Monthly Market Insights

Data and opinions as of January 31, 2022

Volatility roils equity markets; central banks send aggressive signals

January was a rough start to the year for equity investors. Bucking the seasonal trend known as the January Effect, in which stocks typically trade higher in the month, equities had their worst monthly performance since the beginning of the pandemic in March 2020. Inflationary pressures have remained stubbornly persistent, moving consumer price indices to multi-decade highs in many regions around the world. As a result, central banks signaled that they were prepared to move more aggressively to pull back the record accommodative policies in their fight to keep inflation expectations well anchored to the 2.0%–2.5% range. Bonds sold off as both short- and longer-term interest rates moved higher to price in a new central bank rate hiking cycle. Major stock indices across the world declined, led by the tech-heavy U.S. market.

The NEI perspective

Market volatility escalates. December's meeting minutes from the Federal Open Market Committee of the U.S. Federal Reserve revealed a more aggressive central bank stance against inflation, which sent markets downward as investors tried to reassess how to price assets in an environment of rising interest rates.

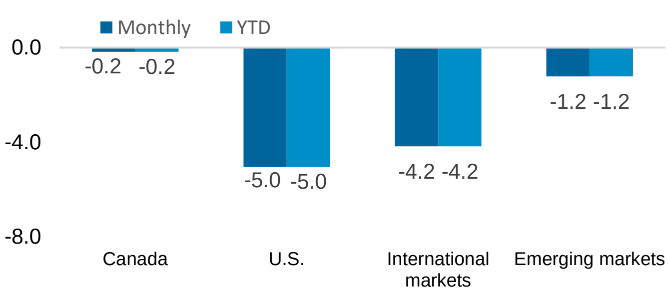
Bank of Canada holds firm. While investors were bracing for a rate increase announcement from the BoC, the central bank instead held the overnight rate steady at 0.25%, with some guidance. The bank's Governing Council expects interest rates will need to increase, with the timing and pace of those increases guided by the BoC's commitment to achieving the 2% inflation target.

Russia-Ukraine tension heats up. Heightened tensions between Russia and Ukraine took centre stage in January. NEI Investments is keeping an eye on developments in the region, including the implications of possible additional sanctions, disruptions in energy supply chains, or further fraying of diplomatic relationships.

From NEI's Monthly Market Monitor for February. Read the full report for more insights.

Equity

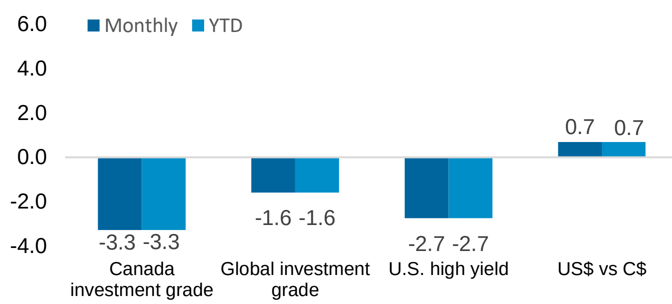
% return in C$



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.

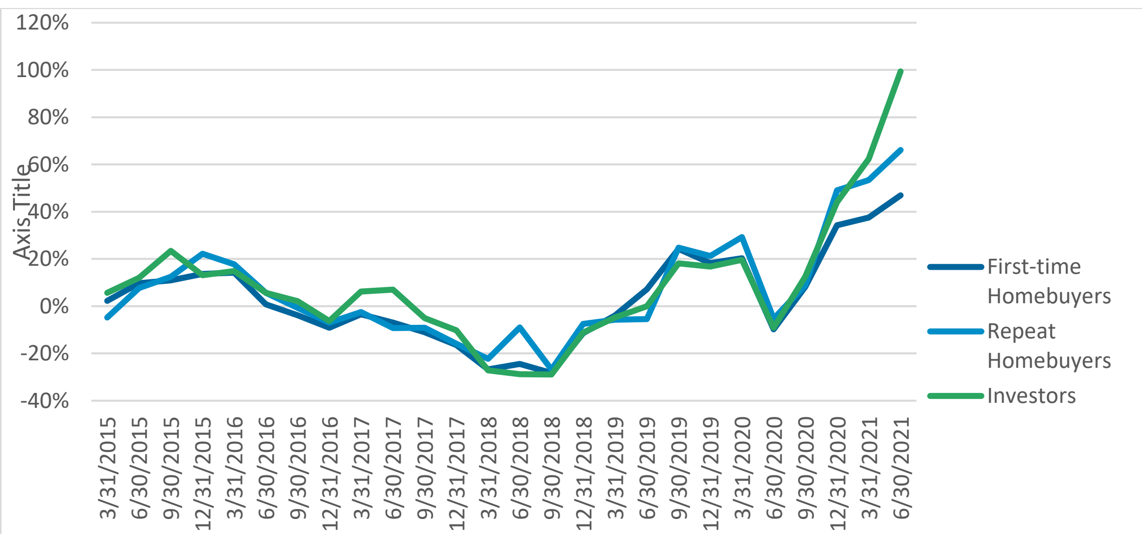
Nation's housing market heats up, but leverage could increase as well

The Canadian residential housing market continued its rise in 2021, on the back of a strong 2020. The MLS Home Price Index (HPI) rose a record 26.6% in 2021. A total of 667K transactions were completed in 2021, up 21% year over year. This was driven by a combination of factors such as ultra-low interest rates, a housing supply crunch, demand for more space amidst continued widespread remote work, and robust immigration levels despite the pandemic. The months-of-inventory (MOI) measure of the housing market stood at 1.6x at the end of 2021. This was the lowest level ever recorded, and significantly below the long-term average of 5x. In addition, the sales-to-new-listings ratio stood at 0.80x in December. Both indicators are good barometers of supply-demand balance, and attest to the strong bargaining power sellers command in the current market environment.

An interesting trend that developed during the year was the change in new mortgage originations between different buyer segments. While repeat homebuyers and first-time homebuyers continue to be the dominant segments, the strongest growth rate was seen in the investor segment. This was a contrast to 2020, when demand from "end users" (e.g., first-time and repeat homebuyers purchasing their primary residence) was purported to be the primary catalyst driving housing strength. By Q2/2021, mortgages originated by investors were growing nearly 100% year over year, compared to 66% and 47% for repeat homebuyers and first-time homebuyers, respectively. This change in the mix of new mortgage originations in favour of investors is noteworthy, as it could heighten what the Bank of Canada has called "extrapolative expectations" for price appreciation. That's when the central bank observes that demand increases are driven more by expectations that prices will keep rising and less by fundamental factors such as population growth and housing starts.

The investor segment tends to carry larger total loan-to-income and total-debt-service ratios relative to other segments. As a result of that higher carried leverage, the gradual dominance of the investor segment in residential real estate tends to be correlate strongly with boom–bust cycles. A factor to closely watch will be what impact higher interest rates in 2022 will have on housing market strength, especially as it relates to demand from investors.

First-time home purchases, repeat homebuyers, investors move in tandem historically (y-o-y growth rates)



Source: TransUnion, regulatory filings of Canadian banks and Bank of Canada calculations. Last observation: Q2/2021.