GLOBAL
Insight
WEEKLY

Perspectives from the Global Portfolio Advisory Committee

July 22, 2021

Hello volatility, my old friend

Kelly Bogdanova – San Francisco

Summer hasn't seen much respite for stock markets. But it's normal for outside forces or concerns to knock down the market from time to time. We look at why the market is on edge and what this means for equity portfolio positioning.

Two steps forward, one step back and get used to some additional volatility. These are the messages we think the U.S. equity market is sending.

Even though the major indexes are only slightly below their all-time highs reached on July 12, the market was jolted recently. The Dow Jones Industrial Average dropped 2.1 percent on Monday and registered a cumulative decline of 3.0 percent over five sessions, before bouncing back in subsequent days when dip-buyers emerged.

This back-and-forth action raises questions about why the market is on edge, and has prompted some unease about this phase of the bull market and economic cycle.

Durable dynamics

We think a mix of interrelated issues jostled the market: the increase in COVID-19 infections, particularly the delta variant; concerns about the degree to which virus-related restrictions would be resumed and their potential economic impact; and the swift decline in the 10-year Treasury yield, which raised uncertainty worldwide about what—if anything—the bond market may be signaling about future economic growth.

At the very least, this is a reminder that volatility and equity investing go hand-in-hand. There is often a "wall of worry," and news about outside forces or concerns about stock fundamentals and/or monetary and fiscal policies can knock down the market from time to time.

We remain moderately Overweight equities in global portfolios as we don't think these recent developments put the bull market and economic cycle at risk. Here's why …

Delta is difficult but there is less tolerance for shutdowns. Even though some U.S. states and many countries are now struggling with delta and other variants are surfacing more frequently, overall hospitalizations and deaths are below prior waves likely due to the uptake in vaccinations. Importantly, authorities in most countries seem reluctant to resume strict lockdowns as they are well aware of the severe employment, household income, and broader economic and social consequences—not to mention the previous shutdowns took a chunk out of government budgets and exacerbated deficit spending.

As long as hospitalization rates don't risk crippling health care systems and vaccines prove to protect people from severe consequences of infections, we think any related economic softness can be absorbed without serious repercussions. It seems investors embraced this thinking as the market rebounded.

The economic cycle has longevity. U.S. GDP growth forecasts have shifted a lot in recent months, pushing the bar higher. Whereas the consensus forecast of economists

For perspectives on the week from our regional analysts, please see pages 3–4.

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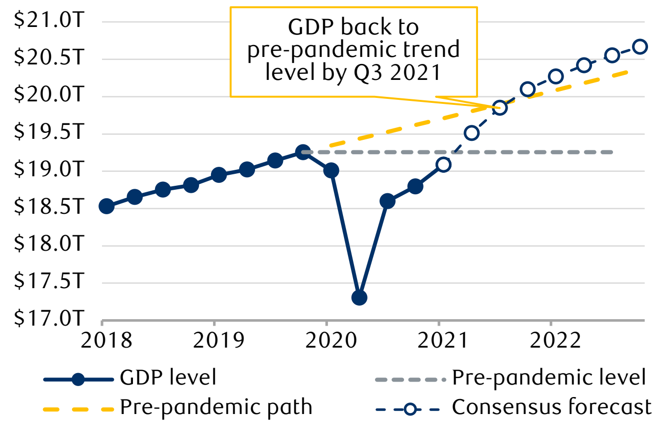
previously expected GDP to reach its pre-pandemic level in 2022, it now anticipates it will get there in Q3 of this year and then extend further thereafter, as the top chart shows. These more optimistic forecasts are now baked into financial markets. The uptick in COVID-19 infections and plunge in the 10-year yield caused some to question whether such a trajectory can be achieved.

We think the recovery is durable—and this is what long-term investors should focus on, rather than any quarter-by-quarter variations versus economists' projections. RBC Global Asset Management Inc. Chief Economist Eric Lascelles wrote, "… our own business cycle work argues that there can probably be several additional years of economic expansion before this particular cycle comes to an end." Nevertheless, he believes it's reasonable to expect some growth headwinds in 2022 due to the strong buildup in inventories that has occurred lately as businesses have been concerned about COVID-19-related supply shortages and inflation. This may be pulling forward some economic activity into this year that would have occurred next year. Even so, he doesn't think this would be game-changing for the economy.

