Investment Strategy Conference Call

June 2021

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Outlook

- U.S., Canada and developed economies have been “bridged” by fiscal spending but the ultimate stimulus will be full re-opening – as the most affected sectors come back to life, more people go back to work, and the return to normal further boosts confidence.
- Monetary policy-makers will “look through” inflation for now, keeping rates accommodative. Bank lending standards are easing. “Tight money” looks to be a long way down the road.
- Earnings estimates are being revised higher. Stocks will go up this year but not as fast as earnings.
- Risks – Virus curve balls, inflation, volatility around the transition from “supercharged” recovery/reopening growth to sustainable growth

From here…

- Equity investment attitudes in 2020 were mostly shaped by the pandemic and by scepticism that life and the economy would ever be the same. In our view, the COVID-19 economic damage will diminish greatly through 2021, while confidence will grow in a return to a recognisable social and business landscape.

- We believe the V-shaped recovery will give way to a possibly bumpier phase of growth. The current quarter should mark the peak growth rate.
  The U.S. and Canadian economies should regain their pre-pandemic high ground by late 2021, perhaps earlier. For Europe, the UK, and Japan, it will likely take a couple of quarters longer. China's economy has already recovered all the ground lost to the COVID-19 shutdown
  but looks to be slowing somewhat as monetary policy tightens.

- Earnings could surprise to the upside in 2021 and 2022 as sectors crippled by the pandemic come back to life, employment grows and becomes more secure, and consumers spend some of their huge savings pile. There is a lot of pent up demand for things and services people have had to do without – travel, dining out, etc.

- Investors may have paid in advance for some of that expected return to "normal." However, the tech-heavy S&P 500 is the only regional index well-above its February 2020 peak. All other major averages including the TSX are moderately above or below their pre-pandemic peaks.

- For 2021, equity prices should appreciate further, although not by as much as earnings advance, bringing P/Es modestly lower.

Monetary Policy

- Near Zero rates for this year and next, possibly longer.
- Tolerant of inflation. Fed would let it run hot for a while. But inflation unlikely to force the Fed to change course on rates for some time. Market thinks not before 2023. Tapering of asset purchases could begin early next year.
- Corporate bond yields and Treasury yields could move up from here, already have over the past several months. Bond yields still below where they were when the pandemic began.

U.S. economy decisively in "Early-to-Mid cycle" phase

U.S. business cycle scorecard

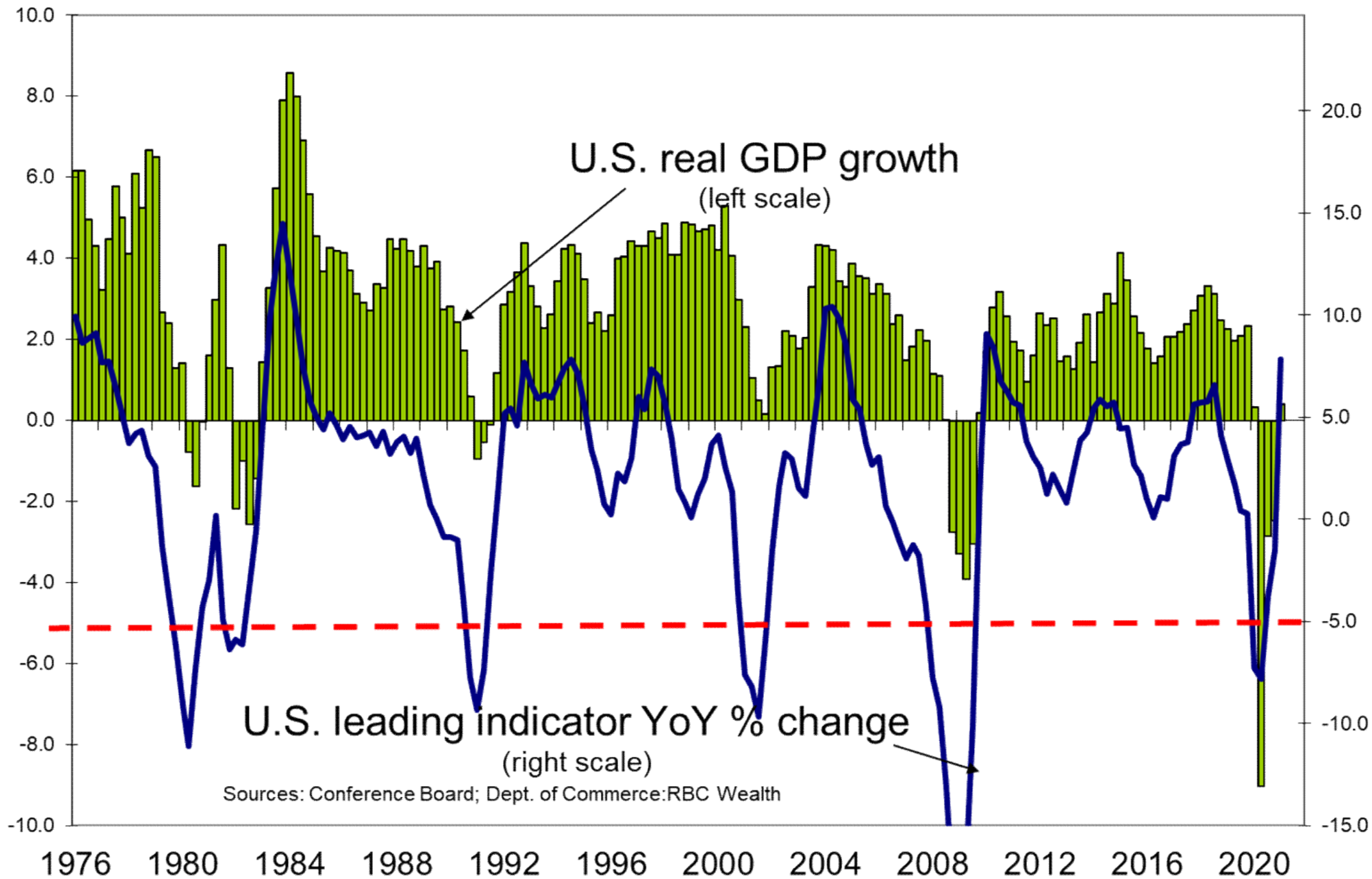
	Start of cycle	Early cycle	Mid cycle	Late cycle	End of cycle	Recession
Bonds						
Employment						
Corporate profitability						
Sentiment						
Credit						
Cycle age						
Leverage						
Inventories						
Monetary policy						
Consumer						
Economic trend						
Housing						
Business investment						
Volatility						
Economic slack						
Equities						
Prices						
Allocation to each stage of cycle	11%	54%	22%	8%	1%	4%

