MARKET RECAP

February 2023

Rotman Commerce
Trading Group

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- Commodity Markets – Gold prices weakened from a strengthening US dollar, while copper and iron-ore futures climbed 11% driven by clean-energy transition.

- Equity Markets – Major US Equity Indices declined from ongoing Fed rate hikes resulting in higher cost of borrowing, offset by strong performance in Asia markets from solid company earnings, accommodative monetary policies, and a weaker yen.

- Industry Overview – The S&P 500 Consumer Staples index declined -3.63% YOY basis, as the war in Ukraine and ongoing inflation add pressure to packaging, oil, labour, and transportation costs. With higher mortgage rates, new home sales declined resulting in lower real consumption of home products. Consumer goods giant anticipates further price increases throughout the year, which is a rising concern for consumers whose purchasing power will be impacted.

FIXED INCOME

Rates

During the last week of January, Bank of Canada Governor Tiff Macklem stated that rate hikes were on “conditional pause”, and this was consistent for February with rates hovering at 4.50%. On the Fed Reserve side, the overnight rate rose by 25 bps, reaching their target 4.50 - 4.75% for the month, slowly bringing about a closing to over 7 months of consistent anti-recessionary increases.

Treasury Yields

All yields increased throughout the month with single month yields increasing the least, and single year yields increasing the most. The 1 month treasury yield maturity fluctuated, with a net increase throughout the month of 2 bps to 4.4%. The 3 month yield steadily increased, ending at 4.56% during the last week of the month. The 6 month increased 9 bps in the first week and ended the month with a net increase of 16 bps to 4.67%. The 1 year yield was on the rise during the first two weeks of February and rounded off the month at 4.76% - a net increase of 28 bps.

Bond Yields

February saw yields continue on the record breaking course set in January. Further interest rate hikes in combination with market uncertainty resulted in both yields and spreads hitting decade highs, with corporate investment-grade bonds yielding 5.53% up a total of 70 bps over the shortest month of the year. As the Government of Canada’s marketable bonds started off at 2.94%, they broke the threshold of 3% by shooting up to 3.09 in the first week , followed by another 20 bps increase just a week later. The real return bond started off at 1.06% and rose to 1.3 % by month-end, with US treasury bonds returning a modest 1.5%.

Issuance

Bond issuance varied heavily by sector throughout February. Rising yields & interest rates led to a mass & unexpected issuance of corporate bonds totaling over $144 billion. Municipal bond issuance dropped 42% year-over-year to $18 billion in 391 issues, fueled by ongoing uncertainty as municipal governments wait for a drop in inflation. On the federal side, the reserve showed no signs of slowing down - issuing over $1.5 trillion throughout February in line with previous months.

COMMODITIES

Metals

Metals markets declined in February, with a 5.97% downtrend on the S&P Metals and Mining Index over the past month. In the beginning of the month, gold prices dropped to a three-week low, with spot gold down by 2.5% to $1,864.79 per ounce and U.S. gold futures falling 2.7%. The dollar rose by 0.9% due to expectation of interest rate hikes, making gold more expensive for foreign buyers and ultimately leading to a reduction in gold demand and prices.

Silver reported negative returns of 8.7% YOY, however, prices are expected to rise due to its high demand in industrial goods. The demand is predicted to surge with the recovering economy, especially with the reopening of China – the world's biggest consumer of metals – following COVID-19. Moreover, silver is also benefiting from the transition toward clean-energy production, with industrial needs in construction and technology. Many other industrial metals have also gained, with copper and iron-ore futures climbing by 11%. Although many opportunities await as the conflict between Russia and Ukraine begins to ease, the tightening relationship between Russia and China is a rising concern for metals markets.

Energy

During most of February, oil prices trended downwards – the fall in prices linked to warmer weather patterns in the US and Europe, a strengthening US dollar, mixed market commentary regarding a possible recession, and Central Banks' continued rate hikes to combat inflation.

Going forward, uncertainty looms over market predictions for oil and gas as some analysts believe that prices could increase driven by China's reopening. Additionally, price increases resulting from further sanctions placed on Russia have led to cuts in production and exports. Continued tensions in Ukraine and rising tensions in Israel, Iran and China could contribute to rising prices as well.
prices.

