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Asset Management

Looking Back

A Quarter of Rebounds

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Following the steepest drop in years, global equity markets rallied sharply during the second quarter on the back of an unprecedented combination of interest rate cuts, quantitative easing, and massive fiscal spending.

Global markets bottomed-out on March 23rd, 2020 but had already begun rallying by the last week of March. The following three months saw markets continue to rally and regain much of what had been lost during the initial selloff. From the low point in March, the S&P 500 and the TSX both rallied over 39%, the MSCI AC World Index rallied 37.5% and the MSCI Emerging Market Index rallied 32.3%. During Q2 specifically, the S&P 500 was up 20.4%, the TSX was up 17.0%, MSCI AC World rebounded 19.2% and MSCI Emerging Market Index followed suit at 18.1%. While markets are currently still in negative territory for 2020 as a whole, the losses are now only in the single digits. For the first half of 2020, the S&P 500 is the best performer at -3.4%, MSCI AC World second at -6.3%, TSX at -7.5% and MSCI Emerging Markets lagging at -9.8%.

From an equity style perspective, the outperformance of growth stocks as compared to value stocks continued in the second quarter - the MSCI World Value Index was up 12.6% but lagged the MSCI World Growth Index which was up 25.5%. Year-to-date, the Value Index is now -17.8% while the Growth Index is +6.5%. This underperformance and undervaluation of value stocks relative to growth stocks is now comparable to that which was seen during the tech bubble of the late 1990s.

Following the massive decrease in the first quarter, interest rates were fairly stable over the second quarter as markets have priced in continued accommodation and no chance of hikes in the foreseeable future. In the U.S., the 10-year Government bond yield ended the quarter at 0.66%, close to the 0.67% from the end of March. In Canada, rates fell more with the 10-year Government bond yield ending the quarter at 0.53%, down from 0.70% at the end of March. Investment grade bonds performed strongly in the quarter with the returns coming not from interest rate declines, but rather from a rally in credit spreads which had widened massively during the equity selloff in Q1. For the second quarter, the FTSE Canada Universe Bond Index was up 5.9%, bringing year-to-date returns to 7.5%. In the U.S., the Barclays Aggregate Index was up 2.9% for the quarter and up 6.1% year-to-date.

In lower quality credit we saw a rebound as well, as both high-yield bonds and levered loans gained back a portion of their first quarter losses. High-yield bonds were up 7.7% in the second quarter and have year-to-date returns of -5.2%, and similarly, levered loans were up 9.7% in the second quarter, bringing year-to-date returns to -4.6%.

When looking at commodities, investors saw some shocking moves in oil prices early in the quarter. Crude oil futures, which had been trending down to the USD $20 level as the massive scope of the pandemic and global lockdown became clear, traded briefly and dramatically into negative territory (USD -$37 at worst). As the quarter progressed and markets began discounting a future recovery with economies reemerging from lockdown, oil gradually traded up through the quarter, ending the quarter around USD $39.

From a currency perspective, there was a reversal of the flight to safety that happened in Q1 when the U.S. dollar rallied against most other currencies. After a significant weakening in the first quarter, the Canadian dollar rallied from 1.41 at the end of March to 1.36 at the end of June.

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The magnitude of the rebound in global markets seems to have caught many participants by surprise. The mismatch in the economic fundamentals, while much of the world remains under some degree of lockdown which has restricted travel and resulted in poor consumer and business sentiment, seems to be at odds with the persistent uptrend in markets during the past few months. Markets are, however, forward looking and the expectation is that, although the economic effects of the global lockdown have been massively negative, they will be temporary in nature and things will gradually get back to a somewhat normal state - which is what markets are pricing in at this point. Having said that, there are risks which do need to be acknowledged. In particular, there is a risk of a second wave of the pandemic which is clearly not being priced in to any degree at this point. Also, the U.S. election is only a few months away and has proven market-moving ability. Currently, the measures that governments and central banks have put in place in the midst of the pandemic have provided the key support for risk appetite that is seemingly outweighing everything else.

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