July 15, 2016

RBC WEALTH MANAGEMENT

Global Insight

Weekly

A closer look

Following the money

Kelly Bogdanov – San Francisco

With money draining out of equity funds, some think the market could sour as well. But we see resiliency and think the outflows don't spell doom and gloom for the global equity market.

The resiliency of equities continues to be on display.

Most markets marched higher during the week, extending the rally that began soon after the Brexit vote. The earlier-than-expected U.K. leadership transition, reports of forthcoming fiscal stimulus in Japan, and respectable U.S. Q2 earnings reports boosted stocks worldwide. The muted market reaction to yet another horrific terrorist attack in France underscores markets' sturdy postures.

The resiliency is also noteworthy because markets have withstood diminishing resources recently and all year.

Equity fund flows, which measure the money moving in and out of mutual funds and exchange-traded funds (ETFs) globally, are in the midst of the second downturn since the Great Recession ended and the third since 2007. Almost $125 billion has exited equity funds year to date (see chart).

History lesson

Are outflows signaling trouble ahead?

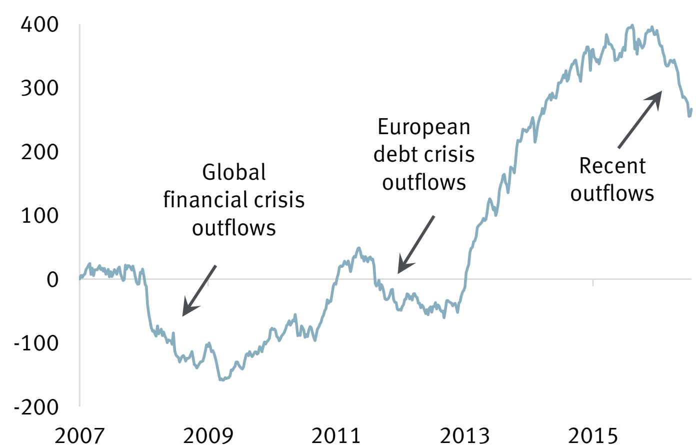
There's a perception that market performance tends to have a tight relationship to fund flows—that they usually run in tandem or one leads the other within a short period of time.

In reality, there is not a strong historical relationship between fund flows and market performance—except during periods of extreme outflows or inflows.

For example, as the U.S. technology bubble burst from late 2000 through mid-2003, global equity fund flows declined by almost 17% of assets under management—a massive hit. At that time, the MSCI World and S&P 500 each plunged 34%.

Recent outflows have not occurred amid a full-blown crisis

Cumulative net global equity fund flows since 2007 (in US$ billions)



Source - RBC Wealth Management, EPFR Global; weekly data through 7/13/16

Market pulse

Click here for authors' contact information.
Priced (in USD) as of 7/15/16 market close, EST (unless otherwise stated).
For important and required non-U.S. analyst disclosures, see Page 6.

RBC Wealth Management

Before fund flows had fully recovered from that episode, another one occurred. As the financial crisis gripped markets and caused the Great Recession, 6.1% of funds moved out of global equities, a meaningful amount. The MSCI World dropped 48% back then, and country/regional markets cascaded lower along with it.

In both instances, as the outflows troughed and money started coming back into equities again, markets began to rebound.

A matter of perspective

Recent outflows have not approached those extreme levels.

The nearly $125 billion that has moved out of stocks is equivalent to 1.7% of global equity funds under management. That's large enough to catch our attention given the short time frame, and we will continue to monitor the data, but at this time it is nowhere close to what we would consider extreme.

Another reason why we are not overly concerned is because the outflows have not occurred amid a crisis or rare, serious event (like the tech bubble bursting)—usually crises fuel extreme outflows. Money often moves out of equity markets in size and at a rapid pace when a crisis is unfolding, and can be accompanied by steep selloffs.

