April 30, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

Speak loudly and carry a big stick

Thomas Garretson, CFA – Minneapolis

The Fed has fashioned its monetary policy response to the COVID-19 pandemic after foreign policy of old, with massive pledges of quantitative easing and liquidity facilities. And, as is usually the goal, the simple promise to act may reduce the need to actually do so.

While this week's Fed meeting lacked any of the Fed fireworks we have seen over the past two months, Fed Chair Jerome Powell again spoke forcibly, stating, "we are committed to using our full range of tools to support the economy in this challenging time, we are going to use them forcefully, proactively and aggressively until we are confident that we are solidly on the road to recovery."

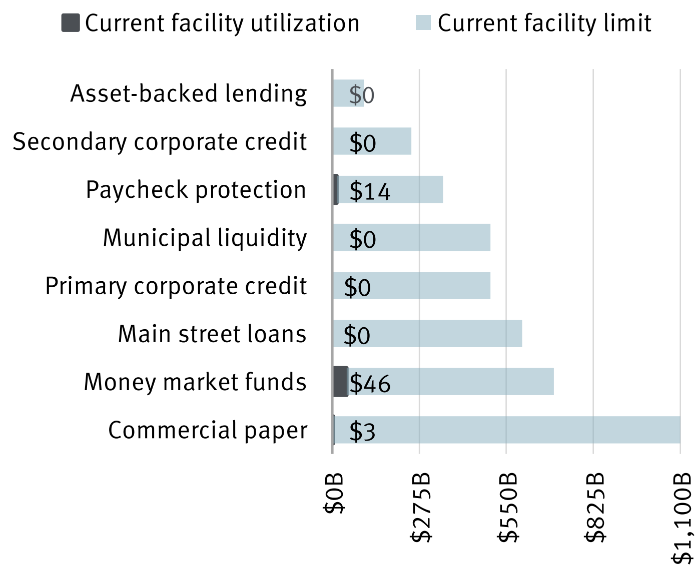
And those tools, or the Fed's big stick in this case, have been the wide swath of lending facilities announced that have cajoled markets back into a more-normal state of operation—even as most of them aren't even up and running, while others stand barely used.

As the first chart shows, two of the first facilities launched, support for money market funds and commercial paper markets, stand mostly unused with just barely $50 billion utilized against total potential lending of nearly $2 trillion.

The $2.3 trillion in credit facilities that were announced to much market fanfare at the beginning of April still aren't ready, with Powell unable to put a date on any launch, simply stating that they would be ready "soon." But even so, markets have already largely reopened and are again functioning smoothly. New corporate bond issuance, as companies look to shore up liquidity, has reached record highs, while even speculative-grade companies have been able to access capital markets to the greatest extent since last year.

While the Fed's balance sheet crossed the $6.5 trillion mark this week, up from $4 trillion at the start of the year, as it continues to buy Treasuries at a daily pace of about $10 billion, the actual utilization of these credit and lending facilities that are

As Fed lending facilities come online, questions remain about their usage



Source - RBC Wealth Management, Bloomberg, Federal Reserve

Market pulse

Click here for authors' contact information. Priced (in USD) as of 4/30/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6.**
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backstopped by the Treasury via funds allocated from the CARES Act might actually go largely unused. For now it seems the simple threat to act has been sufficient for markets, but that the facilities will stand ready to act as a powerful backstop should another bout of volatility rock markets.

Reading the tea leaves

If there was any disappointment in this week's Fed meeting, it was the limited amount of forward guidance, with the statement simply saying, "The Committee expects to maintain this target range [0 percent to 0.25 percent] until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."

So what might that mean for the path forward for interest rates? After the Fed first cut rates to zero percent in December 2008, it took a full seven years until December 2015 for the Fed to leave the zero percent lower bound. We don't expect it to take that long this time around, but believe it will almost undoubtedly be a multi-year process.

