

Global Insight

Weekly

Lopsided leadership

Kelly Bogdanova – San Francisco

It's been a heady run for U.S. stocks off the bottom, yet at the same time the rally has had a distinct lack of diversity. This narrowness doesn't negate the move, and if the bottoming process is for real we should see more inclusive participation in the months ahead. What does this mean for diversified portfolios?

The powerful S&P 500 rally since the Mar. 23 low doesn't necessarily match what's going on inside diversified equity portfolios.

That's because a narrow group of stocks in a narrow group of sectors has been carrying the market, representing a meaningful share of the index's gains.

The five largest stocks in the S&P 500 by market value—known as FAAMG—have done the heavy lifting and are the top contributors to the gains: Facebook, Apple, Amazon, Microsoft, and Alphabet (Google). Another 18 stocks have provided outsized returns as well.

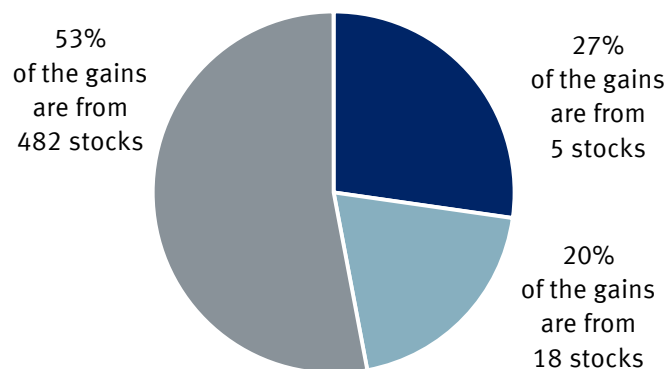
We think the mismatch in performance between many diversified equity portfolios and these stocks that have contributed the most to the S&P 500's gains will sort itself out over time, as the market works through its bottoming and recovery processes, to the benefit of diversified portfolios.

The lion's share

As the S&P 500 has advanced 27.5 percent since the Mar. 23 low, a sizeable 27 percent of that gain comes from just the five FAAMG stocks, all of which play major roles in driving the technology ecosystem. (FAAMG acronym aside, the order of their contribution to S&P 500 gains is Google first, Apple second, and then Microsoft, Amazon, and Facebook, respectively.)

These five stocks represent almost 21 percent of the S&P 500's market capitalization, so in delivering 27 percent of the index's price return, they are punching above their weight.

A small group of stocks has powered the S&P 500 higher
Percentage contribution to S&P 500 gains since the low on Mar. 23, 2020



Note: The 5 stocks in dark blue are GOOG (both share classes), AAPL, MSFT, AMZN, FB. The 18 stocks in light blue are JNJ, UNH, PYPL, CVX, V, HD, NVDA, MA, ABT, PFE, XOM, ABBV, LOW, BMY, NKE, LLY, PG, PEP. The S&P 500 currently includes 505 stocks.

Source - RBC Wealth Management, Bloomberg; data through 5/13/20

Market pulse

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Click [here](#) for authors' contact information. Priced (in USD) as of 5/14/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see [page 6](#).**

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Wealth
Management

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Another 18 stocks represent another big chunk of the S&P 500's gains. This list includes a more diverse group. Five of the 11 sectors are represented: Health Care, Technology, Consumer Discretionary, Energy, and Consumer Staples. (The stocks' ticker symbols are listed below the page 1 chart.)

These 18 stocks are punching even more above their weight as they collectively represent about 15 percent of the S&P 500's market capitalization and have delivered 20 percent of the gains since Mar. 23.

The other 482 stocks that have been included in the S&P 500 in the past couple months represent the other 53 percent of the gains that have occurred since the low.

Correlation quirks

The narrowness of the rally doesn't negate the move. Following a bear market low, it is not unusual for a relatively small group of stocks to lead the S&P 500 out of the fire, although it can be unnerving when comparing the returns of a diversified equity portfolio.

Typically, broader participation from a wide range of stocks and sectors doesn't materialize until the rally becomes more accepted, entrenched, and seasoned. And that process usually transpires as the economy gains strength and stability.

But certain aspects of this initial rally off the bear market low are unusual. Not only have the five biggest stocks helped power the market higher, they represent a greater share of S&P 500 market capitalization (dollar market value) than usual, and have become more correlated with one another.

For example, with the FAAMG stocks representing almost 21 percent of the S&P 500's market capitalization, they are a larger part of the index than the top five largest stocks during the tech bubble in March 2000, another period of market concentration. Back then Microsoft, Cisco Systems, General Electric, Intel, and Exxon Mobil made up 18.2 percent of the S&P 500, according to Bloomberg Intelligence.

