MONTHLY REPORT

September 2021 Edition

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RCTG MARKET RESEARCH

GLOBAL MARKETS INSIGHTS

ALL DATA WITHIN THIS REPORT IS MEANT FOR EDUCATIONAL PURPOSES AND IS SUBJECT TO CHANGE

IN THIS ISSUE

- **Fixed Income Markets –** While a rise in 10-year treasury yields was charismatic for those impatiently waiting for economic recovery, Chairman Powell emphasized the risks associated with long-term effects of the high inflation at hand. Supply chain bottlenecks along with other factors have put upward pressures on prices, however, this is met with a strengthening policy regime with expectations of asset purchase reductions in the next year. Credit markets are racing to recovery, with government bonds outcompeting investment grade and high-yield credit, which previously set records over the past quarter.

- **Commodity Markets –** Energy fundamentals point towards higher prices in the coming months due to colder weather, supply constraints, robust Chinese demand, and Europe's energy crunch.

- **Equity Markets –** Over the course of September, equity markets fell in response to the Evergrande incident and US Federal Reserve's comments on regulatory controls - specifically, the announcement of a tapering agenda to the monetary stimulus over the coming period.

FIXED INCOME MARKETS

Month in Review

Limited change in monetary policy has proven to not aid in the lack of excitement this past month! To some, Chairman Powell may be portrayed as a “dangerous man,” and for those afraid of inflation he may be what they are dressing up as for Halloween this October, but he did highlight the accelerating economic development over the third quarter. Larger than typical moves to the bond market and rate hike expectations in 2022 are making markets giddy, but not without the fear of the Delta variant and rising energy prices.

Rates

The Bank of Canada continues to hold interest rates at the effective lower bound while also maintaining their quantitative easing program in September. Despite the concerns surrounding the delta variant and slow-moving recovery in Q2 of 2021, future expectations in the fourth quarter are in line to stay on track. Keeping an eye out for changes in the employment and inflation rates as we approach the holidays is important in monitoring the highly anticipated reduction in longstanding policy. Across the border, the FOMC unanimously maintains their rate at the zero lower-bound while increasing Mortgage-Backed Securities (MBS) purchases effective September 23rd.

Municipals

With a proposed 3% income tax surcharge to the Modified Adjusted Gross Income (MAGI) above $5 million a year, many high earners are beginning to give special attention to the tax-exempt municipal bonds. With a continued large inflow of funds, municipal bond yields have stayed relatively low. The S&P Municipal Bond index closed at a Yield-to-Maturity (YTM) of 2.29% as of 1st October, barely above its 52-week YTM low of 2.14%.

Credit

After a decline in yields over the past few months, 10-year bonds promptly rose to their highest yields since June. Rising over 6bps in a single day, central bankers discuss the sensitivity of bond pricing related to short-term COVID-related developments. This move is proving itself to be an inflection point, as investors are rapidly pulling out of equities markets to hop on board. This improvement of treasury performance contrasts with the prior high-yield positivity over the past few months. Nonetheless, Emerging markets led the performance of credit thanks to weaker US dollar and better-than-expected earnings.

Sources: Bloomberg News, RBC Capital Markets

COMMODITY MARKET

Agriculture Market

The USDA September's Quarterly Stock report announced depleted levels of soybean, corn, and wheat, which dropped 51%, 36%, 18% respectively, from last year's stock. Both the soybean and corn harvests, while lower than the previous year, were significantly higher than analysts had predicted, leading to a sharp drop in their prices. The volatility came from the unpredictability of the hurricanes that took place in the prior months, which were expected to diminish harvests. While the harvests were significantly lower than the past year's, the surprise increase in harvests on the supply-end led to the uptick in prices.

Palm oil futures have been of recent concern given a potentially large harvest in Malaysia, leading to a stockpile of supply. However, prices have stabilized recently due to labour shortages in Malaysia, leading to diminished yields, in addition to a rally in the price of soybean oil, which is a close substitute. Prices are expected to drop throughout the year due to expectations of favourable weather throughout the following months. These favourable conditions are expected to lead to supply spikes in Malaysia and Indonesia, among other producers.