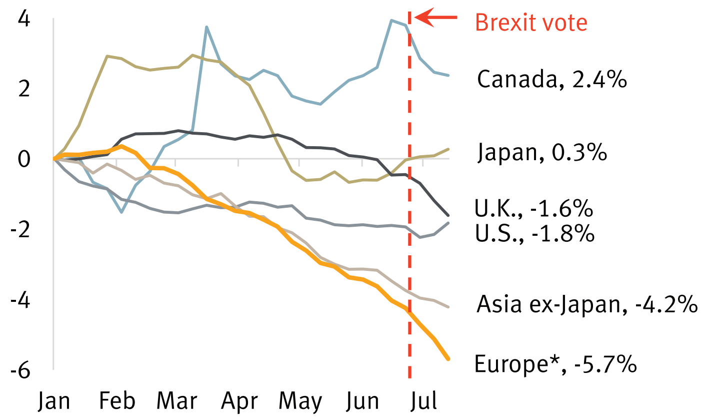
Numerous headwinds have contributed to recent outflows: Chinese policy missteps and uncertainties, and slowing growth; subpar and uneven U.S. economic trends; poor or inconsistent communication by the Fed about interest rate hikes; negative interest rates in Japan and Europe; the continued flight into bonds or cash; concerns about select European banks; and now Brexit risks for the U.K. and Europe. But even with all of these headwinds, financial markets are not currently engulfed in a crisis. To us, this lessens the likelihood that outflows are signaling that a sharp selloff in the global equity market is on the horizon.

On a country and regional basis, trends differ meaningfully. Western Europe has experienced the most sizeable outflows by far with 5.7% of fund assets moving out of equities year to date, followed by Asia ex-Japan at 4.2%. Japan has net inflows in dollar terms, while flows in the U.K. and U.S. have moved in opposite directions following the Brexit vote. The positive outlier is Canada—it has recorded an impressive 2.4% inflow year to date. Money began moving into Canada in late February, shortly after crude oil bounced off the bottom. (See data for these markets in top chart.)

We recently downgraded Continental Europe to Underweight. Should the outflows persist, that market will likely have a tough time keeping up with global benchmarks, in our view. We believe the other equity markets are less at risk at getting sideswiped by outflows.

Money has largely moved out of equities so far in 2016

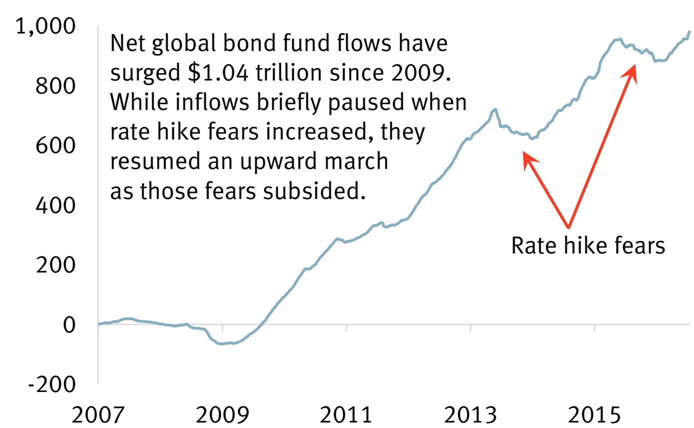
Cumulative YTD net change in equity fund flows (% of AUM in US$)



* Europe represents Western Europe including the U.K.
Source - RBC Wealth Management, EPFR Global; weekly data through 7/13/16

Since the financial crisis money has surged into bonds

Cumulative net global bond fund flows since 2007 (in US$ billions)



