Global Markets Commentary
Netflix at Home or Theme Park Thrills?

Lesley Marks, CFA
Chief Investment Officer

> *"I always like to look at the optimistic side of life, but I am realistic enough to know that life is a complex matter."*
>
> **Walt Disney**

After a strong second-quarter recovery in equity markets and other risk assets, investors are naturally wondering what to expect this summer. Markets could calm down, but they could also force us to strap in for an extended choppy ride. Will we spend many more hours on the couch with Netflix, or can we expect some thrills at the theme park? Since Disney postponed a planned mid-July reopening of its Southern California parks, a stance other outdoor entertainment venues are likely to take, we may have to stay home a little longer.

Right now, there's a tug-of-war between improved economic data and alarming COVID-19 statistics in many parts of the world. It's reasonable to question whether this stock rally is sustainable, given such a negative backdrop.

Economic data indicate that we are in the early stages of a synchronized global expansion. Job numbers are somewhat rosy, economic growth is back and consumer confidence is up. Markets have largely ignored the coronavirus pandemic even though the toll stands at more than 10 million cases worldwide, and at least 500,000 deaths.

Clearly, COVID-19 is an enormous threat. Many countries, including Canada, Australia, France and Italy, seem to be keeping the novel pathogen in check. For the U.S., this is unfortunately not the case. Some of the most populous states (Florida, California and Texas, for example) have recorded huge daily spikes.

Governments are struggling to safely reboot their battered economies. Where infections are soaring, authorities have no choice but to backtrack and close public gathering areas such as beaches and restaurants.

Canada – Suggested for you

After two months of almost full economic and social lockdown, the Canadian economy began to rebound in June. The economy shook off its winter chill well before summer solstice arrived. In May, 290,000 new jobs were added, even though unemployment reached a record high of 13.7% in the same month. Retail sales were estimated to have jumped 19.1% in May after a decline of 26.4% in April. Like many nations, Canada enjoyed a strong recovery after quarantine rules were relaxed and consumers unleashed their pent-up demand for goods and services.

In his first speech as Bank of Canada (BoC) Governor, Tiff Macklem reminded Canadians that our central bank's mission is "to deliver low, stable and predictable inflation," which will be the guiding principle for monetary policy. Interest rates remained at historic lows in Q2. Mr. Macklem pledged to hold the benchmark rate steady (but not lower than its current 0.25 for a long period. The BoC will support the rebound with stability measures, including a purchasing program of Canadian government, provincial government and corporate bonds designed to stabilize markets and make borrowing cheaper for businesses and households.

Fitch Ratings Inc., one of the big three credit rating agencies, downgraded Canada from AAA to AA+, our first sub-AAA rating since 2004. Fitch assumes our economy will contract by 7.1% this year and make a 3.9% recovery in 2021. Canada's deficit is expected to widen substantially and could be higher if direct government support measures are extended beyond their current expiry dates.

CONTINUED

Fitch's downgrade with a "stable outlook" is unlikely to raise government borrowing costs. Because the move was widely anticipated, neither the Canadian dollar nor our bond markets reacted materially. Our deficit could exceed $256 billion as federal spending on COVID-19 aid measures climbs. Before its downgrade, the loonie had appreciated 7% (in U.S. dollar terms) from its March lows. Our currency should stay at these levels as long as oil prices are maintained and appetite for risk assets remains healthy.

Canadian stocks experienced a strong rally, up over 15% for Q2 (measured by the S&P/TSX Composite Index). Our stock market was driven by strength in two sectors: information technology (primarily Shopify) and materials. The materials sector experienced a broad recovery as base metals and forestry companies benefitted from optimism for recovery. Gold companies rose as gold continued its ascent toward 2011 levels. The precious metal appeals to investors who view it as a safe haven in uncertain times as well as inflation protection for their portfolios.

United States – Action and adventure

U.S. stocks enjoyed their best quarter in over 20 years, surging 20% higher in the second quarter (measured by the S&P 500 Index). Stock prices were driven by optimism that the U.S. economy had bottomed when states began to ease coronavirus lockdowns. The tech-heavy Nasdaq Index was the global leader, delivering a 30% return for the quarter that surpassed pre-COVID-19 highs.

On the earnings front, there was also cause for optimism. Bloomberg's profit-outlook index is signalling that the earnings recession could be shorter than expected. For most of June, the index indicated that more companies raised projections than lowered them.

Investors were pleasantly surprised by June payroll numbers; they rose by 4.8 million after rising by 2.5 million in May and plummeting a record 22.1 million in March and April. This brought the U.S. unemployment rate down to 11.1%, still far away from the pre-pandemic low of 3.5%. Although the U.S. economy is enjoying the V-shaped recovery that many had hoped for, it's unclear when the economy will return to pre-COVID-19 levels in terms of jobs and GDP growth.

In congressional testimony, U.S. Federal Reserve Chairman Jerome Powell admitted that the upturn in hiring and spending happened sooner than central bank officials expected. "While this bounceback in economic activity is welcome, it also presents new challenges – notably, the need to keep the virus in check," he said. The Fed remains committed to its nine emergency lending programs, which are aimed at limiting long-term damage to the economy.