While a nearly three percentage point difference in market capitalization between then and now may not seem like a lot at first blush, we think it's meaningful considering these are only five stocks in an index of roughly 500 stocks.

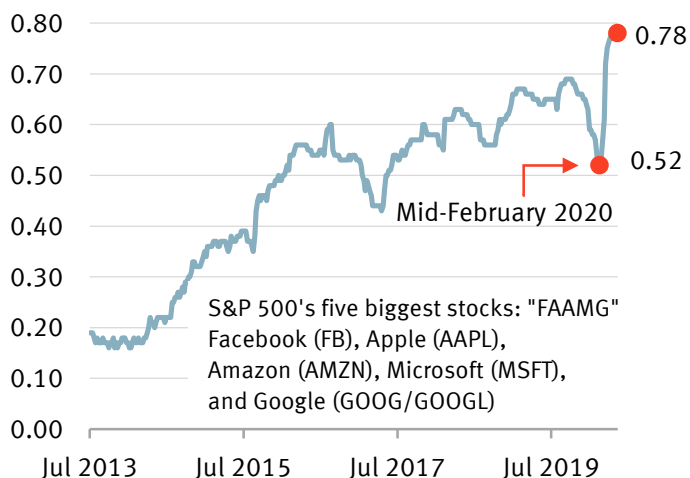
Furthermore, and perhaps even more troubling, the correlation between the FAAMG stocks has spiked recently.

Back in 2013 these stocks were not very correlated with one another, meaning they didn't often trade in lockstep. Their pairwise correlation was +0.2—a positive correlation, but a rather weak one (+1.0 is a perfect positive correlation; -1.0 is a perfect negative correlation).

When the market peaked in mid-February, the FAAMG correlation was 0.52. But since then, during the correction and

The correlation between the five biggest S&P 500 stocks has surged since mid-February

"FAAMG" average rolling 1-year pairwise correlation



Source - Bloomberg Intelligence, RBC Wealth Management; data through 5/11/20

the rally that followed, the correlation has jumped to 0.78, as shown in the chart. This means these stocks have been often trading in tandem, moving higher and lower together, providing little diversification.

Disciplined diversification

We think that mismatches in performance between diversified portfolios and the largest contributors in the S&P 500—FAAMG and the other 18 stocks—will largely sort themselves out over the medium and long term.

Diversified equity portfolios aren't lopsided in their allocations, as they include a number of individual equity positions and/or funds across a wide range of sectors, capitalizations, and markets with different risk parameters and correlations. We continue to believe this is the most prudent way to manage equity portfolio risk over the long term, as it tends to lower volatility and reduces the likelihood that any one stock or a small group of stocks (or any one subsector) can severely damage overall equity portfolio returns.

As the market continues to work through its COVID-19 bottoming process—which could include more downside volatility like we've seen in recent sessions—and then eventually turns higher on a sustainable basis, we think the rally will broaden out beyond FAAMG and the other 18 stocks that have been driving the move recently. This should ultimately benefit diversified equity portfolios.