Source - RBC Wealth Management, EPFR Global; weekly data through 7/13/16

United States

Kelly Bogdanov – San Francisco; Sean Gray – Minneapolis

- After almost 14 months, the **S&P 500** reached a **new all-time high** on Monday and the **Dow Jones Industrial Average** ascended to that pinnacle on Tuesday. The S&P 500 finished Friday's session 1.5% above the prior high reached in May 2015.
- RBC Capital Markets, LLC's **Technical Analyst Bob Dickey believes more upside is in store**. Based on technical indicators, he projects the **S&P 500 can climb to around 2,400 over the next 6–12 months** (11% upside) and the **Dow can reach roughly 20,500** (10.7% upside) during the same period. Dickey wrote, "Of course, the market won't go straight to the target, and there will be periods where it may look like a bad call, but we believe that the overall outlook has been greatly improved as of the recent breakout to new highs." **He does, however, strike a note of caution about the near term**. Because of the recent rally, the market has reached an **overbought condition** and is vulnerable to pulling back moderately, potentially providing more attractive entry points in coming weeks.
- Dickey's expectation of **additional gains is supported by historical return data**. On the 12 previous occasions that it took the S&P 500 one year or longer to reach a new peak—like it did this time—once the new peak was finally achieved, the market typically traded higher in subsequent months. **On average, the S&P 500 rose 7% six months after the new peak and 12% one year later**. While there was wide variation in returns around those averages, the **market rose in most instances**. Regarding the recent all-time high on Monday, the trip to get there was less bumpy and less time consuming than previous occasions. It took only 417 days—a little more than a year—compared to an average of almost three years. Furthermore, the decline between the peaks was only 14% this go-around versus an average drop of 29%. (See table for details.)

U.S. market tends to rise following a pivotal new all-time high

Instances where it took the S&P 500 one year or more to take out the previous all-time high since 1954

Prior peak	New peak	Calendar days peak to peak	Max decline between peaks	Return after new peak 6 mos	12 mos	18 mos
08/02/56	09/24/58	783	-22%	12%	14%	12%
08/03/59	01/27/61	543	-14%	9%	11%	-7%
12/12/61	09/03/63	630	-28%	8%	14%	20%
02/09/66	05/04/67	449	-22%	-3%	4%	9%
11/29/68	03/06/72	1,193	-36%	2%	5%	-3%
01/11/73	07/17/80	2,744	-48%	11%	8%	-5%
11/28/80	11/03/82	705	-27%	14%	14%	13%
10/10/83	01/21/85	469	-14%	11%	17%	35%
08/25/87	07/26/89	701	-34%	-4%	5%	-1%
02/02/94	02/14/95	377	-9%	16%	36%	37%
03/24/00	05/30/07	2,623	-49%	-3%	-8%	-47%
10/09/07	03/28/13	1,997	-57%	7%	18%	26%
05/21/15	07/11/16	417	-14%	TBD	TBD	TBD
	High	2,744	-9%	16%	36%	37%
	Average	1,049	-29%	7%	12%	8%
	Low	377	-57%	-4%	-8%	-47%

