Views from the Desk

Updates in the Equity and Fixed Income Market

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Market Valuations & Earnings

We expect a strong earnings season overall in the U.S: there are high expectations for earnings and there is a possibility these earnings will grow going forward. The U.S. banks have reported earnings already, the numbers were strong but were in line with expectations. Relative to 2009, we are in a different backdrop. The largest difference between 2009 and 2021 is that the consumer is in a very different position. In 2009 we saw a credit crisis, heavy de-leveraging and tightening on lending. In 2021, the consumer demand is there but there are restrictions on what consumers can spend on. This has created a lot of pent up consumer demand. As the economy reopens, money will flow to goods and services. Therefore, we remain cautiously optimistic on equities. Pull backs this year could be buying opportunities as long-term expectations are that earnings will continue to grow supported by continued economic growth.

Yield Curve Steepening & Pref Shares

When we look at the Bank of Canada (BoC) and its treatment of asset purchase programs, they have been more conservative than the Fed and the ECB. The BoC announced they will discontinue these programs as scheduled. We also might see CPI numbers coming in higher in Canada. The U.S. reported yesterday 2.7% CPI. As the economy reopens and CPI numbers go up these puts upward pressure on interest rates and we have seen this already, especially in the middle of the curve. In the preferred share space, tail winds are rising rates but this is only half the story. The supply and demand imbalance which was created by the introduction of LRCN bonds, has created increased demand and stability in the asset class. People are hungry for yield in this low rate environment and preferred shares offer tax efficient yield that is investment grade.

Emerging Markets

To start the year emerging market (EM) equities were posting strong returns. This has pulled back in the last two months, much in part because China has been facing some headwinds. China makes up one-third of the overall EM Index. Some Chinese tech and internet companies were part of the Archegus hedge fund blow up, and these stocks were sold down significantly in the aftermath. The second headwind China is facing right now is increased regulatory scrutiny from both the U.S. and China as well. The U.S. is looking at foreign listed companies and increasing regulations on these companies. There is some concern around what this might mean for U.S. listed Chinese stocks. Chinese regulators are looking at Ant financial in particular to be a bit more regulated as a financial entity. Going forward this could be a decent entry point to get in on the long term EM growth story. Today valuations look more reasonable and the long term drivers are still there.

Credit Spreads

Credit spreads have gone back to pre-covid levels. They were 44bps in February 2020 (all time tight) and are back to 50 bps today. So, there is not a lot of spread compression opportunity in investment grade credit right now. However, there is opportunity in the BBB space in Canada. Spreads are160bps above federal bonds right now, vs pre-covid levels of about 130bps. Oil prices are rising and still have a way to go to be at pre-covid prices. This will be good for the Canadian economy and Canadian credit spreads especially in the BBB space. **The BMO BBB Corporate Bond Index ETF (ZBBB)** is 32% energy so higher oil prices will be good for this ETF. ZBBB also has 19% in financials which is an indirect exposure to oil.

Source: Bloomberg, All returns and data points April, 2021.
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