Note: As at 2021-04-29. Darkness of shading indicates the weight given to each input for each phase of the business cycle. Source: RBC GAM

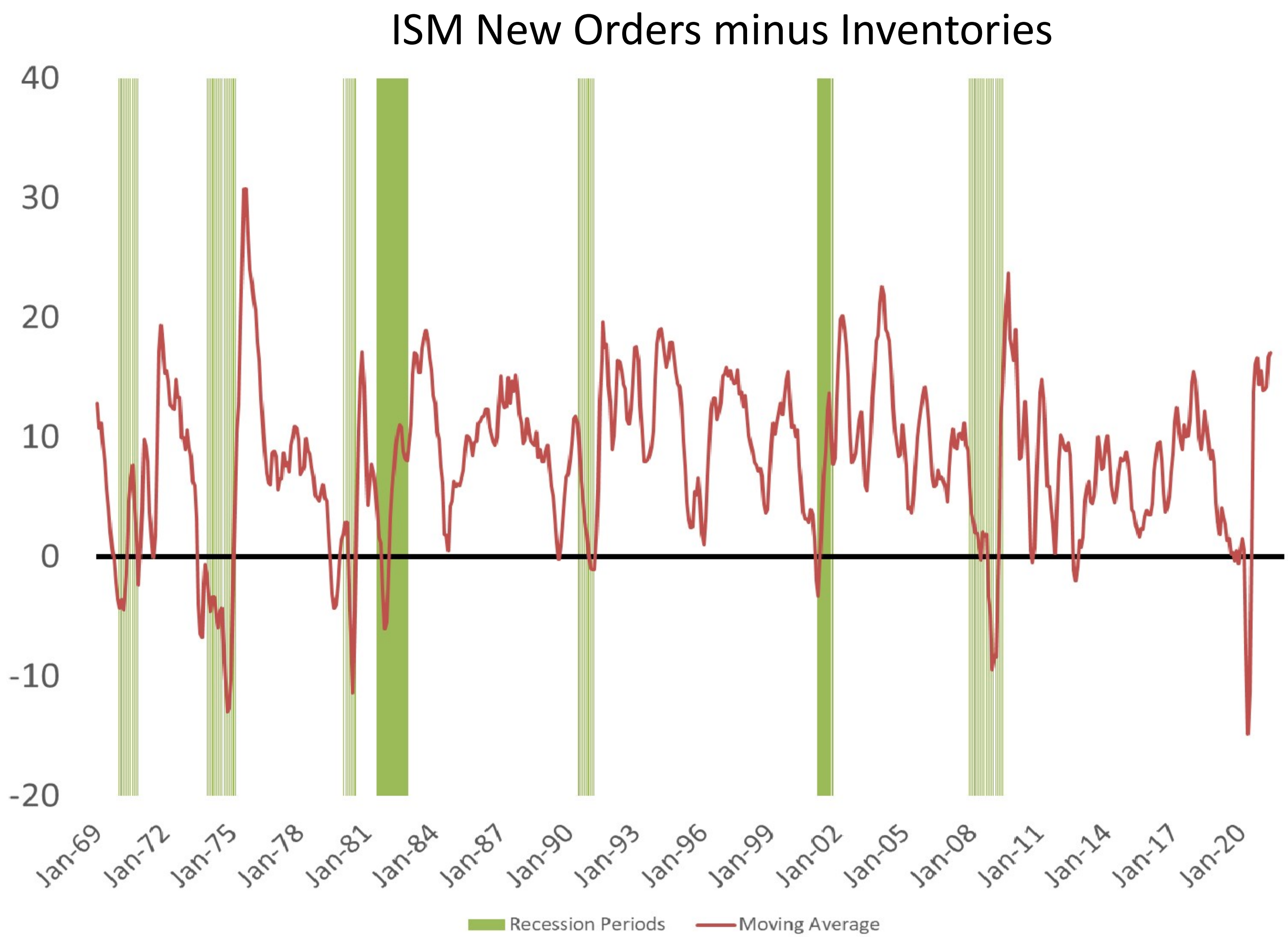
Leading Indicators pointing North

Recession Scorecard

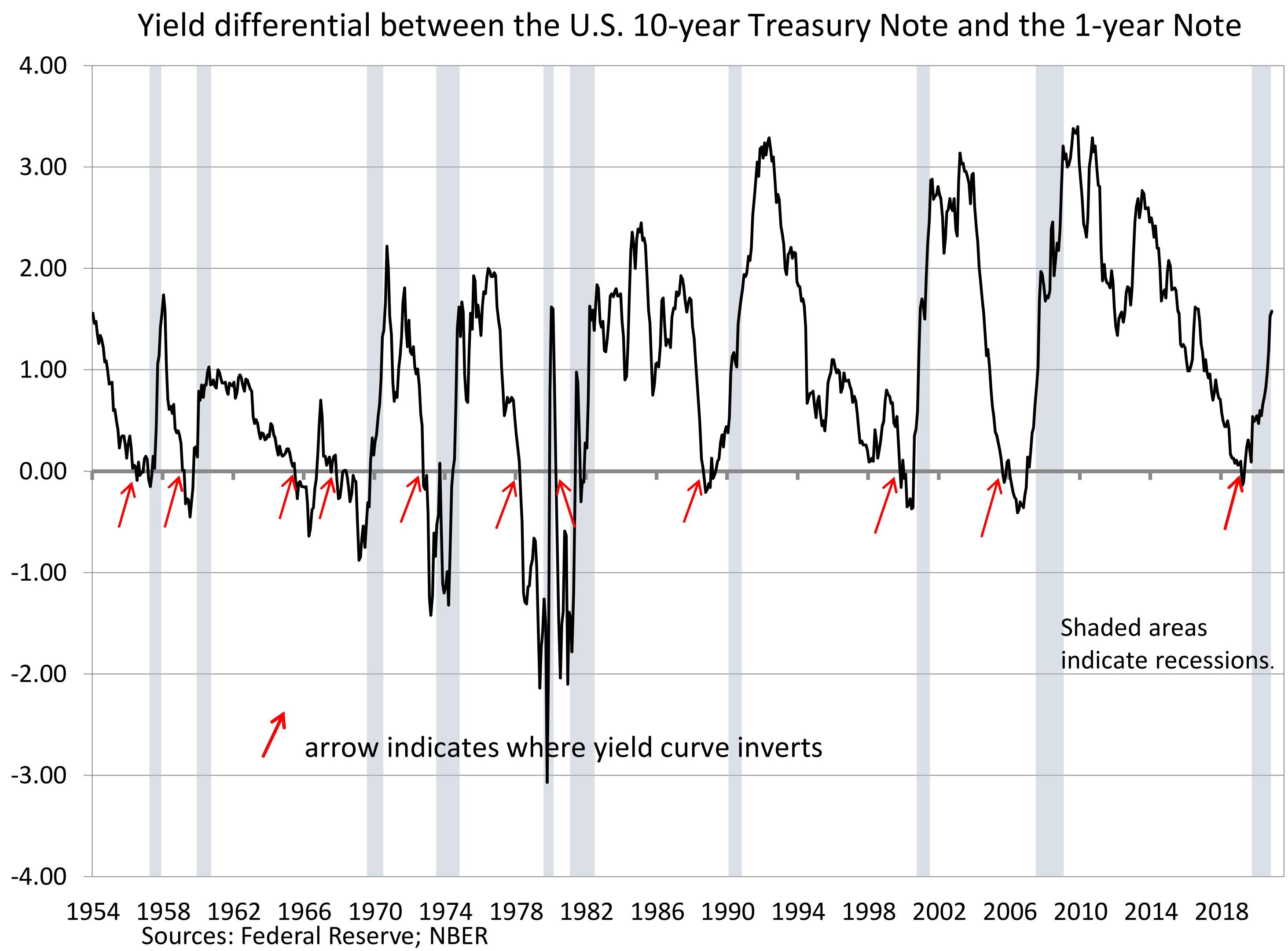
Indicator	Status		
	Positive	*Neutral*	*Negative*
Yield curve (10-year to 1-year Treasuries)	X		
Unemployment claims	X		
Unemployment rate	X		
Conference Board Leading Index	X		
ISM New Orders minus Inventories	X		
Fed funds rate vs. nominal GDP growth	X		



U.S. real GDP growth
(left scale)
U.S. leading indicator YoY % change
(right scale)
Sources: Conference Board; Dept. of Commerce:RBC Wealth
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
-8.0
-10.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
1976
1980
1984
1988
1992
1996
2000
2004
2008
2012
2016
2020



