Wealth Management
& Capital Markets Perspective

Wealth Management
Dominion Securities

For the clients of Grimes Handscomb Asset Management of RBC Dominion Securities | Winter 2022

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U.S. recession scorecard update

by Jim Allworth

In our view, an equity investor's principal focus should be on the U.S. economy—the world's largest and the one that sets the rhythm and tone for much of the developed world. A U.S. recession has usually been bad news for other economies and equity markets. Every U.S. recession has been associated with a bear market for U.S. stocks—and for most other equity markets.

We have monitored six different variables which have done a good job individually and collectively of signaling when a U.S. recession is on the way. Effective with this update we are adding a seventh leading U.S. recession indicator—free cash flow of non-financial corporate business.

All seven indicators (see table on the next page) are giving readings consistent with this economic expansion having quite a bit further to run. Powerful tailwinds are driving the U.S. economy and most developed economies forward including: extremely easy credit conditions; excess savings totaling about 10% of GDP in the U.S. and Canada (somewhat less in the UK and Europe); the need to replenish depleted business inventories; and a U.S. capital spending upswing already underway. It's worth noting that none of the developed economies, including the U.S. and China, are fully reopened, but we expect they will be as this year progresses.

These economic tailwinds provide good reasons to expect above-trend GDP and corporate profit growth through 2022 and probably 2023 as well. It would be unusual for share prices not to maintain an upward trend for at least another 12-18 months in that case.

The seventh leading indicator—free cash flow of non-financial corporate business as a % of GDP

When this indicator has fallen below zero, a recession has followed—typically two to three quarters later. More particularly, shrinking corporate cash flows have most often signaled an upcoming period of weaker capital spending, a highly cyclical component of GDP. Today these cash flows are growing far faster than the economy, and this indicator looks to be in no danger of signaling an approaching recession any time soon.

Yield curve

Most of the time the 10-year Treasury yield is higher than the 1-year Treasury yield, but this relationship

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U.S. recession scorecard

Indicator	Status: Expansionary	Neutral	Recessionary
Yield curve (10-year to 1-year Treasuries)	✓		
Unemployment claims	✓		
Unemployment rate	✓		
Conference Board Leading Economic Index	✓		
Free cash flow of non-financial corporate business	✓		
ISM New Orders minus Inventories	✓		
Fed funds rate vs. nominal GDP growth	✓		

Source: RBC Wealth Management

usually turns upside down (inverts) several quarters before a U.S. recession begins.

As things stand today the gap between the 10-year Treasury yield (1.83%) and that of the 1-year Note (0.53%) stands at a positive 130 basis points. We think any inversion would be at least a year away, probably further.

Unemployment claims

A bottoming of unemployment claims has reliably preceded the arrival of a U.S. recession, with the cycle low typically occurring three to four quarters before the recession's onset. Currently, the smoothed trend of weekly claims continues to move lower. However, with more than 11 million unfilled jobs in the U.S. vs. fewer than 7 million unemployed and with widespread indications of large, medium, and small businesses unable to find the workers they desperately need, we think a sustained uptrend in new weekly claims is not about to start anytime soon.

Unemployment rate

When the unemployment rate begins trending higher, the start of a recession is typically two to six months away. The most recent data leaves the 3.9% unemployment rate still above its pre-pandemic 3.5% low. From here it would take at least six months of readings in the 5%–6% range to turn the trend convincingly higher and signal a recession is approaching. However, as noted above, with record high job openings and widespread job shortages in an economy not yet fully reopened, we believe any concerning new sustained uptrend in the unemployment rate remains a long way off.

Conference Board Leading Economic Index (LEI)

This indicator is something of a hybrid; it is put together by the Conference Board using 10 monthly economic variables. Whenever the LEI has fallen below where it was a year earlier a recession has always followed—typically, about six months later. Currently, the LEI sits a full 12 percentage points above where it was a year ago. We think it could take many months of persistent weakness to trigger a negative signal from this indicator.

ISM New Orders minus Inventories

The difference between the New Orders component of the ISM Manufacturing Index and the Inventories component has fallen below zero near the start of most U.S. recessions. We use this as a corroborative indicator—one to pay attention to if other, longer-term indicators are implying a recession is on the way. The spread between new orders and inventories has narrowed from its post-pandemic peak of a few months ago but remains well above zero.

Fed funds rate vs. nominal GDP growth

Since the federal funds rate arrived in the early 1950s, there has never been a U.S. recession that was not preceded by the fed funds rate rising above the year-over-year nominal growth rate of the economy (the growth rate before adjusting for inflation). As of year-end 2021, we expect the nominal GDP growth rate to have been about 9%. The fed funds rate is now sitting at 0.1%—that's 8.9% below the run rate of the economy, or thirty-five quarter-point Fed rate hikes from here. This indicator implies borrowing rates are nowhere close to high enough to choke off growth in the U.S. economy.

Moderately overweight equities

The unanimity across our recession scorecard strongly suggests the U.S. economic expansion is unlikely to run out of steam anytime soon. However, alongside all the tailwinds noted above are points of contention that are likely to provoke periodic bouts of investor concern and, perhaps, market volatility. These include the course of both inflation and central bank policy as well as China's property debt issues, geopolitics, Congressional logjams as the midterm elections draw closer, and the prospect of more unsettling curve balls from the pandemic.

