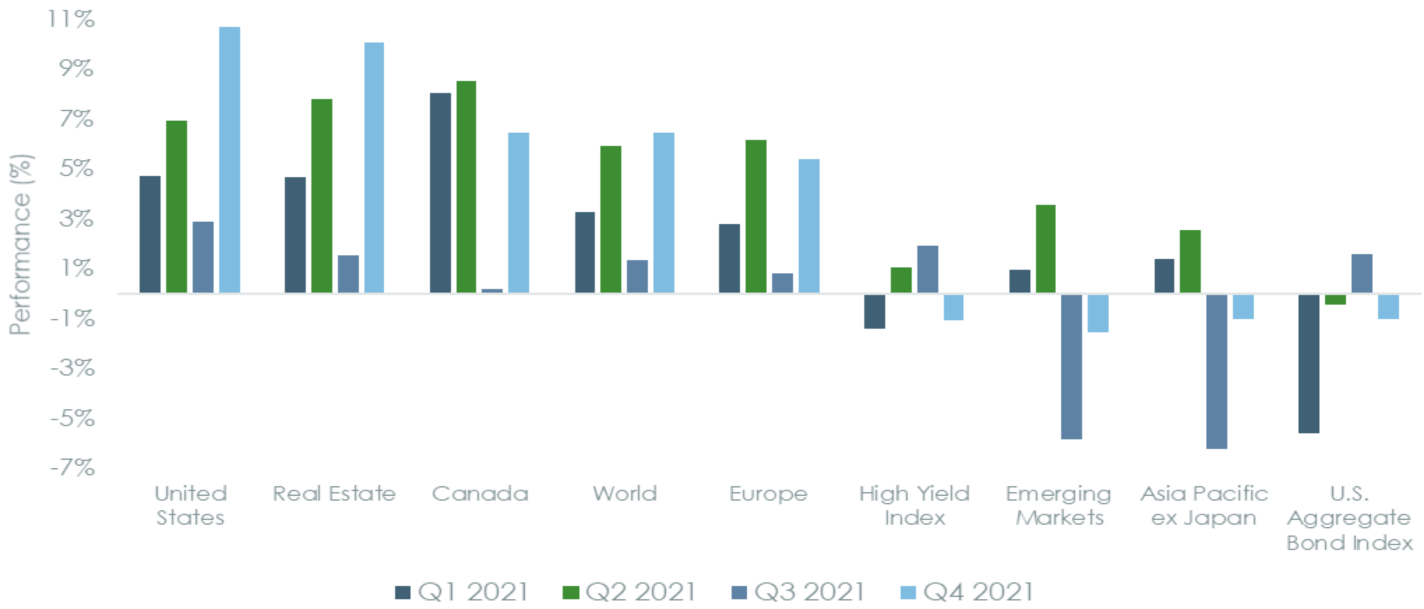
YEAR IN REVIEW

2021

In focus

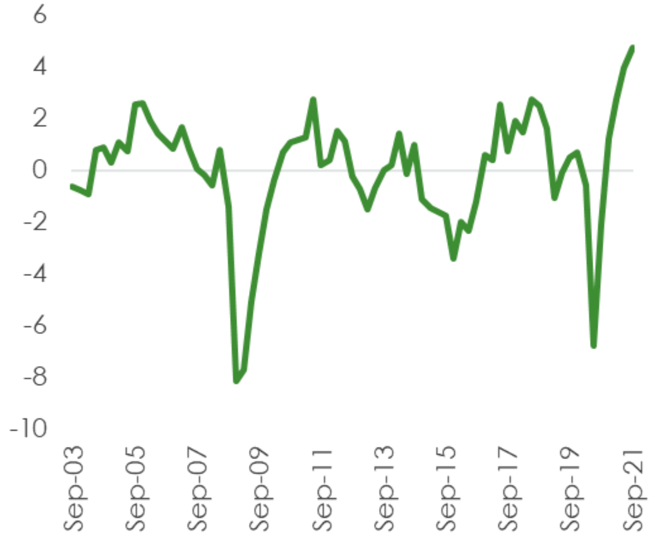
- New variants of COVID-19, delta in the beginning of the second quarter and omicron in the final quarter, overshadowed a largely positive year for global equity markets. The emergence of inflation as being less transitory than initially expected dampened sentiment, leading to some losses in the third quarter, but markets recovered on global economic optimism, ending the year on a strong note.
- Corporate earnings in developed markets consistently beat expectations until the third quarter of 2021, giving valuable insights into the strength of the broader economy. While rising input costs led to some concerns about margin pressure, companies were able to pass on a significant part of the cost pressure, thanks to strong consumer demand.
- From a regional perspective, the U.S., Europe and Canada fared better than Asia, where risks stemming from regulatory interventions in China dampened investor sentiment. Emerging markets as a group were subdued for most of the second half of the year as they battled rising inflation, slowing growth in China and political turbulence in Latin America, where Brazil and Mexico reported negative growth.
- On the policy front, the strong economic recovery so far prompted the U.S. Federal Reserve to potentially consider a faster tapering in the coming months. In the U.K., the Bank of England raised its benchmark rate of interest, while in Canada, the Bank of Canada announced the end of its quantitative easing program. Notwithstanding the omicron impact, macro data continue to point to an above-trend recovery across both the manufacturing and service sectors.
- As a result, global investment-grade and sovereign debt came under pressure; yields rose to compensate for higher interest rates, and bond prices fell. Investors also worried about tightening financial conditions, which, in turn, could raise the borrowing costs for consumers and businesses alike, limiting the scope of economic growth.