Treasury yields have more influence on sector positioning than the level of equity indexes. Equity markets have lived with ultralow government bond yields for many years, and this has not impeded overall growth in corporate earnings or the ability for major equity indexes to move higher so long as recession risks remained low.

But whether the 10-year Treasury yield is on a downward trajectory, like when it briefly dipped to 1.19 percent recently, or a modestly upward trajectory can impact the performance of various equity market segments and sectors. The same goes for the shape of the Treasury yield curve. When the curve flattens (when the difference in short-term rates versus long-term rates narrows), the growth segment of the equity market has a tendency to outperform. Conversely, when the curve steepens, value stocks have a tendency to lead.

Consensus economic forecasts have U.S. Real GDP reaching the previous trend rate in Q3 of this year



Source - RBC Wealth Management, Bloomberg Analyst Survey for July 2021; consensus forecast through Q4 2022

For equities, we maintain a modest bias toward value sectors as our Fixed Income Strategies team anticipates the 10-year yield will gradually move up toward 1.75 percent by year-end while short-term rates will likely climb more slowly, resulting in a slightly steeper yield curve.

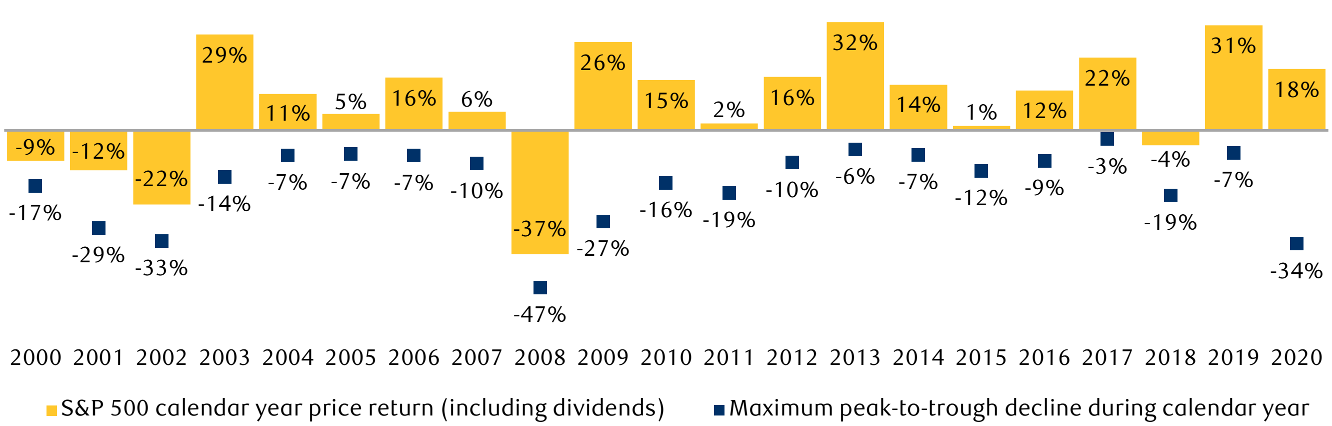
Par for the course

With COVID-19, inflation, and fiscal and monetary policy uncertainties lingering, investors should expect additional equity market volatility and potentially a bigger pullback this year.

As the chart below shows, meaningful pullbacks often occur. Since 2000, in more than half of the years the S&P 500 pulled back 10 percent or more at some point during the year. Importantly, pullbacks and corrections are not uncommon even in good years. Among the 12 years with above-average annual returns, 10 of them included periods where the market pulled back seven percent or more.

Bottom line, volatility—an old familiar friend—is back, and its presence is normal.

Reality check: Pullbacks happen even in good years. Since 2000, more than half of the years have included pullbacks of 10% or more for the S&P 500.