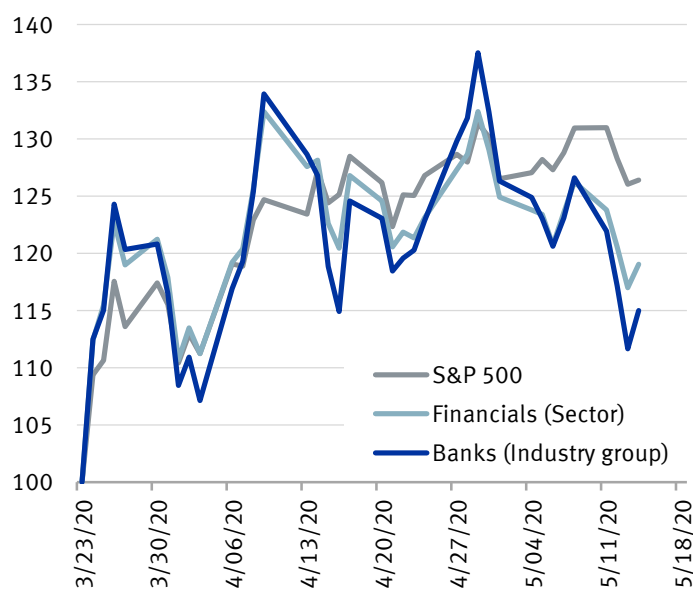
United States

Alan Robinson – Seattle

- **Stocks hit an air pocket during the week** on a combination of poor economic data, harsh trade rhetoric, and warnings about the limits of policy tools by Federal Reserve Chair Jerome Powell.
- In a speech at the Peterson Institute for International Economics in Washington, D.C., Powell said while the policy response has provided some relief, **additional policy measures may be needed**. He noted the Fed has “lending powers, not spending powers” and that additional fiscal support would be **costly, but worth it** to avoid long-term damage. This was seen as a reminder to Congress of the urgency for additional rescue packages beyond the existing Coronavirus Aid, Relief, and Economic Security (CARES) Act. Powell also **closed the door on negative interest rates as a policy tool**, saying it is “not something we are looking at.”
- **Nearly 3 million Americans filed for unemployment during the week ending May 9**. While this weekly data remained elevated, it continued its weekly decline from the high of nearly 7 million at the end of March. But a closer look at the details reveals **a major difference compared to previous recessions**. During the last recession, large firms

Increasing credit concerns starting to impact bank stocks

Relative performance since market low on Mar. 23



Source - RBC Wealth Management, Thomson Reuters; normalized with 3/23/20 values = 100; data as of 14:30ET 5/14/20

let go of 8.1% of their workers and small businesses 6.9% of theirs. In April 2020, large firms fared relatively better, laying off 13.6% vs. 17.8% for small businesses, as social distancing disproportionately impacted smaller firms. This may help explain the disconnect between a clearly souring economy and a relatively resilient stock market dominated by larger companies.

- **The U.S. bank sector was hit particularly hard during the week as concerns grew over growing credit strains**. Bank customers are increasingly requesting forbearance on their debt payments to weather the COVID-19 shutdown. Additionally, while most banks have suspended share buybacks, many also face **pressure to suspend their dividends**. In response to Senate questions, Fed Governor Randal Quarles said the Fed could limit banks' ability to pay dividends by mandating bigger capital cushions. As bank stocks are closely correlated to the value of their assets, we expect banks with relatively stable book values to perform better than their peers during this recession.



Canada

Richard Tan, CFA – Toronto

- While the **S&P/TSX Composite** remains in negative territory on the year, the index has **pushed about 30% higher since its Mar. 23 lows**, recovering a significant portion of its losses. **Financials and Energy**, the two largest sectors in Canada, continue to **trail the index** year to date, driven by rising credit concerns and persistently low oil prices. The Consumer Staples, Utilities, and Materials sectors, on the other hand, have held their own during this pandemic as investors attempt to shore up some defense in their portfolios via regulated businesses and exposure to precious metals. **Information Technology**, which has grown to about 9% of the Canadian market, has proven to be **surprisingly resilient** in the midst of recession. The sector has gained about 40% year to date as its largest constituent has benefited from retailers' accelerated adoption of e-commerce services in the face of dramatically lower foot traffic.
- The **Canadian banks** will report Q2 2020 results the week of May 25. **RBC Capital Markets believes earnings, on average, will come in about 82% below Q2 2019 numbers** due to a significant uptick in credit provisions. While RBC Capital Markets concedes there are a lot of moving parts in the current environment, capital levels are not projected to fall below levels that might induce discrete equity issuance. In our view, the **upcoming earnings will be a vital data point** to assess the strength of the Canadian banks and the outlook for the economy.