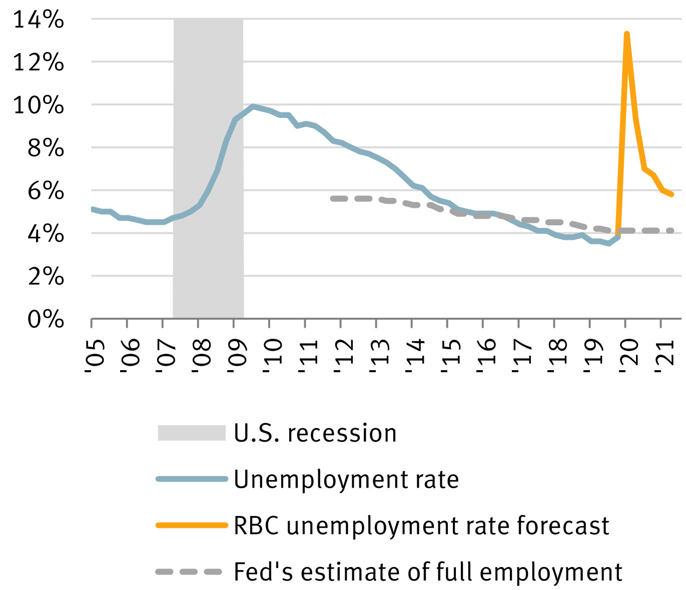
As was the case then, the primary bar for beginning to raise rates will be a return to full employment. The difference now is that the Fed is likely to judge the level of full employment as being even lower. In 2015, the unemployment rate had converged with the Fed's estimate of full employment at five percent, which then kicked off the rate hike cycle. When the Fed last provided economic estimates in December 2019, it had estimated that level at nearly four percent. In our view, that should provide a rough approximation for when the Fed may again leave the zero percent lower bound.

And as the last chart shows, that will take time. RBC economists currently project that the unemployment rate will only fall under six percent by the end of 2021, after averaging 13.3 percent this quarter. And the recovery from there would likely be more gradual; the last move from six percent to four percent unemployment took place over the course of four years from 2014 to 2018.

Conclusion

In our view, the Fed has been largely successful in its stated goal of ensuring financial markets continue to operate smoothly. As the economy edges closer to at least a first phase of reopening, we don't believe the Fed is anywhere near the point of pulling back on the reins. While questions remain about the large scale of fiscal and monetary support, the Fed's approach of speaking loudly while carrying a big stick appears to be working, and may actually limit what it might ultimately need to do.

Fed unlikely to raise rates again until U.S. economy returns to full employment



Source - RBC Wealth Management, Bloomberg

United States

Ben Graham, CFA – Minneapolis

- **U.S. equity markets have sharply rebounded in April**, albeit not to the levels seen in late February. The week's low single-digit gains have pushed equity markets into low double-digit territory for the month. Specifically, **the S&P 500 has climbed 2.7% thus far this week and is up 12.7% for the month**. Small caps and the NASDAQ have been even better, and growth has outpaced value in April, despite the outperformance of value stocks so far this week. **Sector leadership has been pro-cyclical** for the month and week as the industries hit hardest in the COVID-19-related bear market have often seen the sharpest reversals. For context, Energy is still the worst-performing sector for the year, down more than 30%, but it's also delivering near double-digit weekly gains. Other outperforming sectors include risk-on trades such as Financials, Industrials, and Materials.

