Monthly Market Insights

Data and opinions as of January 31, 2021

Stocks and bonds fell in January

January started off strong, with stock market momentum carrying over from December. Even the storming of the U.S. Capitol by a mob of Trump supporters was unable to shake market confidence. A unified U.S. government means we are likely to see less bipartisan strife and more immediate pandemic support. President Biden was quick to announce another US$1.9 trillion aid package, a deal that includes giving each qualified American an additional US$1,400. Volatility surged in the last week, however, as a retail investor frenzy led to several hedge funds coming under pressure for their short positions. Bond values also fell (yields rose).

The NEI perspective

Main street vs Wall street sparks volatility. Markets ended January in the red as day traders hurt several hedge funds through an epic coordinated short squeeze involving stocks such as videogame retailer GameStop. Short covering and the seeking of liquidity led to a broad-based sell off.

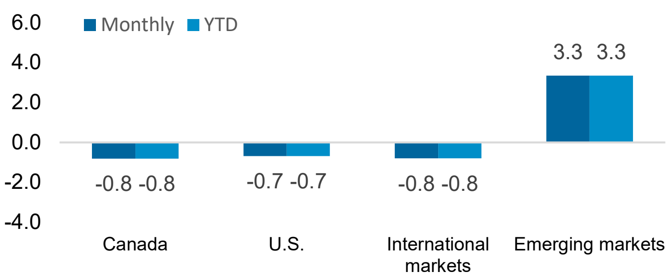
Vaccines will drive the global recovery and vaccination rates will determine how quickly we get there. Already, we are seeing regional differences in vaccine distribution rates which could potentially lead to an uneven recovery.

Policy to remain accommodative. Central banks show no intention of letting off the gas pedal anytime soon. With former Fed Chair Janet Yellen as Treasury Secretary, U.S. President Joe Biden's pandemic relief priorities should provide the necessary support in the meantime.

From NEI's Monthly Market Monitor for February 2021. Click here to get the full report (pdf).

Equity

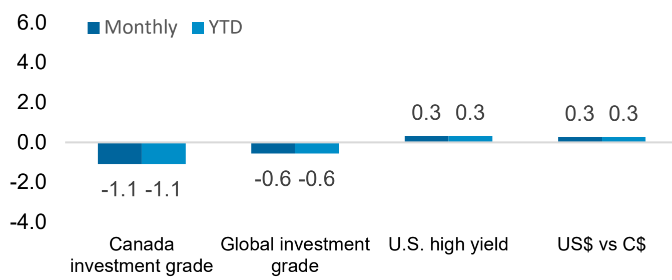
% return in C$



Canada: MSCI Canada; **U.S.:** MSCI USA; **International markets:** MSCI EAFE; **Emerging markets:** MSCI Emerging Markets. Source: Morningstar Direct.

Fixed income and currency

% return in C$



Canada investment grade: Bloomberg Barclays Canada Aggregate; **Global investment grade:** Bloomberg Barclays Global Aggregate; **U.S. high yield:** Bloomberg Barclays U.S. High Yield. Source: Morningstar Direct.

Thoughts on the recent retail investor frenzy

What happened? Last week, members of a popular Reddit trading forum were actively buying up a number of stocks that were short-selling targets of hedge funds. The resulting short squeeze led to losses across several firms, as well as increased market volatility as the hedge funds were forced to liquidate long positions to cover their short ones.

How did this happen? If one thinks that a stock's price will decline, one can borrow the shares from a broker and sell them without actually owning the stock. If the share price declines, the investor can profit by buying back the shares at the lower price and returning them to the lender. In this case, the investor is taking a "short" position (as opposed to a "long" position, which equates to buying the shares and owning them outright). A short "squeeze" occurs when the price of the stock moves higher (in the opposite direction of what the investor was expecting), and to mitigate further losses, the investor is forced to buy the stock back (covering) at a higher price. Doing so, especially when many others are also short the same stock and trying to cover their positions, can "squeeze" the stock price higher.

Why did this happen?

1) Record fiscal stimulus pumped into the U.S. economy, combined with restricted spending due to lockdowns, has nearly doubled the personal savings rate from 7.2% at the end of 2019 to 13.7% at the end of 2020. Also, with interest rates near zero, investors seeking higher returns are flocking to the stock market.
2) The proliferation of self-directed investment platforms has democratized access to capital markets. At the click of a button, anyone with an internet connection can day-trade stocks and other exotic financial instruments.
3) Main street animosity toward Wall Street lingers more than a decade after the 2008/2009 financial crisis. The idea that strangers on an internet forum can unite against billion-dollar hedge funds added fuel to the fire.

What does this mean for markets and the economy? The market volatility will pass, and we expect little impact to the economy. However, the meteoric rise of GameStop and other "chat group" favourites has already sparked talks of increased financial market regulation. There is a question of potential market manipulation, and whether mechanisms and platforms that enable such behaviour need additional rules and/or oversight. Expect more news to follow, but one thing is for sure—we believe investing should not be treated like a game nor financial markets like a casino. Planning for your financial future should be taken seriously. We applaud the empowerment of "main street" investors and believe that more will use their investments to have a positive impact on the planet and social issues. But we would use this episode as a reminder that a successful investment strategy should be purposeful, disciplined, and with long-term objectives in mind.