Source - RBC Wealth Management, Bloomberg; data through 12/31/20

UNITED STATES

Atul Bhatia, CFA – Minneapolis

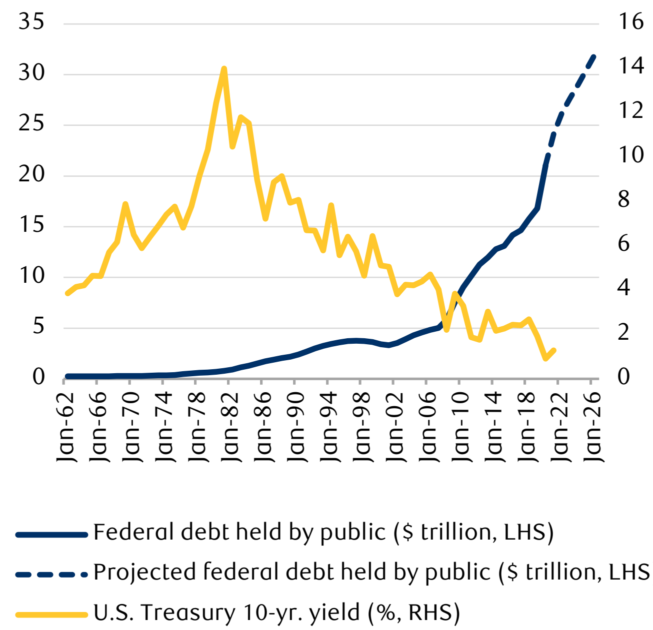
■ **Growth concerns early in the week led investors to aggressively seek the relative safety of U.S. Treasuries**; during the rally, yields on 30-year government bonds reached 1.78%, the lowest level since February 2021. The bond-buying wave eventually subsided, and by Wednesday longer-maturity bonds, such as the 10-year and 30-year Treasury, had given back all of their recent gains. Shorter-maturity bond yields remained lower, restrained for now by the potential for an extended period of near-zero rates from the Fed.

■ Expectations for monetary support are driven in part by rising domestic and international COVID-19 case counts and partly by the continued lack of progress on fiscal policy. Despite a bipartisan agreement to increase traditional infrastructure investment by nearly $600 billion, legislative action on the measure has stalled amid a disagreement on funding the plan and a dispute between the House and Senate on the timing of broader budget legislation. The bipartisan plan failed to advance in the Senate this week, although backers believe it will eventually move forward in that chamber. **Lack of fiscal progress raises pressure on the Fed to reiterate its commitment to low interest rates**, increasing focus on the central bank's policy meeting next week.

■ **Debt ceiling limits are set to be reimposed** in nine days after the current two-year suspension expires on July 31. In the near term, the debt ceiling limits will require the Treasury Department to cut bill issuance and prepay debts to reduce cash balances, putting further pressure on money market rates. Longer term, the Congressional Budget Office estimates that new legislation will be required by October to avoid a government shutdown. **One possible beneficiary of debt ceiling inactivity is infrastructure legislation**; if the bipartisan deal is still at an impasse by fall, proponents may be able to attach their bill to the must-pass debt ceiling law, potentially smoothing its path to enactment.

Rising federal debt no problem for markets; congressional limit approaches

Yields remain low despite rising debt levels



Source - RBC Wealth Management, Bloomberg; data as of 7/21/21

CANADA

Carolyn Schroeder & Arete Zafiriou – Toronto

■ **Canadian housing market activity decreased in June, but remained strong**. Home resales fell for the third consecutive month, down 8.4% from May. The decline was seen across all major markets, with the exception of Montreal, where resales increased by a modest 0.7%. New homes for sale also dropped for the third month in a row, down 0.7% in June. While conditions appear to be becoming more balanced, it remained a seller's market, with the ratio of sales to new listings across Canada at 0.69 in June compared to 0.75 the previous month. The Canada Mortgage and Housing Corporation notes that a ratio above 0.55 reflects a seller's market, while a ratio below 0.40 indicates a buyer's market. Despite the decline in housing activity, home prices continued to rise across most markets, with Canada's composite MLS Home Price Index up 0.9% m/m and 24.4% y/y in June. **RBC Economics expects the upward price trend to continue** in the coming months as demand-supply conditions remain tight.