The month also endured rising natural gas prices partly attributable to the reopening of China after the pandemic, which resulted in higher consumption and prices. The geopolitical environment, coupled with the energy transition occurring in Europe and some Asian countries, has increased reliance on gas and placed upward pressure on prices.

Agriculture

The end of February saw wheat futures fall to less than $7.2 per bushel – their lowest level in 17 months. This is due to an anticipated increase in the supplies from the primary exporters of the commodity in the near future. Namely, India has stated they will release 5 million tonnes of the commodity, Ukraine made a deal to ship wheat out of Black Sea ports, and Russia reached a record high harvest of 143.8 million tonnes in 2022.

EQUITIES

US & Canada

Unlike the optimism and rally seen in January, February was a shaky month for the US equity market as major indices reported declines. The beginning of February marked the Fed's decision to raise its benchmark interest rate by a quarter percentage point. Although inflation slowed, the market remained wary of inflation stickiness as well as the gap between the inflation rate and the Fed's target rate. Investors believed interest rates would remain high for longer than expected, with worries of another potential 0.5% increase. The S&P 500 was up 2.53% at the start of the February, however, saw a total decline of 2.6% by month-end. The Nasdaq Composite ended the month with a 1.1% decline, and US equities experienced their biggest weekly fall in two months nearing the end of February.

Europe

European share prices declined near month-end after data released from France and Spain indicated long-lasting inflation. The STOXX 600 went down by 0.3% on the last business day, marking its worst weekly decine this year. However, the index still managed to end the month higher by 1.7%. Throughout the continent, major economies including Spain, France, and Germany all reported higher than expected inflation. Many investors anticiapte a 0.5% interest rate hike by the European Central Bank in the upcoming March meeting. Since banks tend to profit from a high interest rate due to higher net interest income, the STXE 600 Banks Index (SX7P) went up 1.4%, reaching its highest level since 2018. With a reduction in earnings and earnings outlook, share prices fell, with the healthcare index (SXDP) closing 1.5% lower at the end of the month.

Asia Pacific

Asia's equity markets had a mixed performance in February 2023, with some markets reporting gains while others experienced losses. Altogether, the MSCI Asia Pacific Index increased by 1.2% during the month.

Japan's NIKKEI 225 index rose by 2.5% in February, reaching a new all-time high. The index was supported by strong earnings from Japanese companies, particularly in the tech and consumer sectors, and a weaker yen. The Bank of Japan's decision to maintain its accommodative monetary policy also boosted investor sentiment.

Hong Kong’s Hang Seng Index increased by 1.6% in February, supported by gains in the technology and consumer goods sectors. However, ongoing protests in Hong Kong and concerns over the Chinese government's regulation of technology companies weighed on investor sentiment.

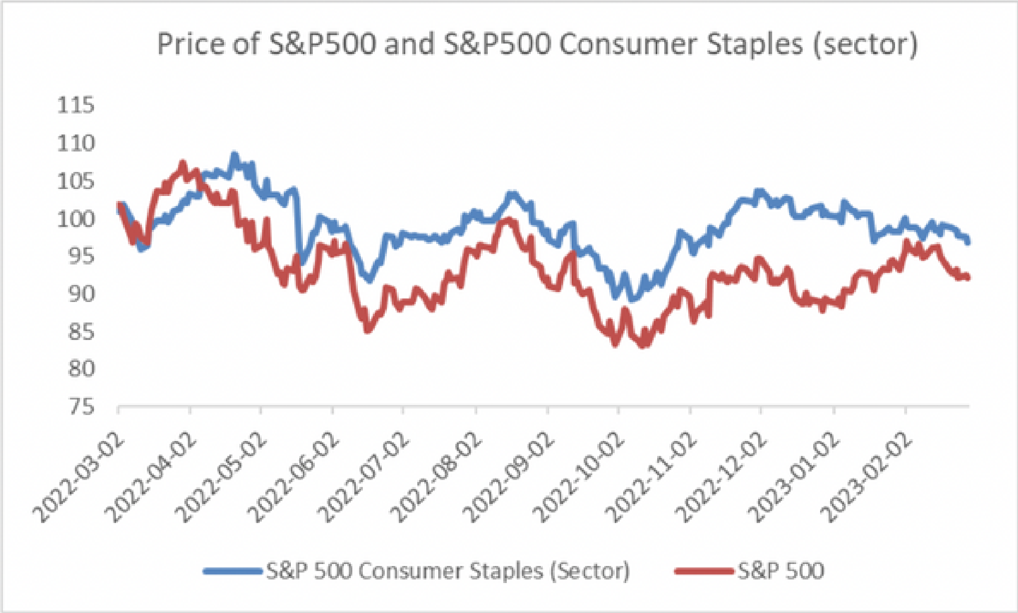
Singapore’s FTSE Straits Times Index rose by 1.1% in February, led by gains in the financial, healthcare, and real estate sectors. Despite this, concerns over the impact of the coronavirus outbreak on the Singaporean economy continued to weigh on investor sentiment.