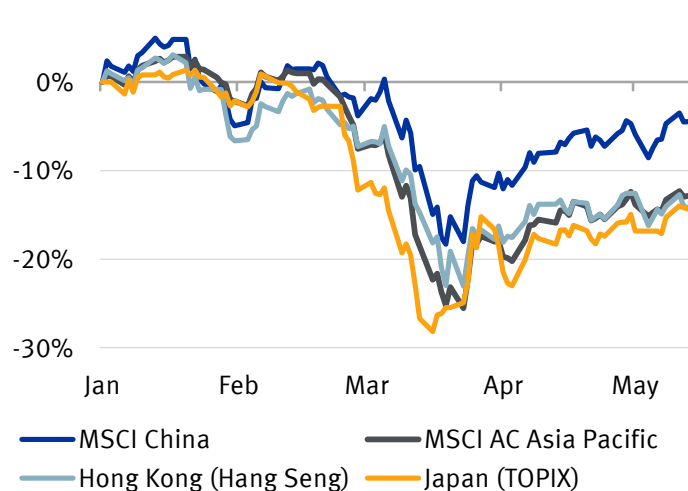
Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **European and UK financial markets adopted a risk-off tone**, with the STOXX Europe 600 ex UK and the FTSE All-Share indexes giving up some recent gains as the difficult economic outlook preoccupied investors. **UK 10-year Gilt reached a two-month low** of 0.2%.
- Monetary and fiscal authorities acknowledged that economies needed more support. In a televised interview, **Bank of England Governor Andrew Bailey said it was “pretty clear” that financial markets expected a further expansion of quantitative easing (QE)**, and the Monetary Policy Committee members who recently voted for an immediate increase in QE held “perfectly reasonable” views. The UK government’s signature job retention measure, the furlough scheme that subsidizes 80% of employees’ salaries up to £2,500 per month, is to be extended until the end of July. With this scheme, taxpayers are in effect paying the wages of up to a fifth of the country’s workforce.
- In equity markets, **Vodafone jumped almost 9%** on May 12 after reporting service revenue growth ahead of consensus expectations as well as maintaining its dividend; the latter appeared to have been taken well by investors, given broad-based cuts elsewhere across the UK and European markets.
- UK investments and savings platform **Hargreaves Lansdown was the top-performing stock in the STOXX Europe 600 Index** over the past week, up over 19%, helped by reporting net new business inflows and revenues significantly higher

Asian equities rebound but remain well below year-end 2019 levels as second wave risk rises

Year-to-date performance



Source - RBC Wealth Management, FactSet; data through 5/13/20

than anticipated by consensus; the latter benefitted from **significantly higher stock brokerage revenues year over year**, driven by record dealing activity across March and April amid the heightened market volatility.

- At the opposite end of the leaderboard was **ArcelorMittal**, the world’s largest steelmaker, which **fell almost 30%** during the week as the company **announced it would raise \$2 billion in capital** via the issuance of equity and convertible notes.



Asia Pacific

Jasmine Duan – Hong Kong & Nicholas Gwee, CFA – Singapore

- **Asia-Pacific equity markets traded mostly lower for the week as investors became increasingly concerned about the risk of a second wave of COVID-19 infections.** South Korea, one of the most successful countries in containing the virus, reported a spike in the number of new infections, with a new cluster centered in a handful of nightclubs in Seoul. Over in China, Wuhan reported its first cluster of infections since a lockdown on the city was lifted a month ago. According to Reuters, authorities are planning to conduct city-wide nucleic acid tests for the infection. A few northern Chinese cities also announced partial lockdowns following a rise in daily new cases. Hong Kong reported two new locally transmitted cases for the first time in three weeks.
- In its quarterly monetary policy report, **the People’s Bank of China (PBoC) pledged “more powerful” policies** to counter the economic hit China is taking, with more focus on growth and jobs. The PBoC reiterated that prudent monetary policy will be more flexible and appropriate, and it will keep liquidity at a reasonable level. We believe the remarks reflect the PBoC’s growing concern over the unprecedented economic downturn and the risk of a second quarter of contraction.
- **India is planning to spend 10% of GDP to help jumpstart its locked-down economy.** The 20 trillion rupee (US\$265 billion) stimulus package includes 3 trillion rupees of unsecured loans to small businesses and 900 billion rupees of cash to power distributors. The government will also cut taxes for services providers. Economists, however, cautioned that the boost to India’s GDP may be limited given the sharp contraction of economic activity seen during the lockdown.
- **Tencent Holdings’ (700 HK) Q1 results exceeded market expectations.** Mobile gaming revenue posted a strong beat, up 64% y/y, benefiting from more online play due to the COVID-19 lockdowns. Management expects a gradual normalization for mobile games and advertising revenue as a resumption of work leads to less time being spent online.