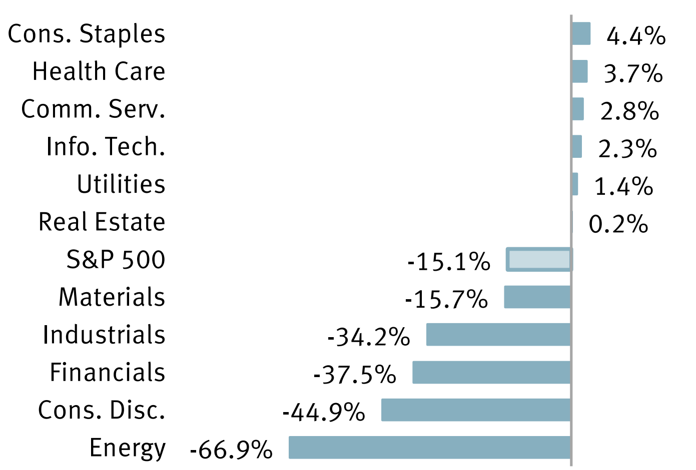
- Earnings season is in the midst of its peak week and, so far, **results have pushed earnings expectations steadily lower** to the current consensus view of a 15% contraction in Q1 2020 earnings per share. However, the good news is that Q1 consensus views are solidifying around this estimate, and the uncertainty around the quarter's results is diminishing. Per Thomson Reuters I/B/E/S, six sectors are forecast to deliver earnings growth this quarter, while the others are on track for an earnings contraction, led lower by Energy (-67%) and Consumer Discretionary (-45%).

- **RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina has recently attempted to put the most recent bear market [into the context] of the previous three corrections**. She found that, first, this rebound has been legitimate but remains fragile given the current assumption that a recession will end in the second quarter. Second, she discovered that the current leadership trends seen in small caps and economically sensitive stocks are on par with similar rebounds during previous recessions. Finally, equities typically bottom four months before a recession ends with a median rebound of 34%. Today, the S&P 500 is about 30% higher than its Mar. 23 lows, which also happens to be just more than three months prior to the end of Q2.

- **U.S. GDP contracted 4.8% in Q1**, the sharpest decline since Q4 2008. The decline was largely fueled by a 7.6% contraction in personal consumption. Finally, **new jobless claims continued to trend above the 3 million mark** with this week's reading of 3.8 million pushing the total new claims for the year north of 30 million and with consensus forecasts indicating that 18% of the workforce is currently unemployed.

U.S. earnings expectations are led lower by cyclical sectors

First-quarter 2020 earnings growth expectations



Source - RBC Wealth Management, Thomson Reuters I/B/E/S; data as of 4/30/20

Canada

Sayada Nabi & Meika McKelvey – Toronto

- Extraordinary times call for extraordinary measures, as shown by the response to COVID-19 from all levels of the Canadian government. However, **the bill for pandemic response is growing rapidly**. The cost of the federal government's programs to manage the health crisis and support the economy has exceeded CA$230 billion (10% of GDP). Each province has unique needs and this means the way the crisis is handled will vary, but RBC Economics estimates all provinces will run stimulus programs into the billions of dollars. As an example, British Columbia and Alberta plan to spend CA$5 billion and CA$7.7 billion, respectively, while Ontario's spending is at CA$17 billion to date and Quebec has allotted CA$18 billion. **While Canadian provinces will see a material deterioration in their fiscal positions, the deficits currently forecasted would not be the worst they have faced relative to economic output**. According to RBC Economics, increased provincial deficits in the near future will not become a major near-term issue as the Bank of Canada (BoC) is expected to provide liquidity support by keeping funding costs manageable and funding channels open.

- The BoC, through the introduction of several liquidity measures and the launch of its first-ever quantitative easing program, has played a central role (alongside the U.S. Federal Reserve) in unclogging the corporate bond market in Canada, compressing Canadian credit spreads, and fueling the swift turnaround seen over the past month across risk assets. Although the proper functioning of most markets has been restored and this has been a positive development from a liquidity perspective, the **solvency of many of the corporations benefiting from these measures remains in question**. With the traffic jam in the credit market cleared, corporate bond issuance has surged dramatically, allowing companies to shore up liquidity; however, the economic impact of the virus continues to pose a significant threat to cash flows. The result of this combination is **rising corporate leverage**, from already-elevated levels. As Fed Chair Jerome Powell has repeatedly pointed out, "this is not the time to be concerned about debt levels", but we believe this is **a risk further down the line that is worth thinking about**.

Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- Two trends are clear this earnings season with respect to consensus estimates of COVID-19's economic impacts. First, consensus has generally underestimated **the size of impairments to be taken by banks** in light of the deterioration of the economic outlook. Second, consensus has generally underestimated the **positive impact of stockpiling for the Consumer Staples and Health Care sectors**.

- Looking at the three largest UK-listed banks by market capitalisation, impairment charges made by HSBC ($3 billion), Lloyds Banking Group (£1.43 billion), and Barclays (£2.1 billion) were 73%, 61%, and 129% more than consensus expectations. It has been **a similar story for European banks**.

- Meanwhile, Health Care giants **Novartis, AstraZeneca, and GlaxoSmithKline all reported earnings ahead of consensus expectations**, with COVID-19-related stockpiling of drugs contributing to this. Within the pan-European Consumer Staples space, **Reckitt Benckiser** delivered the biggest beat to consensus estimates, as surging consumer demand for health- and cleaning-related products drove like-for-like sales growth of 13.3% in Q1 versus the consensus estimate of 5.3%.

- The downturn in commodity prices has resulted in **Royal Dutch Shell cutting its dividend for the first time since World War II**. The company will reduce its quarterly dividend payment by 66% to $0.16 per share from $0.47 previously, in order to "provide financial resilience and further flexibility to manage the uncertainty".

- **Flash estimates for Q1 euro area GDP suggest the economy contracted 3.8% q/q**, making this the most severe downturn for the economic block in some 50 years. With most of the lockdowns having taken effect mid-March, the full economic impact is likely to be even more dramatic in Q2. European Central Bank (ECB) governor **Christine Lagarde suggested the regional economy could contract by as much as 12% in 2020, slightly less than RBC Capital Markets' -13.5% projection**. The ECB announced additional liquidity operations but stopped short of expanding its quantitative easing programme, preferring to reserve some ammunition for future use, if needed.

Asia Pacific

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

- **Asia-Pacific equity markets traded higher during the week, led by India and Taiwan**. India's Nifty 50 Index tracked its U.S. peers higher on hopes that the COVID-19 curve is flattening in the western world and positive data on a potential treatment. **The optimism in the Indian equity market, however, does not truly reflect the COVID-19 situation in the country**. India reported its highest daily increase in COVID-19 fatalities on Apr. 29 with the death toll passing the 1,000 mark. The numbers remain low compared to Europe and the U.S. According to a report in Barron's, with crowded cities, a shaky health care system, and a lack of testing, some health care professionals are concerned that the actual number of infected cases may be much higher than what is being reported by the government.

- China's official manufacturing Purchasing Managers' Index (PMI) for April came in at 50.8, missing consensus expectations of 51.0 and falling below March's reading of 52.0. Officials from the National Bureau of Statistics noted that **as the spread of COVID-19 accelerated overseas and global economic activity contracted sharply, demand for Chinese goods has been recovering at a slower pace than production**. Data showed that most companies surveyed reported "insufficient orders," and some firms said market demand was weak, with difficulties in product sales and more time needed before orders return. Meanwhile, the non-manufacturing PMI came in at 53.2, up from 52.3 in March and above consensus expectations. Observers believe China's manufacturing activity has split onto two tracks, with domestic demand recovering on increased infrastructure spending, while export headwinds are mounting. If overall demand remains weak, we think Beijing may have to step up its policy support to help businesses, particularly manufacturers. **Investors will likely have more clarity in late May, when the National People's Congress is slated to convene, on what other steps the government may take**.

- According to an unconfirmed Reuters report, **Chinese e-commerce retailer JD.com is pressing ahead with plans for a secondary listing in Hong Kong**, to be completed as early as June, to raise at least US$3 billion.