Australia’s S&P/ASX 100 index rose by 2.1% in February, supported by gains in the mining, healthcare, and financial sectors. The Australian economy’s continued signs of recovery since the pandemic, and the Reserve Bank of Australia's decision to maintain its low-interest-rate policy also boosted investor sentiment.

Overall, Asian equity markets performed well in February, aided by solid earnings from companies across various sectors, accommodative monetary policies, and a weaker yen. However, ongoing geopolitical concerns and the impact of the coronavirus outbreak on the global economy remain potential risks for investors.

INDUSTRY OVERVIEW

CONSUMER STAPLES



INDEX NAME	1 YR RETURN
S&P 500	-9.24%
S&P 500 Consumer Staples (Sector)	-3.63%

Industry Trends and Performance

The S&P 500 Consumer staples reported a negative -3.63% one year return, higher than S&P500 index. It is known as a defensive sector that holds up better than others even during economic downturn as consumers continue to purchase essential goods like food, drinks, and household products. However, it is not immune to challenges of current high inflationary environment as consumers are adjusting their shopping habits and adopting cost-saving behaviours. 96% of survey respondents (PWC's 2023 Global Consumer Insights Pulse Survey) intend to adopt cost-cutting behaviour over the next six months. With the Fed Reserve easing inflationary pressure by increasing the federal funds rate and mortgage rates, the real consumption of home products fell as new home sales continued to decline.

Packaging, labour, oil, and transportation have risen where over 80% of Consumer staples executives believe growing profit margins will remain challenging. Oil is an essential input to various household products and packaging types, where prices are pressured by the Ukraine war. There are trends where consumer staples companies will make significant digital investments, increase product innovation capabilities to better meet changing consumer demands, expand through acquisition, and improve supply chain management through data analytics. The companies that will shine are those that can increase prices without drastically impacting sales volume and exposure to emerging markets. Emerging markets are expected to perform well due to the countries having a fast-growing middle class (higher per-capita growth than developed markets) and consumers that are already used to rising prices to likely not change purchasing habits.

Industry Spotlights

Loblaws Defends Against Price Hike Backlash

The end of February marked the culmination of an 11-week price freeze on the No Name product line meant to assuage inflation-weary consumers of the Canadian retailer, Loblaw.

The rising cost of fuel and wages, combined with the pressures of geopolitical tensions have kept prices outpacing general inflation in the Canadian grocery sector for months. In this inflationary environment, Loblaw attributes their rising profit margins to an increase in customers buying high-margin products such as those found in its Shoppers Drug Mart stores. While company spokespeople maintain Loblaw is not profiting from inflation, a lack of transparency in their financial reports, which fail to separate the profits of grocery stores from pharmacies, casts doubt on these claims.

Nestle Prepares for Markups After Missed Targets

Multinational food and beverage conglomerate Nestle is ready to hike prices once more this year after missing key target profit forecasts in 2022. With net profit totalling 9.3 billion Swiss Francs, Nestle fell short of expected profits by nearly 2.3 billion Francs – a rare occurrence for the world's largest food and drink company. Even after raising prices by 8.2% in 2022, the consumer goods giant anticipates further increases will be needed to offset the surging cost of commodities fueled by the war in Ukraine. This news comes at a bad time for consumers, who struggle to afford basic necessities as they experience further hits to their purchasing power.

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