Equities delivered robust gains; emerging markets, Asia and bonds struggled.



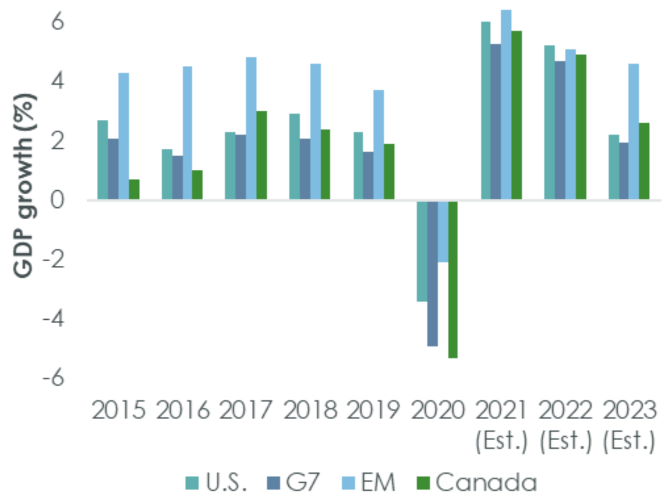
Source: Refinitiv DataStream, as at December 31, 2021. MSCI indexes for all, except U.S. (S&P 500 Index) and Canada (S&P/TSX Comp.). Returns in Canadian dollars. ICE BoFA Index. All returns (except U.S. agg. debt) are total returns.

Business optimism at fresh highs



Source: Bank of Canada, as at September 30, 2021.

Strong GDP outlook for Canada



Source: IMF, World Economic Outlook, GDP growth data for 2021 to 2023 based on estimates, October 2021.

Canadian equities and economy were up strongly.

Canadian equities rose in line with other developed markets, encouraged in part by a robust post-pandemic economic recovery for the year. Supported by a combination of government spending and Bank of Canada policy support, Canada's economic recovery was swift as most COVID-19 related restrictions were eased. Broad-based job gains brought the employment rate close to the strong pre-pandemic levels.

Inflation emerged as a concern due to significant global supply chain bottlenecks, strong consumer demand and a relatively healthy labour market. That said, core measures of inflation were stable. At its December policy meeting, the Bank of Canada decided to maintain its policy interest rate at 0.25%. Earlier it had also announced an end to its quantitative easing program, noting the robust growth in the economy.

The outlook for growth in the near to medium term remains positive. According to the business outlook survey, most firms continue to anticipate healthy growth in both domestic and foreign demand, although for those offering hard-to-distance services, such as travel, this means recovering from low levels. To meet demand and alleviate capacity constraints, most businesses plan to increase their capital expenditures and staffing levels over the next year.

