U.S. Federal Reserve signals plans to ease bond buying, adding to market jitters

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A shopper leaves a Home Depot with merchandise that he purchased on Aug. 17 in Alexandria, Va. Shares of Home Depot dropped more than four per cent despite its quarterly profits surpassed analysts expectations.
ALEX WONG/GETTY IMAGES

The U.S. Federal Reserve signalled plans to begin pulling back on its easy-money policies later this year, adding to unease in the markets alongside signs the fast-paced economic recovery may be shifting down a gear.

North American stock markets fell for the fifth straight day on Wednesday, after the U.S. central bank released minutes of its meeting in late July, which showed officials were apparently ready to begin scaling back US$120-billion monthly asset purchases that have helped prop up the economic recovery. The S&P 500 dropped more than 1 per cent, while the S&P/TSX Composite slipped 0.3 per cent.

Markets had already been wobbling before the Fed news on Wednesday afternoon, weighed down by weaker-than-expected recent data from some of the world's largest economies and rising COVID-19 cases worldwide.

The market has “curbed its enthusiasm over the strength of recovery,” said Doug Porter, chief economist at BMO Capital Markets.

The Fed minutes showed most officials felt recent employment gains in the U.S. could justify curtailing the central bank’s purchases of Treasury bonds and mortgage securities this year. The Fed has made the purchases to provide liquidity in credit markets and keep interest rates down during the pandemic.

It remains unclear, however, when any pullback in asset purchases would begin, and some officials indicated they want to see further evidence the job gains will remain on track.

On Tuesday, the U.S. Commerce Department said retail spending fell by a seasonally adjusted 1.1 per cent in July from a month earlier. Shares of giant retailers Home Depot Inc. HD-N +0.69% increase and Target Corp. TGT-N +0.03% increase dropped this week despite solid earnings reports as investors focused on future sales potential.

The University of Michigan Consumer Sentiment Index, a key consumer indicator, also dropped dramatically to 70.2 in its preliminary August reading, its lowest level since 2011. Economist Richard Curtin, who conducts the monthly survey, described the decline as “a stunning loss of confidence in the first half of August,” amid “dashed hopes” the pandemic would end soon.

In China, retail sales climbed 8.5 per cent in July versus a year ago, but were well below the forecast gain of 11.5 per cent, according to analysts polled by Reuters.

The International Monetary Fund said recently that access to vaccines are the “principal fault line” that’s splitting the global recovery into two parts: most advanced economies with greater access to vaccines than weaker ones without it.

“The recovery, however, is not assured even in countries where infections are currently very low so long as the virus circulates elsewhere,” the IMF stated in its latest economic outlook, released last month. The outlook forecast global growth of 6 per cent this year and 4.9 per cent in 2022.

Mr. Porter said there could be more disappointing economic data ahead, particularly if the Delta variant continues to spread, which could curb business activity and consumer spending, and supply chain bottlenecks persist.

“I don’t think that trend is over yet,” he said. Still, he said, the markets may not react negatively.

“There might still be the view that bad news is good news,” Mr. Porter said, because it could mean interest rates will need to remain low for longer, which benefits the markets.

However, there is potential for volatility owing to the so-called September effect – a history of disappointing returns in the ninth month of the year for equities worldwide.

While not all Septembers end in the red, “I think there might be some volatility in the next six weeks or so,” Mr. Porter said.

Christine Poole, chief executive officer and managing director at Toronto-based GlobeInvest Capital Management Inc., said markets are often sensitive to signs of softer economic growth.

Her strategy is to buy stocks she likes on the pullbacks, which is why she added more Home Depot shares to some client portfolios on Tuesday after its share price fell 5 per cent.

While growth may be slowing in some sectors, Ms. Poole said consumers still have money to spend, “especially in services as economies reopen and interest rates stay low.”

Strong corporate earnings being reported over the past few weeks are also a good sign the economy is steadily recovering.

“As long as really the profit growth continues to come through, I think the market could still continue to grind higher,” she said.

While the market recovery appears to have stalled in recent days, money manager Jason Del Vicario doesn’t believe it’s pricing in a slowdown – at least not yet.

“That’s not to say that it’s not going to happen. ... The stock market is usually the last to react,” said Mr. Del Vicario, a portfolio manager at Hillside Wealth Management, a division of iA Private Wealth, based in Vancouver.

He pointed to late 2019 and early 2020, when stock markets continued to rise despite a handful of weakening indicators such as a rising U.S. dollar and falling bond yields.

Even after widespread pandemic shutdowns in March, 2020, sent stocks tumbling, government stimulus created a relatively quick comeback, he said.

“Investors have now been conditioned to know that, when things slow down, central banks are going to start printing more money,” Mr. Del Vicario said, which he sees as a “dangerous scenario.”

Mr. Del Vicario said his plan is to stick to owning “high-quality, predictable businesses trading at reasonable valuations,” to withstand whatever market moves are ahead.