While each of these can present problems for equity markets, we think a recession will require a prolonged period of monetary tightening, which has yet to get underway, suggesting the economy, corporate earnings, and share prices have further to run. In our view, the investment climate favours moderately overweight equities positioning until an economic downturn becomes inevitable.

What is a Trusted Contact Person?

It's something new that you should know about as an investor. Your Trusted Contact Person is someone you choose who can help us protect your financial well-being.

What is the role of a Trusted Contact Person?

A Trusted Contact Person is someone you give us written consent to contact. We may contact them if we suspect you are being financially exploited, if we're concerned about your ability to make decisions due to physical or mental incapacity, or if we're unable to reach you.

We may ask your Trusted Contact Person to provide or confirm information, such as:

- Whether anyone may be financially exploiting or abusing you.
- Your state of mind, if we have reasonable concerns about your ability to make financial decisions.
- Your Power of Attorney's contact information.
- Your current contact information. For example, you may be travelling and have an alternate phone number we don't have. Or you may have simply changed your contact information, and haven't updated us yet.

Your Trusted Contact Person's role is to provide or confirm information only – they do not have any authority over your account, cannot make decisions on your behalf, and will not be given access to your detailed account information. We will not ask your Trusted Contact Person for information unless we believe it's absolutely necessary to help you.

Who should you appoint as your Trusted Contact Person?

You can appoint anyone you want as your Trusted Contact Person. However, we encourage you to select someone who is not already involved in making decisions with respect to your account (such as your Power of Attorney or Trading Authority). Ideally, your Trusted Contact Person is someone separate who provides you with an additional layer of protection against potential financial exploitation.

We recommend that you choose someone who, regardless of their age, is mature, knowledgeable about your personal situation, and familiar with your support network. They need to be capable of speaking to you, and us, about potentially difficult subjects, like concerns about diminishing mental capacity.

How do I appoint one?

We will invite you to appoint a Trusted Contact Person when you open a new account or when we're updating the "Know Your Client" information we have on file for you.

For more information about appointing a Trusted Contact Person, please contact us.

Use of position titles in the Canadian investment industry

As part of a major initiative called Client Focused Reforms by our country's regulatory authority (Canadian Securities Administrators (CSA)), the use of position titles in the investment industry has recently changed. Why? Traditionally, it has been industry practice to recognize more senior advisors who have achieved a certain level of experience with an additional designation such as "vice-president". After extensive consultation with investors across the country, the CSA determined that using a different title to recognize senior advisors, in place of vice-president, would have two benefits:

1. It would help investors more clearly understand their advisors' roles – as advisors, and;
2. It would reduce confusion that advisors are acting in a different role as "corporate officers" of a firm.

At RBC Dominion Securities, the role of "Senior Portfolio Manager" has been granted in recognition of the accomplishments of only our most senior advisors who meet the required standards. To receive the new designation, an advisor must meet the same rigorous criteria as before, which includes having extensive experience in managing client assets, maintaining high quality business practices, and an ongoing commitment to helping their communities.

Administrative corner

To help with this busy time of year, here are some tips for tax reporting:

- Tax slips will be mailed starting early in February until approximately the end of March. In addition to your tax slips, your tax package will include your fee summary, gain / loss report and foreign property summary.
- Please provide the tax package in its entirety to your accountant. If you would like your accountant to receive a duplicate copy of your tax package, please contact us directly.
- You also have the option to switch to e-Tax, which would enable you to receive your tax package via your DS Online access, faster than with mail delivery. To learn more about this option, please contact us directly.

RBC Dominion Securities – Tax reporting schedule	
RBC DS completes all tax reporting by	March 31, 2022
Important personal tax deadlines	
Personal income tax installments	March 15, 2022 June 15, 2022 September 15, 2022 December 15, 2022
Personal income tax return filing	April 30, 2022
Self-employed income tax return filing	June 15, 2022
Balance owing for taxes payable	April 30, 2022

TFSA and RRSP information

TFSA information	
Maximum annual contribution limits	\$5,000 each year 2009 - 2012 \$5,500 each year 2013 - 2014 \$10,000 for 2015 \$5,500 each year 2016 - 2018 \$6,000 each year 2019 - 2022
Maximum contribution limit since inception	\$81,500 from 2009-2022, if born in 1991 or earlier and eligible resident of Canada during those years
RRSP information	
RRSP maximum annual deduction limit	18% of the prior year's earned income to a maximum of: \$27,830 for 2021– deadline March 1, 2022 \$29,210 for 2022 – deadline March 1, 2023

Benchmarks

Equity market 12-month trailing return (for month ending December 31, 2021)	
S&P/TSX composite total return index	25.1%
S&P 500 total return (C$)	27.7%
S&P 500 total return (U$)	28.7%
DJIA total return (C$)	20.0%
DJIA total return (U$)	20.9%
Nasdaq composite price return (C$)	20.5%
Nasdaq composite price return (U$)	21.4%

RBC CM Canadian bond market indices 12-month trailing return (for month ending December 31, 2021)	
Short-term index	-0.9%
Intermediate-term	-2.7%
Three-month T-Bill (C$)	0.1%
Three-month T-Bill (U$)	0.0%

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