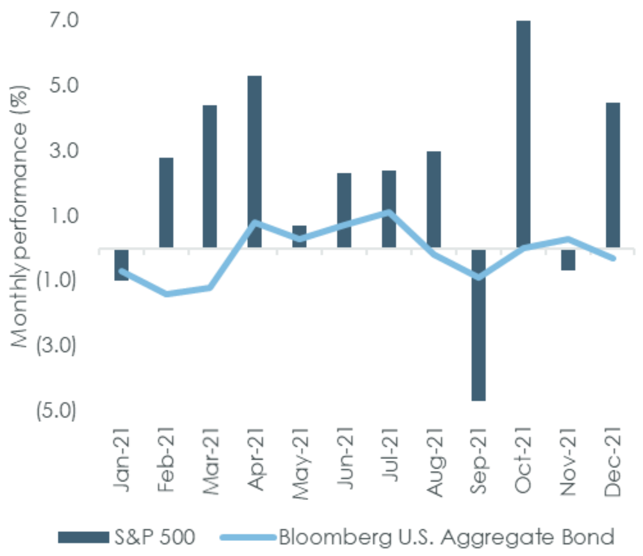
Bonds under pressure

Canadian investment-grade bonds declined for the year, with yields rising in line with higher longer-term interest rate and economic growth expectations. Meanwhile, relatively lower-credit bonds, which provide higher yields, delivered positive returns, with many investors seeking to compensate for the decline in investment-grade bond yields. Lower default rates among lower-grade issuers, generally strong balance sheets and sustained economic expansion supported investor confidence in this space.

Cyclicals gained.

International oil prices rose, supporting gains in the energy sector. Financials and real estate advanced; rising bond yields and strong housing demand for most of the year supported the profitability outlook for companies in these sectors.

U.S. equities gained; bonds were subdued.



Stronger household balance sheets

Source: Refinitiv DataStream, Bloomberg, as at December 2021. U.S. household balance sheet data from IMF Global Financial Stability Report, October 2021.

Cyclicals outperformed in the U.S.

Fiscal and monetary policy support contributed to a strong recovery in the U.S. economy. This helped investors overcome the disruptive effect of COVID-19 when the delta variant struck in the first quarter and omicron variant emerged in November. Toward the end of the year, the U.S. Federal Reserve indicated that it would increase interest rates to combat rising inflationary pressure as employment and economic growth indicators solidified.

Equities started the year with some losses but recovered quickly as governments eased COVID-19 related lockdowns. This favoured the cyclical and value areas of the market, such as banks, airlines and travel and leisure industries. However, with inflation emerging as a key concern and doubts about the growth outlook for the global economy, the more growth-oriented stocks advanced in the second half of the year. Better-than-expected earnings also supported sentiment. While many companies reported upward pressure on wages and input costs, they were able to pass on a significant part of the cost pressure, thanks to strong consumer demand.

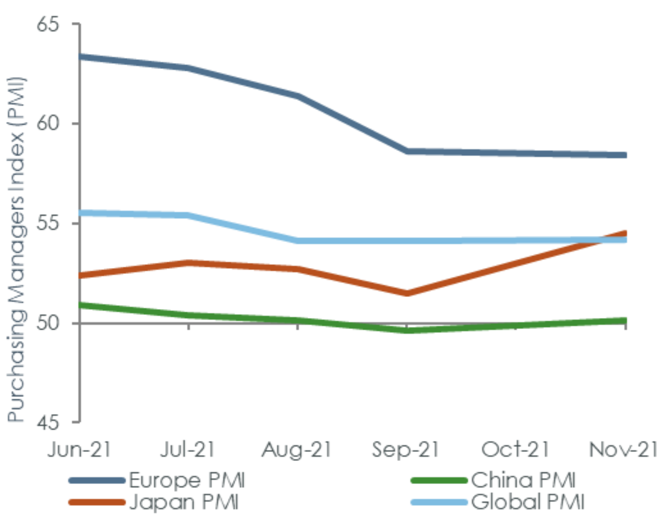
Mixed results among bonds

In fixed income, U.S. ten-year Treasury bond yields rose from 0.91% at the start of the year to 1.75% at the end of March – when confidence soared regarding a sustained rise in growth and inflation – before settling at 1.50% at the end of the year. Bond prices declined to compensate for the rise in yields. While government and highly rated investment-grade bonds came under pressure, higher-yielding bonds continued to perform well, thanks to demand from income-seeking investors and falling default rates.

Economic optimism remains.

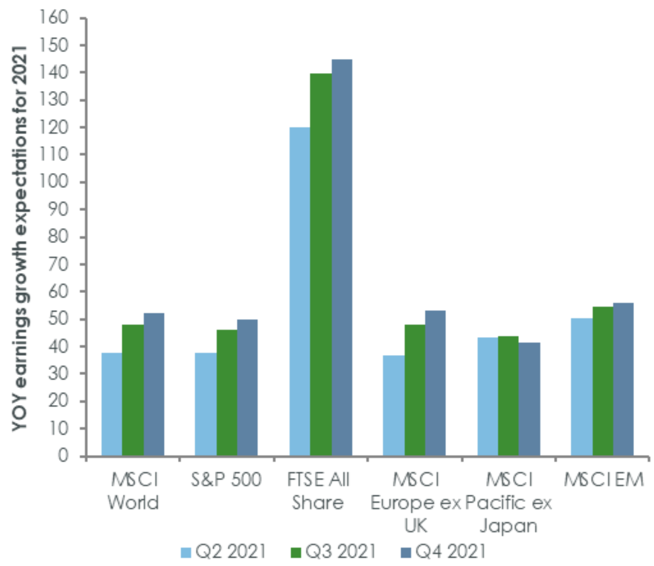
Rising interest rates, due in part to persistent inflation and the worsening COVID-19 spread, remain key risks to a largely positive growth outlook. However, as COVID-19 risks ease, further reopening of the service sector, a continued rise in consumer spending and inventory restocking to fulfill demand should all support growth in 2022.