MARKET SCORECARD

Data as of May 14, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,852.50	-2.1%	-11.7%	0.6%	4.5%
Dow Industrials (DJIA)	23,625.34	-3.0%	-17.2%	-7.5%	-5.1%
NASDAQ	8,943.72	0.6%	-0.3%	15.6%	20.7%
Russell 2000	1,237.56	-5.6%	-25.8%	-19.8%	-22.7%
S&P/TSX Comp	14,509.66	-1.8%	-15.0%	-10.9%	-9.8%
FTSE All-Share	3,153.15	-3.4%	-24.9%	-20.6%	-25.6%
STOXX Europe 600	326.71	-3.9%	-21.4%	-13.2%	-16.7%
EURO STOXX 50	2,760.23	-5.7%	-26.3%	-18.0%	-22.6%
Hang Seng	23,829.74	-3.3%	-15.5%	-15.3%	-24.4%
Shanghai Comp	2,870.34	0.4%	-5.9%	-0.5%	-9.6%
Nikkei 225	19,914.78	-1.4%	-15.8%	-5.5%	-12.9%
India Sensex	31,122.89	-7.7%	-24.6%	-16.6%	-12.5%
Singapore Straits Times	2,522.31	-3.9%	-21.7%	-21.8%	-29.2%
Brazil Ibovespa	79,010.80	-1.9%	-31.7%	-14.2%	-7.3%
Mexican Bolsa IPC	36,094.14	-1.0%	-17.1%	-16.9%	-22.4%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	1,731.74	2.7%	14.1%	33.5%	31.8%
Silver (spot \$/oz)	15.87	6.0%	-11.1%	7.4%	-3.9%
Copper (\$/metric ton)	5,190.90	0.6%	-15.6%	-13.4%	-24.3%
Oil (WTI spot/bbl)	27.56	46.3%	-54.9%	-55.4%	-61.2%
Oil (Brent spot/bbl)	31.26	23.7%	-52.6%	-56.1%	-60.0%
Natural Gas (\$/mmBtu)	1.67	-14.3%	-23.7%	-37.2%	-41.2%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.619%	-2.1	-129.9	-179.2	-238.4
Canada 10-Yr	0.528%	-1.9	-117.4	-116.3	-189.7
U.K. 10-Yr	0.204%	-2.7	-61.8	-90.1	-126.7
Germany 10-Yr	-0.543%	4.3	-35.8	-47.3	-115.4

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.35%	-0.3%	4.7%	10.0%	16.5%
U.S. Invest Grade Corp	2.75%	-1.1%	0.3%	8.5%	15.9%
U.S. High Yield Corp	7.96%	0.6%	-8.2%	-2.8%	2.7%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	100.3340	1.3%	4.1%	2.9%	8.4%
CAD/USD	0.7119	-0.7%	-7.5%	-4.2%	-8.8%
USD/CAD	1.4045	0.7%	8.1%	4.3%	9.6%
EUR/USD	1.0801	-1.4%	-3.7%	-3.6%	-9.4%
GBP/USD	1.2226	-2.9%	-7.8%	-5.3%	-9.8%
AUD/USD	0.6457	-0.8%	-8.0%	-7.0%	-14.2%
USD/JPY	107.3000	0.1%	-1.2%	-2.1%	-2.2%
EUR/JPY	115.9000	-1.3%	-4.8%	-5.6%	-11.4%
EUR/GBP	0.8834	1.6%	4.4%	1.8%	0.4%
EUR/CHF	1.0514	-0.6%	-3.1%	-7.0%	-11.9%
USD/SGD	1.4235	1.0%	5.8%	4.0%	6.6%
USD/CNY	7.0957	0.5%	1.9%	3.2%	11.9%
USD/MXN	23.8634	-1.3%	26.1%	24.6%	21.6%
USD/BRL	5.8137	6.0%	44.2%	53.9%	60.4%

Source - Bloomberg. Note: Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday'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 9:35 pm GMT 5/14/20.

Examples of how to interpret currency data: CAD/USD 0.71 means 1 Canadian dollar will buy 0.71 U.S. dollar. CAD/USD -7.5% return means the Canadian dollar fell 7.5% vs. the U.S. dollar year to date. USD/JPY 107.30 means 1 U.S. dollar will buy 107.30 yen. USD/JPY -1.2% return means the U.S. dollar fell 1.2% vs. the yen year to date.

Authors

Kelly Bogdanova – San Francisco, United States

kelly.bogdanova@rbc.com; RBC Capital Markets, LLC

Alan Robinson – Seattle, United States

alan.robinson@rbc.com; RBC Capital Markets, LLC

Richard Tan, CFA – Toronto, Canada

richard.tan@rbc.com; RBC Dominion Securities Inc.

Frédérique Carrier – London, United Kingdom

frederique.carrier@rbc.com; RBC Europe Limited

Thomas McGarrity, CFA – London, United Kingdom

thomas.mcgarritty@rbc.com; RBC Europe Limited

Jasmine Duan – Hong Kong, China

jasmine.duan@rbc.com; RBC Investment Services (Asia) Limited

Nicholas Gwee, CFA – Singapore

nicholas.gwee@rbc.com; Royal Bank of Canada, Singapore Branch

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			Count	Percent
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Hold [Sector Perform]	619	42.34	126	20.36
Sell [Underperform]	88	6.02	11	12.50

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