The aggregate vegetable oil market is expected to experience a growth of 5 million tons this year, compared to a growth of 2.5 million tons last year. This coincides with a growth in demand of 4 million tons, which matches last year's growth.

Precious Metals

At the beginning of the month, a weaker dollar supported gains in gold, as underwhelming US job data releases loomed, and discouraged the Fed from cutting back stimulus measures. This made the bullion more appealing as a hedge against inflation. However, as more US economic reports were released, especially regarding the slight 0.1% uptick in CPI, gold prices tightened around $1800, and the 10-year US bond yield dipped to its lowest levels since late August. This reduced the opportunity cost of holding gold. Towards the end of the month, gold prices settled around $1750 as expectations of stimulus tapering and rising yields in the near future could result in larger losses for the yellow metal.

China released more aluminum from its strategic reserve to try to keep price increases down and prevent commodities inflation stunting growth. Unfortunately, in the Western markets, aluminum prices soared to 10-year highs as fears of limited supply resulted in a jump in demand. These decisions stem from their attempts to limit the carbon output and maintain their energy consumption levels at a minimum, with cuts exceeding 1M T/year. Concerns for the availability of aluminum in industries such as construction, renewable energy (namely solar panels), and transportation, spurred prices to surpass $2870 USD/T.

Energy

Multiple factors over the month of September have pushed natural gas and crude oil-price forecasts, with Brent crude trading near a three-year high at $78.72 per barrel and the Western Texas Intermediate (WTI) trading at $73.95 per barrel. U.S. crude oil inventories are about 7% below the five-year average for this time of year, at 418.5 million. Throughout the month of September, natural gas prices have surged more than 35%, trading at $6 per million British thermal units due to the energy crunch in Europe. Price surges can be attributed to significant shortages in global energy supply, with issues at LNG export plans and lower European gas production. Natural gas prices have since seen significant volatile-year with futures dipping 8% at the end of September, however; energy fundamentals point to higher prices, with the amount of gas in storage 7.6% below the five-year average, robust Chinese demand, Europe's energy crunch, and the weather cooling off for winter. With the natural gas shortage, focus shifts towards oil-fired power generation, thereby increasing crude oil prices in addition to natural gas prices.

EQUITY MARKETS

Month in Review

In the wake of a global debt crisis spurred by the Evergrande fiasco, the name of the game was de-risking. This being the case, equity prices across the board fell in response to uncertainty and fears. The S&P 500 lost about 5% over the course of September with the Dow closely in tow alongside eurozone equities, as measured and marked by the Euro Stoxx 50 index.

While the Evergrande event was pacified by the end of the month, equities remained lower with poor sentiment in favour of a rally as indicated by futures activity. However, price fluctuations reflected a positive sentiment given the high premiums paid on earnings dollars at these levels; with a market that has already returned 18% since January, suspending any drastic advances will allow underlying fundamentals a chance to catch up. To that end, the broader S&P's P/E multiple regressed 2% MoM.

All things considered, markets fared well, given the macroeconomic environment presented. However, as a result of the Fed's decision not to raise rates and their warning of tapering to come, the de-risking effects of smart money and large asset owners could have taken the form of a far more discounted market rather than one where the vix hit a high of just under 26. It is also important to remember that markets are cyclical and that pullbacks are healthy - when they happen, individuals should really be buying the dip rather than succumbing to the irrational finance schools of thought as they have been; while this phenomenon can keep markets expensive by propping them up on stilts for prolonged periods, they can also cause them to fall greatly once the dominos of buyers exit the market one by one.

Final note - Investors must keep on an eye on fundamentals as this "return to normal" really happens and hope the market is able to recouple some sense of value in the face of a tapering Federal Reserve agenda

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