Mixed global manufacturing growth indicators



Source: Fidelity International, BofA Global Investment Strategy, June 2020.

Positive near-term earnings growth outlook



Source: Refinitiv DataStream, I/B/E/S Estimates, December 31, 2021.

Europe rose; emerging markets declined.

European equities surged for the year, thanks to strong economic growth indicators, robust consumer demand and better-than-expected corporate earnings growth. The European Central Bank maintained its accommodative stance and repeated its view that current inflationary pressures across the eurozone are transitory. However, Asia-Pacific (ex Japan) and emerging market equities declined after slowing growth in China dampened sentiment and Latin American economies combated political uncertainty and adverse growth indicators.

In China, a regulatory overhaul affecting after-school tutoring businesses and companies that handle large amounts of data, as well as new regulations on how Chinese entities list on stock markets outside of the country, weighed on investor sentiment. In the final quarter, COVID-19 outbreaks and stringent lockdowns in some cities resulted in some weakness as well. Nevertheless, a leading growth indicator, the purchasing managers index, rose strongly in the final quarter.

In light of emerging risks to growth, China's central bank moved to ease its monetary policy stance, cutting its benchmark policy rate in mid-December. The cut indicates the government's focus on stabilizing the economy in 2022. Analysts expect that policy makers in China are likely to boost public spending on environmentally friendly technologies and new infrastructure, while providing tax incentives for corporates to upgrade their technologies.

Promising outlook for emerging markets, including China

Emerging markets have underperformed developed markets through 2021. Risk aversion centred on China's regulatory clampdown, stress in the property sector and a slowing economy. The U.S. Federal Reserve's stance on raising interest rates in the face of higher inflation has also weighed on risk appetite. While emerging markets are not cheap in absolute terms, the shakeout in the markets means that relative to developed markets, emerging markets are trading at a peak discount, providing an attractive entry point for investors.

Appendix

Global markets (returns in Canadian dollar terms)

S&P/TSX Composite	21,222.84	17,433.36	25.2%
S&P 500	4,766.18	3,756.07	27.5%
NASDAQ	15,644.97	12,888.28	21.1%
DJIA	36,338.30	30,606.48	19.8%
Russell 2000	2,245.31	1,974.86	13.7%
FTSE 100	7,384.54	6,460.52	16.3%
Euro Stoxx 50	4,298.41	3,552.64	14.5%
Nikkei 225	28,791.71	27,444.17	-4.3%
Hang Seng	23,397.67	27,231.13	-13.2%
Shanghai Comp.	3,639.78	3,473.07	8.9%
MSCI ACWI	754.83	646.27	17.9%
MSCI EM	1,232.01	1,291.26	-3.4%
FTSE Canada Uni.	1,190.26	1,221.24	-2.5%
BBG Global Agg.	532.43	558.73	-4.7%
TSX Preferred Shares	1,948.53	1,632.68	19.3%
10 yr Canada Govt.	1.43%	0.68%	75
10 yr U.S. Govt.	1.51%	0.91%	60
30 yr Canada Govt.	1.68%	1.21%	47
30 yr U.S. Govt.	1.90%	1.64%	26
Oil ($/bbl.)	75.21	48.52	53.6%
Natural gas ($/Mmbtu)	3.73	2.54	45.5%
Gold ($/Oz)	1,829.20	1,898.36	-3.6%
Silver ($/Oz)	23.31	26.40	-11.7%
Copper ($/lb)	4.46	3.52	25.7%
CAD/USD	0.7913	0.7853	0.8%
USD/EUR	0.8793	0.8186	7.4%
CAD/EUR	0.6956	0.6429	8.2%
USD/JPY	115.08	103.25	11.5%
USD/CNY	6.3561	6.5272	-2.6%
USD/MXN	20.5294	19.9143	3.1%
GBP/CAD	1.7096	1.7402	-1.8%
GBP/USD	1.3532	1.3670	-1.0%

Source : Bloomberg, Refinitiv DataStream. Total returns.

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