Sources: Institute for Supply Management; NBER

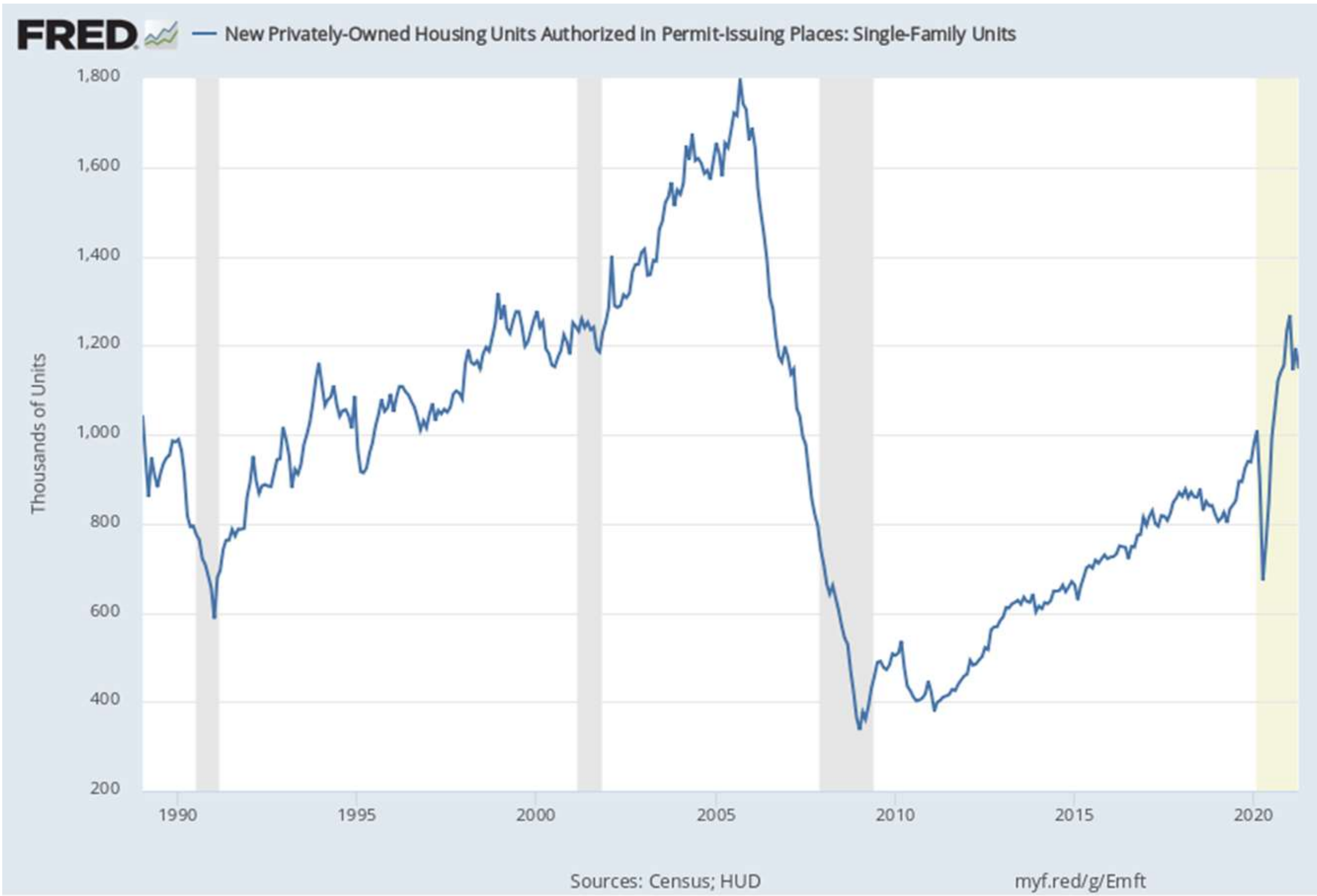

Yield differential between the U.S. 10-year Treasury Note and the 1-year Note
4.00
3.00
2.00
1.00
0.00
-1.00
-2.00
-3.00
-4.00
1954
1958
1962
1966
1970
1974
1978
1982
1986
1990
1994
1998
2002
2006
2010
2014
2018
Shaded areas indicate recessions.
arrow indicates where yield curve inverts
Sources: Federal Reserve; NBER

Month of yield curve inversion inverts	Month recession begins begins	Interval between
Dec-56	Sep-57	9
Sep-59	May-60	8
Apr-68	Jan-70	21
Mar-73	Dec-73	9
Sep-78	Jan-80	16
Sep-80	Jul-81	10
Feb-89	Jul-90	17
Apr-00	Mar-01	11
Jan-06	Dec-07	23
Aug-19	Mar-20	7
	average	11 months
	median	11 months

