believe, going to impact global food supplies. Ukraine and Russia produce a third of the world's grain, and some countries, such as Egypt, rely completely on that grain supply. A prolonged conflict could therefore be problematic.

Canadian stocks

The current environment supports commodities and oil prices, which is positive for Canadian stocks. In recent quarters, many Canadian companies have been reducing debt, buying back shares and increasing dividends (all shareholder return of capital, as opposed to growth). Canadian railway companies provided a bullish outlook in the presentations they gave to investors on Wednesday. Canadian banks, which all report next week, are expected to show good results in their Canadian businesses, although there could be volatility in their capital markets components.

Fixed Income

Volatility in equity markets spilled over into credit markets on Wednesday. Investment-grade credit spreads widened in Canada, while government bonds rallied.

This flight to safety trade, in which risk assets are selling off as government bonds rally is a relationship one typically associates with these two asset classes. However, this dynamic has broken down the past few months as expectations of rising rates to fight inflation have caused bonds to selloff, while concerns of economic slowdown has caused equity markets to stumble alongside them. Wednesday was a good reminder for investors of why fixed income still has an important diversifying role to play in a well-balanced portfolio.

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