Europe and the U.K. – Trending now

The sun shone brightly on European equities in the second quarter as the Euro Stoxx 50 Index rose more than 16%. In contrast to the U.S., Europe has been relatively successful at keeping the coronavirus case count under control while gradually restarting its economy. European equities largely ignored trade tussles with the U.S., despite President Trump's threats to levy US$3.1 billion in tariffs on European goods.

The United Kingdom and the European Union continued trade talks, which intensified when face-to-face negotiations resumed in June. British Prime Minister Boris Johnson has said a deal could be reached this month "with new momentum." Both sides believe a trade deal must be in place by October if it is to be ratified by December 31.

At their July summit, EU leaders will review plans for a new recovery fund that will help revive the distressed economies of Italy and Spain, the European nations hardest hit by the pandemic. In May, the EU announced a co-ordinated recovery fund worth 750 billion euros to help countries weather a painful recession. Since its March lows, the euro has risen over 5% in U.S. dollar terms, reflecting confidence in economic revival for the eurozone.

Japan – Because you watched

As expected, Japan reported more negative economic news in June as the economy slumped deeper into recession. In April, GDP fell at an annualized rate of 4.4%, factory output fell 9.1% and the jobless rate rose to 2.6%. In May, inflation dropped to 0.1% and exports decreased 28.3%, the country's fastest export decline since September 2009. To aid in Japan's economic recovery, the government lifted a country-wide state of emergency. This helped buoy Japanese equities. Like most global stock markets, the Nikkei rebounded in Q2, delivering a 17.8% return.

In line with other central banks, the Bank of Japan said it would probably not hike interest rates through 2022. Welcome signs

CONTINUED

of stabilization emerged in consumer spending and business sentiment. This prompted the government to report that in June the economy "almost stopped deteriorating."

China – International drama

Chinese equities continued their upward climb from March lows and posted an 8.5% return for Q2 (measured by the Shanghai Composite Index). Although Chinese equities lagged most markets throughout that period, the Chinese benchmark is now down by just 2%, making it one of the best performing markets in the world this year.

The Chinese economy continued to recover after months of crippling lockdowns. Beijing focused on supporting small and medium-sized enterprises by delaying loan repayments and increasing access to bank loans. The International Monetary Fund (IMF) forecast that the world's second largest economy will grow at a rate of 1% in 2020. This is in stark contrast to the IMF's projection that the global economy will contract by 4.9% this year.

A recent spate of COVID-19 infections within Beijing served as a warning that a second coronavirus wave could materialize. Government officials raced to contain the outbreak with a partial lockdown and testing of over eight million people.

U.S.-China relations reached their lowest point in years, with tensions escalating on many fronts. In June, trade concerns emerged once again when White House trade advisor Peter Navarro told Fox News that the trade deal was "over." Skittish investors reacted quickly and stocks plunged. When U.S. President Donald Trump jumped on Twitter to say that "the China Trade Deal is fully intact," markets breathed a sigh of relief.

The last word

It's hard to believe we are at the mid-point of the year. In some ways, it seems like we've endured a lifetime over the last six months. While the next quarter will include the dog days of summer, it may also bring melodrama with increased market volatility. Extreme economic shutdown, pandemic tragedies and a visceral election battle in the U.S. will demand our attention. As our real-life Netflix series unfolds before our eyes, we can expect some unexpected twists and turns, culminating in the fall finale.

Please contact your BMO financial professional if you have any questions or would like to discuss your investments.

BMO | Private Wealth

Information contained in this publication is based on sources such as issuer reports, statistical services and industry communications, which we believe are reliable but are not represented as accurate or complete. Opinions expressed in this publication are current opinions only and are subject to change. BMO Private Wealth accepts no liability whatsoever for any loss arising from any use of this commentary or its contents. The information, opinions, estimates, projections and other materials contained herein are not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information, opinions, estimates, projections and other materials be considered as investment advice, tax advice, a recommendation to enter into any transaction or an assurance or guarantee as to the expected results of any transaction.

You should not act or rely on the information contained in this publication without seeking the advice of an appropriate professional advisor.

BMO Private Wealth is a brand name for a business group consisting of Bank of Montreal and certain of its affiliates in providing private wealth management products and services. Not all products and services are offered by all legal entities within BMO Private Wealth. Banking services are offered through Bank of Montreal. Investment management, wealth planning, tax planning, philanthropy planning services are offered through BMO Nesbitt Burns Inc. and BMO Private Investment Counsel Inc. Estate, trust, and custodial services are offered through BMO Trust Company. Insurance services and products are offered through BMO Estate Insurance Advisory Services Inc., a wholly-owned subsidiary of BMO Nesbitt Burns Inc. BMO Private Wealth legal entities do not offer tax advice. BMO Nesbitt Burns Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada. BMO Trust Company and BMO Bank of Montreal are Members of CDIC.

® Registered trademark of Bank of Montreal, used under license.

ID3969 (07/20)