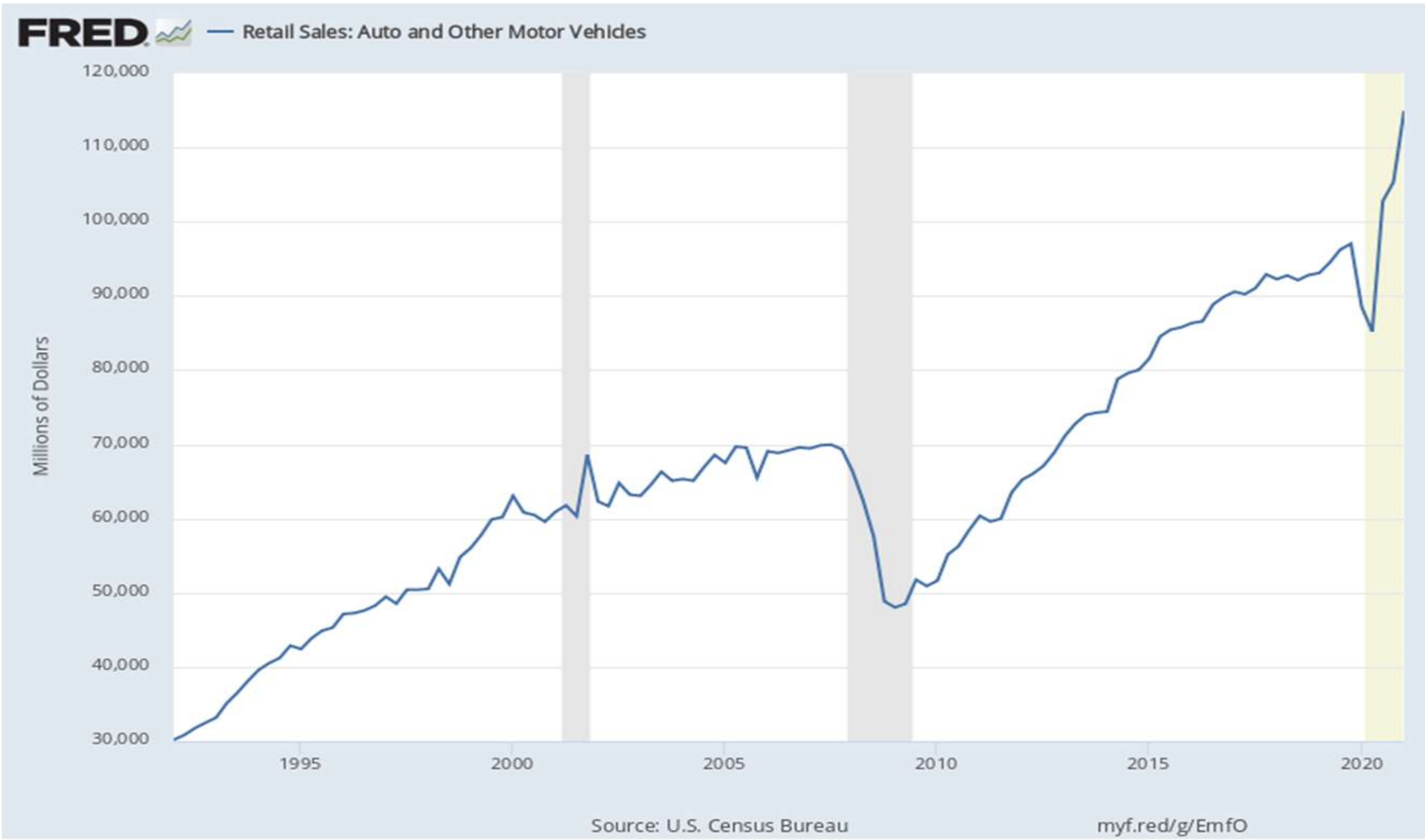
Source: Federal Reserve; NBER

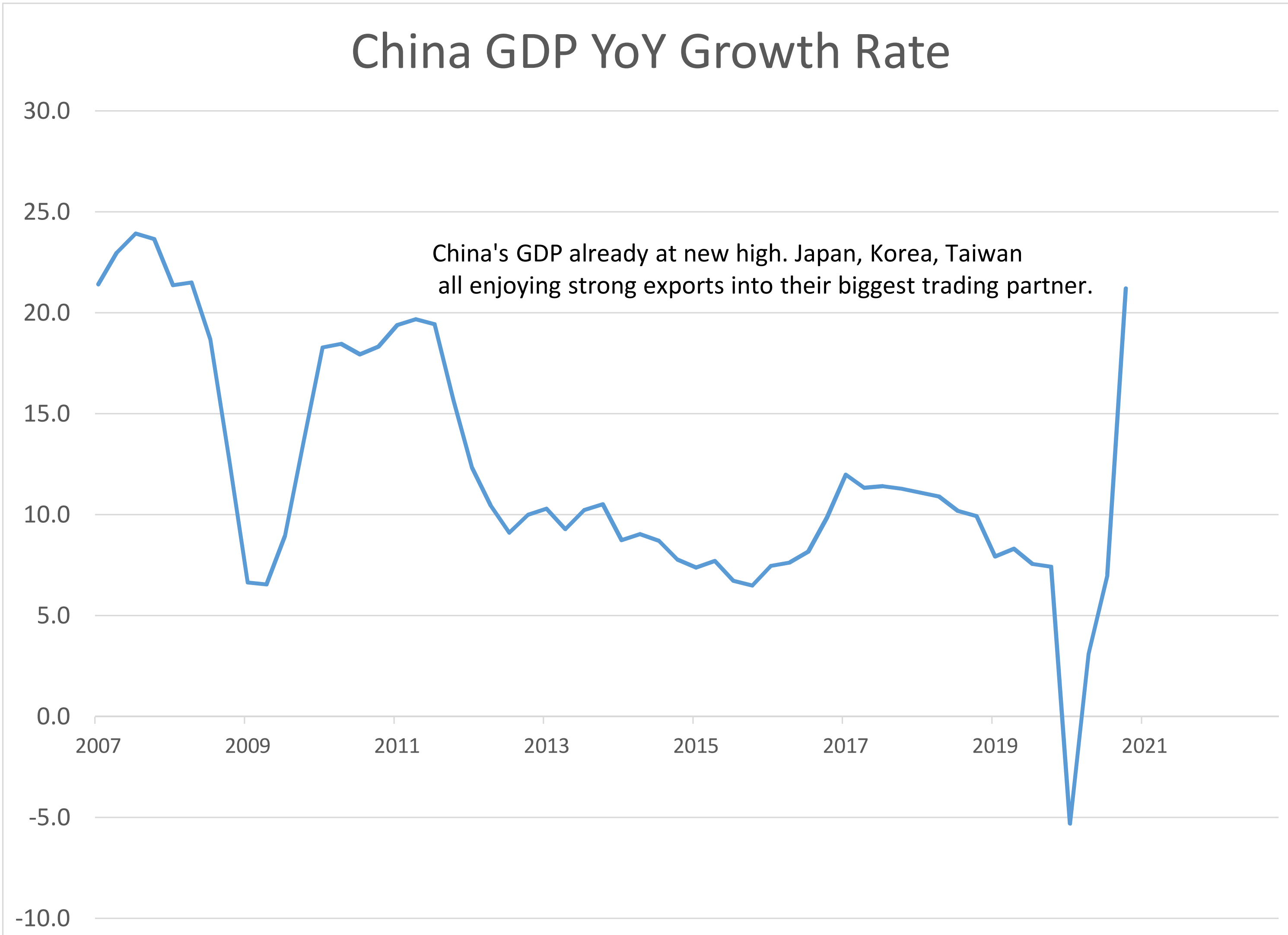
Hard Data Doing Likewise

Building permits for new single-family homes near a 14 year high.