Source - RBC Wealth Management, Bloomberg

Canada

Patrick McAllister & Diana Di Luca – Toronto

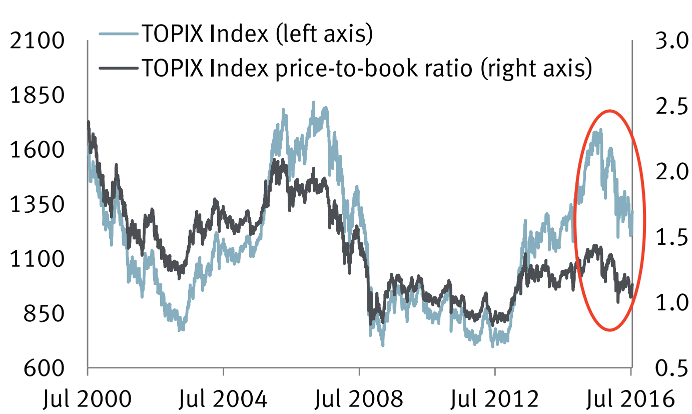
- The S&P/TSX Composite marked its **third consecutive weekly gain** since the June 24–27 selloff. Performance of high dividend-paying and traditionally defensive sectors stalled while the Consumer Staples, Consumer Discretionary, and Industrials sectors outperformed.
- **RBC Capital Markets raised its outlook for gold** with a forecast price of **$1,500 per ounce** in both 2017 and 2018. While accommodative monetary policy and low interest rates have been supportive for some time, RBC Capital Markets cited **heightened geopolitical uncertainty as key to its more bullish stance** on precious metals.
- The past two months of **relative stability in crude oil prices** has helped **retail fuel margins expand** in both the U.S. and Canada. This trend was reflected in **Alimentation Couche-Tard's quarterly results** and has provided some **relief to share prices across the fuel and convenience store industry**.
- In its first rate decision since the U.K. referendum, the **Bank of Canada** left its **overnight rate unchanged** at 0.50%. The accompanying statement highlighted "a **weaker outlook for business investmen**t and a **lower profile for exports**, reflecting a downward adjustment to U.S. investment spending." As such, the central bank **lowered its Canadian GDP growth forecast** to 1.3% in 2016 and 2.2% in 2017 from 1.7% and 2.3%, respectively.
- **Lower corporate issuance** has been **supportive of credit spreads** in Canada. After a period of declining yields and credit spread tightening, **we would generally expect** to see a number of **issuers taking advantage of attractive conditions**. But this has **not been the case** recently as issuance has remained quite light despite credit spreads at some of the tightest levels of the year and rates near the lows.

Europe

Frédérique Carrier & Thomas McGarrity – London

- **European equity markets were strong** during the week with the STOXX Europe 600 increasing over 3% helped by the **expectation of increased stimulus** from the European Central Bank (ECB) in the coming months, and continued loose monetary policy.
- The U.K.'s blue-chip **FTSE 100 Index** hit an **11-month high before retracting** after the **Bank of England** (BoE) **surprised** markets by **holding the U.K. Base Rate at 0.5%**. Financial markets had priced in a 0.25% cut. The BoE's reticence to reduce rates at this month's meeting appears to be driven by a desire to **take its time to assess and collect more evidence** on the impacts of Brexit before deciding the best course of policy action. RBC Capital Markets forecasts a 0.25% cut in the U.K. Base Rate in August.
- **Theresa May** was appointed as the **U.K.'s prime minister** following the sudden withdrawal of Andrea Leadsom from the leadership race and swiftly made **sweeping changes to the cabinet**. While new leadership removes one layer of political uncertainty, the question of how May and her cabinet will handle Brexit remains unanswered, which we think will weigh on economic activity, at least in the near term.
- **Italy's biggest bank**, **UniCredit**, the country's only financial institution of global systemic importance, raised over €1B in asset sales to help **bolster its balance sheet**. The cash generated **increased UniCredit's common equity Tier 1 ratio** (CET1 ratio), a key gauge of a bank's ability to withstand shock losses, by 0.20%. At the end of March the bank's transitional CET1 ratio was at 10.5%, uncomfortably close to the ECB's minimum guidance level of 10%. UniCredit's efforts to strengthen its financial position come amid increasing concerns over the stability of the Italian banking system ahead of the EU bank stress test results to be released at the end of July.
- German pharmaceuticals and chemicals group **Bayer sweetened its takeover offer for U.S. rival Monsanto** to \$65B. The combination would create the world's biggest supplier of agricultural chemicals and seeds. Monsanto's board of directors is in the process of considering the new bid after rejecting Bayer's original \$62B approach in May.

We've seen low valuations before, but the large discount to the price index is fairly new