MARKET SCORECARD

Data as of April 30, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,912.43	12.7%	-9.9%	-1.1%	10.0%
Dow Industrials (DJIA)	24,345.72	11.1%	-14.7%	-8.5%	0.8%
NASDAQ	8,889.55	15.4%	-0.9%	9.8%	25.8%
Russell 2000	1,310.66	13.7%	-21.4%	-17.6%	-15.0%
S&P/TSX Comp	14,780.74	10.5%	-13.4%	-10.9%	-5.3%
FTSE All-Share	3,262.51	5.0%	-22.3%	-19.8%	-21.0%
STOXX Europe 600	340.03	6.2%	-18.2%	-13.1%	-11.8%
EURO STOXX 50	2,927.93	5.1%	-21.8%	-16.7%	-17.2%
Hang Seng	24,643.59	4.4%	-12.6%	-17.0%	-20.0%
Shanghai Comp	2,860.08	4.0%	-6.2%	-7.1%	-7.2%
Nikkei 225	20,193.69	6.7%	-14.6%	-9.3%	-10.1%
India Sensex	33,717.62	14.4%	-18.3%	-13.6%	-4.1%
Singapore Straits Times	2,624.23	5.8%	-18.6%	-22.8%	-27.4%
Brazil Ibovespa	80,505.90	10.3%	-30.4%	-16.4%	-6.5%
Mexican Bolsa IPC	36,470.11	5.5%	-16.2%	-18.2%	-24.6%

Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot $/oz)	1,683.84	6.8%	11.0%	31.2%	28.0%
Silver (spot $/oz)	14.96	7.0%	-16.2%	0.0%	-8.4%
Copper ($/metric ton)	5,233.00	6.0%	-14.9%	-18.6%	-22.7%
Oil (WTI spot/bbl)	18.84	-8.0%	-69.1%	-70.5%	-72.5%
Oil (Brent spot/bbl)	25.27	11.1%	-61.7%	-65.3%	-66.4%
Natural Gas ($/mmBtu)	1.94	18.4%	-11.3%	-24.6%	-29.8%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.638%	-3.2	-128.0	-186.4	-231.5
Canada 10-Yr	0.542%	-15.5	-116.0	-117.0	-176.5
U.K. 10-Yr	0.231%	-12.5	-59.1	-95.4	-118.7
Germany 10-Yr	-0.586%	-11.5	-40.1	-59.9	-114.5

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.36%	1.8%	5.0%	10.8%	16.7%
U.S. Invest Grade Corp	2.68%	5.3%	1.5%	9.9%	17.1%
U.S. High Yield Corp	8.18%	4.1%	-9.1%	-4.5%	2.0%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	99.0180	0.0%	2.7%	1.6%	7.8%
CAD/USD	0.7179	1.0%	-6.7%	-3.9%	-7.8%
USD/CAD	1.3929	-0.9%	7.2%	4.0%	8.5%
EUR/USD	1.0954	-0.7%	-2.3%	-2.3%	-9.3%
GBP/USD	1.2596	1.4%	-5.0%	-3.3%	-8.5%
AUD/USD	0.6515	6.3%	-7.2%	-7.6%	-13.5%
USD/JPY	107.2100	-0.3%	-1.3%	-3.8%	-1.9%
EUR/JPY	117.4400	-1.0%	-3.6%	-6.1%	-11.1%
EUR/GBP	0.8696	-2.1%	2.8%	1.1%	-0.9%
EUR/CHF	1.0576	-0.3%	-2.6%	-7.5%	-11.6%
USD/SGD	1.4105	-0.8%	4.8%	3.7%	6.4%
USD/CNY	7.0633	-0.3%	1.4%	4.9%	11.5%
USD/MXN	24.1345	2.0%	27.5%	27.4%	29.0%
USD/BRL	5.4710	5.1%	35.7%	44.8%	56.0%

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 4/30/20.

Examples of how to interpret currency data: CAD/USD 0.71 means 1 Canadian dollar will buy 0.71 U.S. dollar. CAD/USD -6.7% return means the Canadian dollar fell 6.7% vs. the U.S. dollar year to date. USD/JPY 107.21 means 1 U.S. dollar will buy 107.21 yen. USD/JPY -1.3% return means the U.S. dollar fell 1.3% vs. the yen year to date.

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