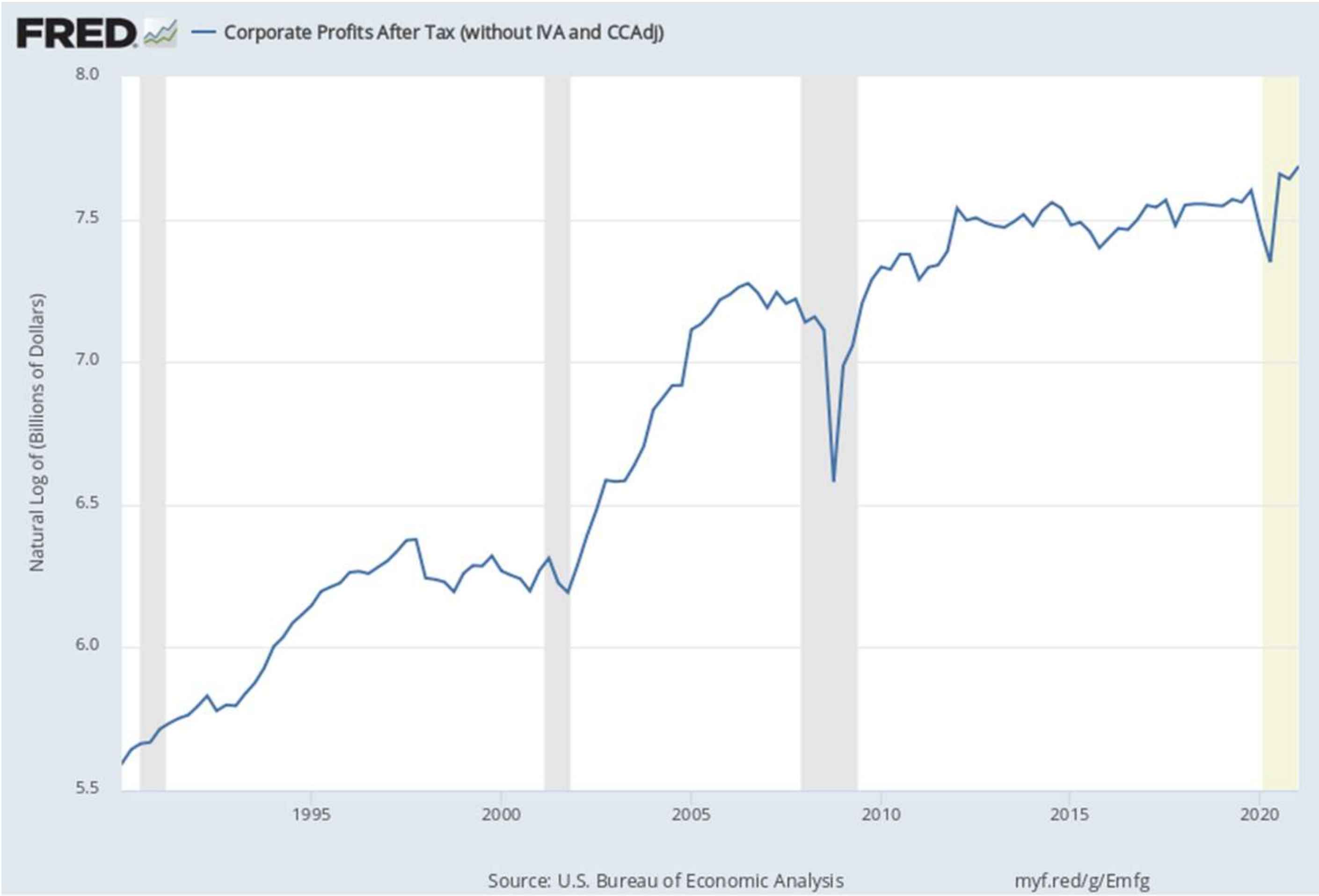


Auto sales booming




China GDP YoY Growth Rate
30.0
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
2007
2009
2011
2013
2015
2017
2019
2021
China's GDP already at new high. Japan, Korea, Taiwan
all enjoying strong exports into their biggest trading partner.

Corporate profits on a National Accounts basis already at new all-time highs…



…Usually a year or so ahead of S&P profits. Peak long before recession begins

No bear market in sight but corrections are another matter.

Since 1980, the S&P 500's average intra-year drop is 14.3%. That means about half the time it was something worse.

There are at least three risks (among many) that could induce unsettling volatility in equity markets. One is the course the pandemic takes from here. Recent months have provided a reminder that the virus remains capable of tossing nasty curve balls. New more challenging variants, vaccine production/delivery issues, vaccine hesitancy forestalling the arrival of herd immunity, the possibility the passage of time reveals some vaccine shortcomings – the road to convincingly vanquishing the pandemic could be, is likely to be, a bumpy one.

Another is inflation and the effect it can have on monetary policy and p/e multiples. We are encountering some larger-than-usual increases in consumer price indexes. In large part that is because of comparisons with a year ago when consumer prices were falling in April and May. In addition, gasoline prices have moved steadily higher. The Fed has made it clear it sees these inflation increases coming but expects them to be transitory, subsiding later in the year and further in 2022. However, the prices of many industrial commodities are also on the rise suggesting finished goods inflation is likely to be somewhat stronger in the coming 12 months. Agricultural commodity prices are also rising portending higher food prices down the road.

If these inflation increases look as if they are becoming persistent rather than transitory then investors will start to worry that Fed rate hikes could begin sooner that the late 2023 currently priced into debt markets. Inflation expectations are also an important component of the equity valuation equation – a dollar of earnings earned 10 years from now is worth approximately 13% less today than it otherwise would if inflation runs over that interval at 3% per annum rather than today's prevailing rate of 1.5%.