Source - RBC Wealth Management, Bloomberg; daily data series through 7/15/16

Asia Pacific

Jay Roberts – Hong Kong

- **Asian equities were strong** during the week. The **MSCI AC Asia Pacific Index closed just below its high** for the year and is now slightly positive in 2016.
- The **standout** performer was **Japan**. The TOPIX rose by 8.9%, the **biggest weekly gain since 2009**. Even after the rally, the valuation of the index remains low at 1.13x book value. The sizeable fall in the yen, reversing months of strength, contributed. The **yen declined by over 5%** against the dollar to USDJPY105.8, the **biggest weekly decline since 1999**. A key driver of these moves is an **expectation of fiscal stimulus** via a supplementary budget after an impressive election victory by Prime Minister Shinzo Abe's Liberal Democratic Party for the Upper House of the Japanese Diet.
- **Chinese economic data for Q2 2016** was broadly as expected. The **official growth figure of 6.7%** was a **touch higher than expected**. Retail sales showed strength. Growth in **fixed asset investment (FAI)**, still a large part of the economy, was **lower than forecast** at 9.0% (forecast: 9.4%). However, FAI has been very much supported by a large increase in government spending. Both **private and manufacturing FAI** actually **declined slightly** in June year over year, an **unusual development** that shows the Chinese economy is still not firing on all cylinders.
- However, the **most important takeaway** is that the **Chinese economy has steadied**. The pace of deceleration is slowing. Additionally, **capital outflows** from China, which were a concern at the start of the year, have **largely abated**. See page 4 in last week's *Global Insight Weekly*.
- **Line Corp** (LN), the Japanese social networking company that is owned by a South Korean company, Naver, became the **largest U.S. IPO of 2016**. Line, which also operates in several other Asian markets, **raised over \$1B** in the U.S. and also listed in Japan. The stock rallied strongly on its first day of trading in both markets.

MARKET SCORECARD

Data as of July 15, 2016

Equities (local currency)	Level	1 week	MTD	YTD	12 mos
S&P 500	2,161.74	1.5%	3.0%	5.8%	2.6%
Dow Industrials (DJIA)	18,516.55	2.0%	3.3%	6.3%	2.6%
NASDAQ	5,029.59	1.5%	3.9%	0.4%	-1.4%
Russell 2000	1,205.31	2.4%	4.6%	6.1%	-4.7%
S&P/TSX Comp	14,482.42	1.6%	3.0%	11.3%	-1.2%
FTSE All-Share	3,606.72	1.6%	2.6%	4.7%	-1.9%
STOXX Europe 600	337.92	3.2%	2.4%	-7.6%	-15.5%
German DAX	10,066.90	4.5%	4.0%	-6.3%	-12.8%
Hang Seng	21,659.25	5.3%	4.2%	-1.2%	-13.6%
Shanghai Comp	3,054.30	2.2%	4.3%	-13.7%	-19.7%
Nikkei 225	16,497.85	9.2%	5.9%	-13.3%	-17.8%
India Sensex	27,836.50	2.6%	3.1%	6.6%	-1.3%
Singapore Straits Times	2,925.35	2.8%	3.0%	1.5%	-12.4%
Brazil Ibovespa	55,578.24	4.6%	7.9%	28.2%	5.1%
Mexican Bolsa IPC	46,713.43	2.1%	1.6%	8.7%	3.6%

Commodities (USD)	Price	1 week	MTD	YTD	12 mos
Gold (spot $/oz)	1,336.03	-2.2%	1.0%	25.9%	16.2%
Silver (spot $/oz)	20.16	-0.6%	7.7%	45.4%	33.5%
Copper ($/metric ton)	4,922.00	4.8%	1.7%	4.6%	-10.6%
Oil (WTI spot/bbl)	45.95	1.2%	-4.9%	24.1%	-10.6%
Oil (Brent spot/bbl)	47.59	1.8%	-4.2%	27.7%	-16.6%
Natural Gas ($/mmBtu)	2.75	-1.7%	-5.9%	17.8%	-5.7%
Agriculture Index	305.76	1.8%	-1.5%	7.8%	-3.8%

Govt bonds (bps chg)	Yield	1 week	MTD	YTD	12 mos
U.S. 2-Yr Tsy	0.678%	7.3	9.6	-37.0	5.3
U.S. 10-Yr Tsy	1.556%	19.8	8.6	-71.3	-79.6
Canada 2-Yr	0.572%	10.6	5.4	9.1	17.1
Canada 10-Yr	1.085%	12.4	2.4	-30.9	-50.7
U.K. 2-Yr	0.166%	4.3	6.7	-48.5	-45.3
U.K. 10-Yr	0.834%	9.9	-3.3	-112.6	-128.2
Germany 2-Yr	-0.652%	4.2	0.9	-30.7	-42.0
Germany 10-Yr	0.006%	19.5	13.6	-62.3	-82.2

