Monthly Market Insights

Data and opinions as of May 31, 2021

Markets trade in range on signs of U.S. growth slowdown

Markets consolidated in May and continued to process the strength of the economic recovery, a decline in global COVID-19 cases, and the potential for inflation. Global stock markets were essentially flat, while bond indices rose as investors looked past historically high inflation readings and instead focused on disappointing employment data. Markets are currently in a holding pattern as they await direction from incoming economic data. Investors are positioned for a reflationary environment but due to a near-term peak in U.S. growth momentum, they may be evaluating the possibility of stagflation in the short-term. There have been positive surprises in European and Japanese economic data, and we believe those countries are positioned to benefit from improving economic sentiment and increased vaccination rates.

The NEI perspective

Commodity price correction. Commodities corrected last month as China clamped down on rising prices, though gold bounced back on stagflation concerns.

Slowdown in U.S. economic growth. The U.S. Federal Reserve is keeping policy easy as markets process historically high inflation and disappointing employment data. U.S. growth momentum may have peaked in the near-term.

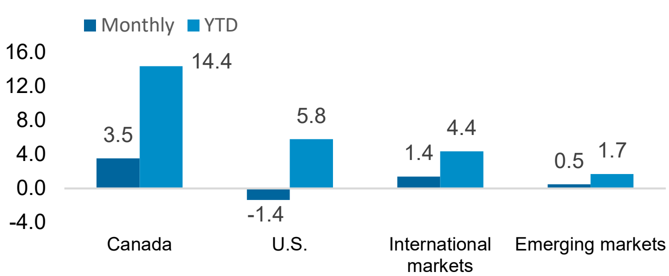
Europe and Japan looking stronger. We expect the rest of the world to pick up the slack from slowing U.S. growth. Signs of economic strength are emerging in Europe and Japan as both regions try to accelerate vaccine distribution.

From NEI's Monthly Market Monitor for June. [Click here to get the full report](#).

NEI

Equity

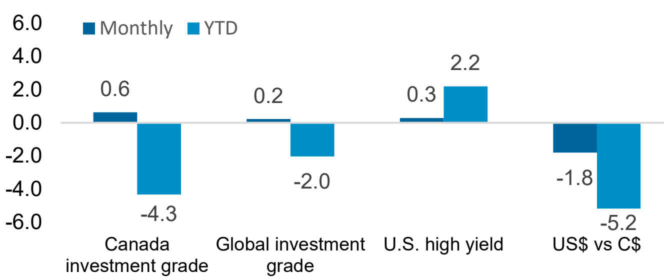
% return in C$



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.

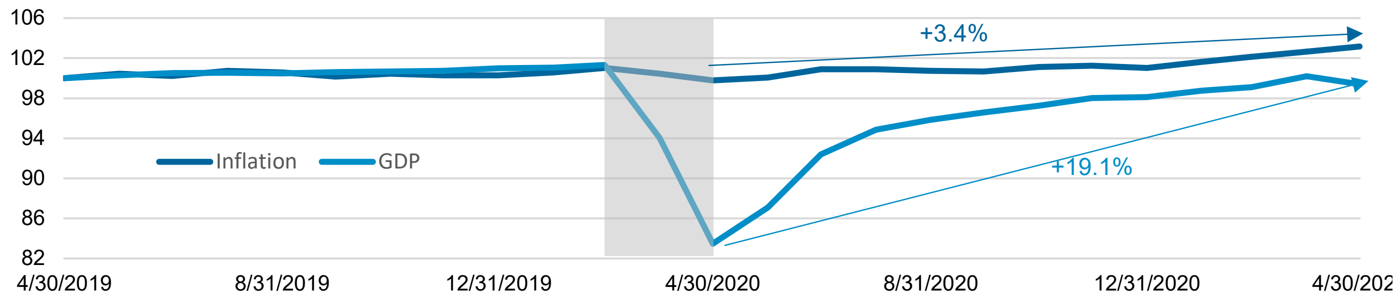
How base effects distort economic data

The Canadian Consumer Price Index (CPI) rose 3.4% in April, the fastest pace in almost 10 years, stroking inflation fears among investors. However, Statistics Canada was quick to point out that much of this rise can be attributed to “base effects” that are expected to be temporary. What are “base effects” and how are they distorting recent economic data?

The onset of the pandemic saw entire industries shut down and global economies suffered heavily. Less than a year later, vaccines were introduced, and economies are quickly recovering with the support of loose monetary policy and unprecedented amounts of fiscal spending. This extraordinary decline and ascent have resulted in large distortions in data due to base effects. Base effects refer to the impact that year-ago data has on the current year’s data. So when this month’s data is compared to an unusually low or high data point from the prior year, this will cause distortion that economists attribute to base effects. Base effects are impacting much of the data being released today, such as GDP and CPI. The weak readings in Q2 2020 result in unusually strong Q2 2021 data. This does not mean the latest data is wrong, but we need to look at month-over-month data to get a better understanding of near-term trends.

Inflation and GDP

Indexed to 100 as of April 30, 2019.



Source: Bloomberg, Statistics Canada. Data as of May 31, 2021.

- Using StatsCan’s preliminary estimate for April 2021, GDP rose an increditble 19.1% year-over-year. However, when compared to pre-pandemic February 2020 levels, GDP is still down 1.9%.
- CPI rose a solid 3.4% year-over-year in April, but when compared to pre-pandemic February 2020 levels, inflation has risen just 2.1%.