No bear market in sight but corrections are another matter cont'd

A third risk to the stock market is the coming downshift from "supercharged" recovery/reopening growth to sustainable growth. That is likely to begin in Q3. The quarter we are in now (Q2) is expected to mark the peak year-over-year growth rate for the cycle. On a calendar year basis our forecast for 2021 is 6.5% GDP growth for the U.S. with a more subdued but still above-average 4.0% expected in 2022. No one is forecasting 2023 growth except the Congressional Budget Office which has the U.S. economy settling back to much slower 1.5%-1.8% pace for the rest of the decade.

Any slowdown in the second half from the current very high growth rates will likely provoke debate/worries over whether "something worse" is happening putting the expansion at risk. That will be all the more likely if over the same period (as we expect) 10-year Treasury yields are moving up closer to 2%. This may be all the market needs to correct/consolidate after the almost 100% advance in the S&P 500 off the March 2020 panic low or the less spectacular 24% gain from the peak of the last cycle in February 2020.

That said, our track record at correctly calling the start of the next correction and, just as importantly, its end, is just as bad as everyone else's.

Valuations

Stock valuations are mixed – S&P at 22.5x is 5.5 multiples above its 30 year average. But the TSX, FTSE, Eurostoxx, and Japan's TOPIX are all only marginally above theirs. The S&P multiple has been driven higher by large cap tech (now correcting). But these stocks are also delivering the strongest sales and earnings growth. The 5 largest S&P 500 constituents comprise about 22% of market value. At the Dot.Com peak in 2000 the tech sector alone was nearly 50% of the market. In 1980 the five largest US oil companies were almost 50% of the S&P.

There is a lot of "bubble" talk but bubbles can inflate for a long time, especially when, as now, earnings estimates are rising, offsetting worries about higher inflation and bond yields.

Earnings estimates are in flux

Laurie Calvasina, who was at $177, has raised her S&P 500 2021 estimate to $187 and her 2022 estimate to $200.

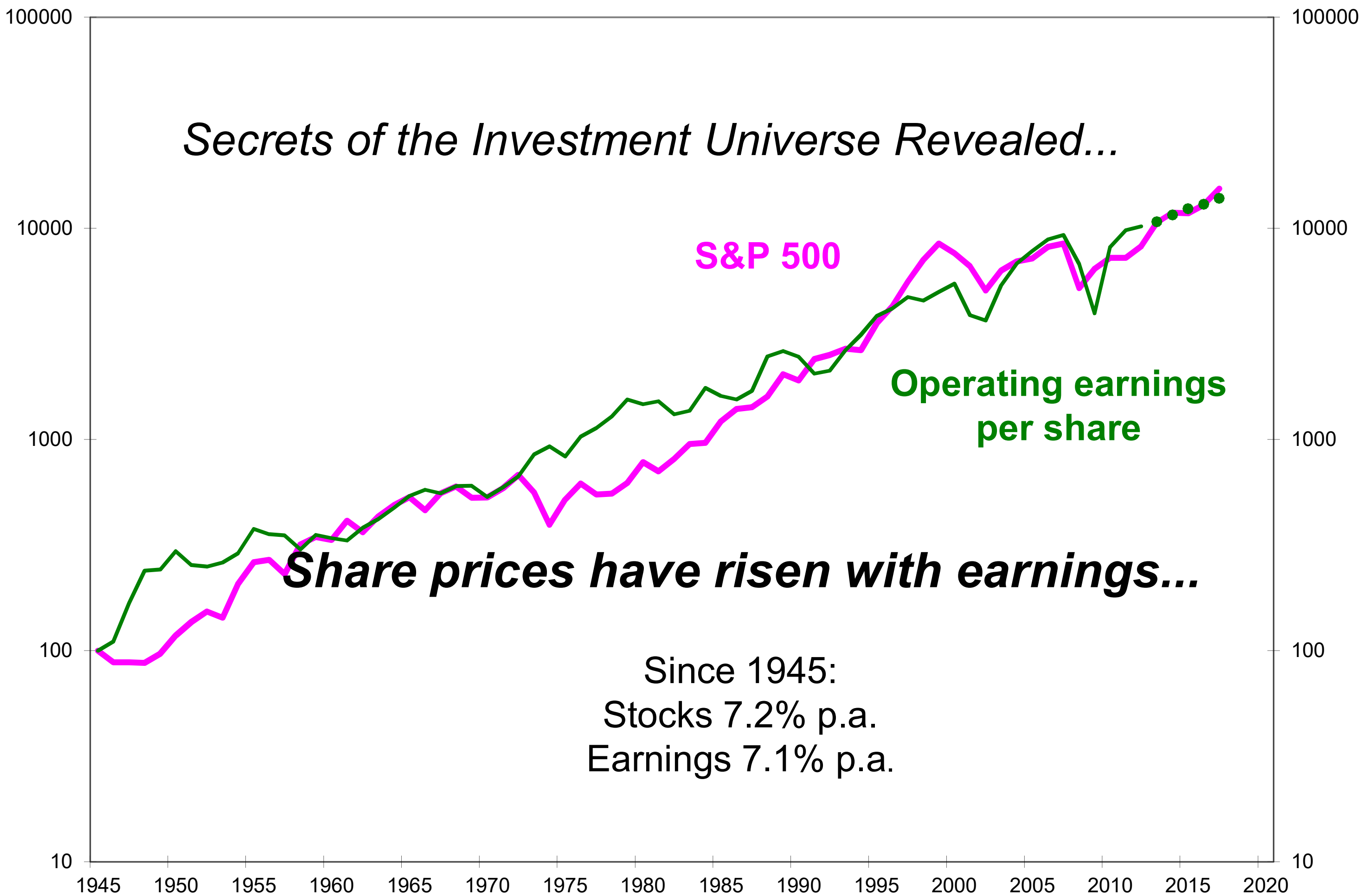
Jonathan Golub at Credit Suisse, formerly at $185, has raised 2021 to $200 and 2022 to $215 from $210.