Currencies	Rate	1 week	MTD	YTD	12 mos
U.S. Dollar Index	96.61	0.3%	0.5%	-2.0%	-0.6%
CAD/USD	0.77	0.6%	-0.3%	6.7%	-0.4%
USD/CAD	1.30	-0.6%	0.3%	-6.3%	0.4%
EUR/USD	1.10	-0.1%	-0.6%	1.7%	0.9%
GBP/USD	1.32	1.8%	-0.9%	-10.5%	-15.6%
AUD/USD	0.76	0.1%	1.7%	4.0%	2.7%
USD/CHF	0.98	-0.2%	0.6%	-2.0%	3.1%
USD/JPY	104.79	4.2%	1.5%	-12.8%	-15.3%
EUR/JPY	115.74	4.2%	1.0%	-11.4%	-14.6%
EUR/GBP	0.84	-1.8%	0.3%	13.6%	19.6%
EUR/CHF	1.08	-0.2%	0.0%	-0.4%	4.0%
USD/SGD	1.35	0.3%	0.2%	-4.9%	-1.2%
USD/CNY	6.69	0.0%	0.7%	3.1%	7.8%
USD/BRL	3.28	-0.6%	2.1%	-17.2%	4.5%

Source - Bloomberg. Note: Equity returns do not include dividends, except for the German DAX. Bond yields in local currencies. Copper and Agriculture Index data as of Thursday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing. Data as of 8:35 pm GMT 7/15/16.

Examples of how to interpret currency data: CAD/USD 0.77 means 1 Canadian dollar will buy 0.77 U.S. dollar. CAD/USD 6.7% return means the Canadian dollar rose 6.7% vs. the U.S. dollar year to date. USD/JPY 104.79 means 1 U.S. dollar will buy 104.79 yen. USD/JPY -12.8% return means the U.S. dollar fell 12.8% vs the yen year to date.

UPCOMING EVENTS

100 S&P 500 companies are scheduled to report earnings during the week of July 17.

Sun, Jul 17
China Property Prices

Mon, Jul 18
U.S. NAHB Housing Market Index

Tue, Jul 19
Eurozone ECB Bank Lending Survey
Eurozone ZEW Surveys
U.K. CPI (0.4% y/y, 1.3% core)
U.K. RPI (0.2% m/m, 1.4% y/y)
U.S. Housing Starts (1.17M)

Wed, Jul 20
China Swift Global Payments
Eurozone Consumer Confidence
U.K. Unemployment (5.0%)
U.K. Employment Change (75K)

Thu, Jul 21
Japan Nikkei Manuf. PMI
ECB Meeting
U.K. Public Sector Net Borrowing
U.K. Retail Sales ex-Fuel (4.9% y/y)

Thu, Jul 21, cont.
U.S. Chicago Fed Nat'l Activity
U.S. Existing-Home Sales (5.47M)
U.S. Leading Index (0.2% m/m)

Fri, Jul 22
Eurozone Markit Manuf. PMI
Eurozone Markit Services PMI
Eurozone Markit Composite PMI
Germany Markit Manuf. PMI
U.S. Markit Manuf. PMI (51.5)

Fri, Jul 22, cont.
Canada CPI

Sun, Jul 24
Japan Trade Balance
Japan Exports
Japan Imports

Wed, Jul 27
Fed Meeting

Fri, Jul 29
BoJ Meeting

The dates reflect North American time zones. All data reflect Bloomberg consensus forecasts where available.

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As of June 30, 2016

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Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	878	50.51	246	28.02
Hold [Sector Perform]	741	42.64	129	17.41
Sell [Underperform]	119	6.85	10	8.40

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