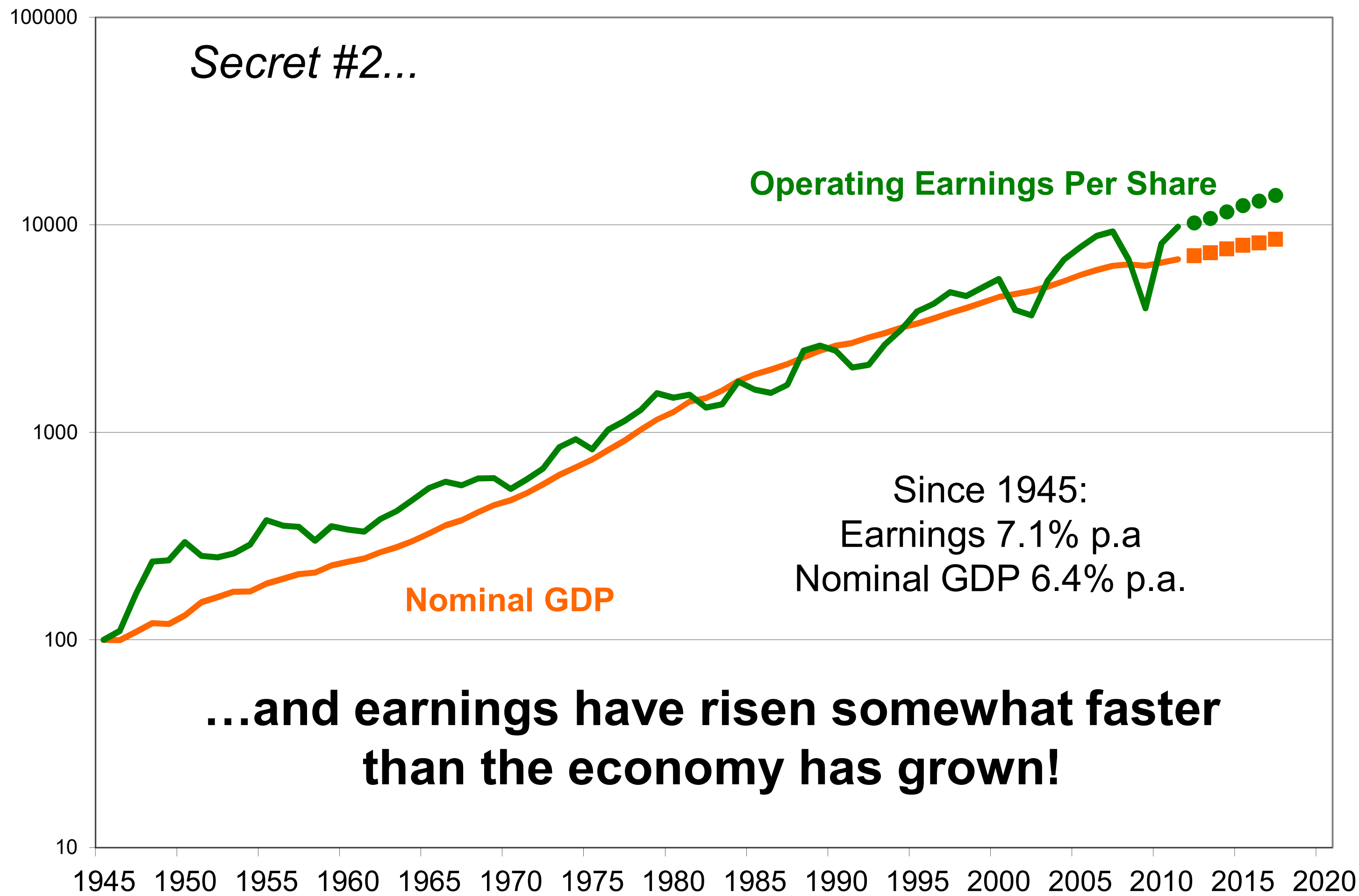
At Calvasina's $187 the S&P is at 22.2x this year's earnings.

Using Golub's $200, it's at 20.7x

We think share prices and the index will move higher from here over the next 12 months but more slowly than earnings grow.

How to pick stocks


Secrets of the Investment Universe Revealed...
Share prices have risen with earnings...
S&P 500
Operating earnings per share
Since 1945:
Stocks 7.2% p.a.
Earnings 7.1% p.a.
100000
10000
1000
100
10
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
2020



Secret #2...
Operating Earnings Per Share
Nominal GDP
Since 1945:
Earnings 7.1% p.a
Nominal GDP 6.4% p.a.
…and earnings have risen somewhat faster than the economy has grown!
100000
10000
1000
100
10
1945 1950 1955 1960 1965 1970 1975 1980 1985 1990 1995 2000 2005 2010 2015 2020

Long-term considerations

- CBO forecasts U.S. GDP will grow at just 4-4.5% per annum over the next decade or two. (Nominal growth without adjusting for inflation)
- Much slower than the 65 years following WWII when growth averaged 6.9%+
- Slower growth means more intense competition, even more corporate concentration than we saw in the last decade, sharper distinction between winners and also - rans.
- Portfolios should be populated with stocks where there is a high conviction that sales, earnings, and dividends will grow faster than the economy
- Dividend growth conviction is more important/valuable than yield.
- Beware of value traps – high yield, high payout ratio, high debt, low/no growth.

- Thank you!