■ **After weakening early in the pandemic, the Canadian dollar went on its strongest run in more than a decade**, rising to a six-year high of US$0.83 in early June. The rally made it the best-performing advanced-economy currency through the first five months of the year. However, recent developments suggest the loonie's June peak could be a high-water mark for 2021. **RBC Economics sees the Canadian dollar remaining within a range around the US$0.80 level over the second half of this year and weakening slightly in 2022**. The relatively flat forecast doesn't exclude the possibility of some volatility along the way. Key uncertainties, including pricing of the commodity complex, the possible convergence of the guidance from the U.S. Federal Reserve and the Bank of Canada (the former is mulling a reduction in quantitative easing and has indicated rates could rise in 2023, if not sooner, which has supported the U.S. dollar at the Canadian dollar's expense) and less investor appetite for riskier assets from equities to currencies such as the Canadian dollar could also put downward pressure on Canada's currency.

EUROPE

Thomas McGarrity, CFA – London

- **The Q2 earnings season kicked off in earnest during the week**, with five of the 10 largest companies by market capitalisation in the STOXX Europe 600 Index reporting results. **ASML**, a manufacturer of lithography systems and a key supplier to the world's leading chipmakers, upgraded its guidance for the second time this year. The company now expects sales to grow around 35% y/y in 2021, up from 30% y/y previously, as **semiconductor manufacturers seek to add new capacity as quickly as possible** to combat global chip supply shortages. ASML's Q2 orders of €8.27 billion came in over 200% above consensus estimates of €2.73 billion. The company's share price has gained more than 55% so far in 2021.

- The shares of **software giant SAP** slipped slightly, despite the company announcing Q2 results broadly in line with consensus expectations as well as slightly raising its full-year guidance. The company, which announced last October it was **accelerating its shift to cloud-based products and away from on-premises licensed software**, demonstrated continued momentum on this front, with the growth in both cloud revenues (+17% y/y) and its cloud backlog (+20% y/y) accelerating sequentially quarter over quarter.

- Quarterly results from both **Roche** and **Novartis** came in ahead of consensus expectations, and showed **signs that health care systems are normalising**. Roche saw a strong rebound in routine (non-COVID-19) testing within its base diagnostics division, while Novartis said that demand had begun to return to pre-pandemic levels in most geographies and therapeutic areas over the course of Q2, but noted that the company continued to still see a slight impact in certain areas, including oncology.

- **Unilever** slightly reduced its margin outlook for 2021 in response to **inflationary pressures from rising raw materials, packaging, and transport costs**. The company now expects its operating margin to be "around flat" y/y (i.e., 18.5%), versus a "slight increase" expected previously. Unilever shares fell almost 6% on the day following the announcement.

ASIA PACIFIC

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

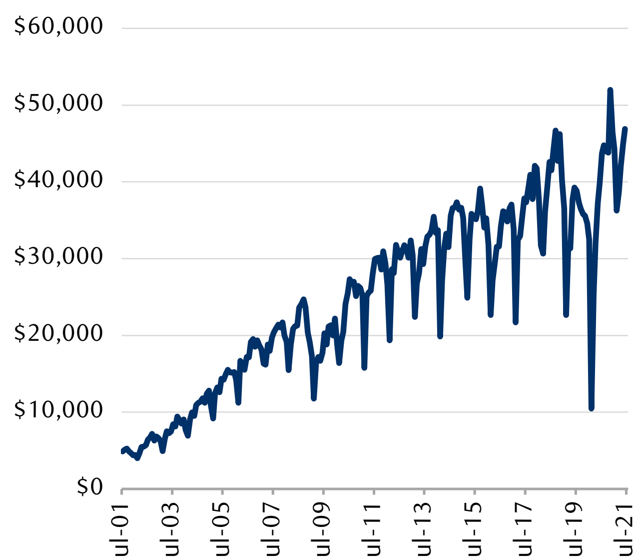
- **The Asia-Pacific equity market traded broadly lower during the week as investors' confidence was dampened by the COVID-19 situation in the region**. Both Thailand and South Korea reported record new infections. Japan's top coronavirus adviser warned that cases in Tokyo could hit a new high in early August, before the end of the Olympics. A third state in Australia went into lockdown, and stay-at-home orders are now in place for about half of the Australian population. Finally, Singapore will be returning to Phase 2 of the reopening after a spike in new cases. Against this backdrop, **we expect the economic recovery in East Asia ex-China to be pushed back**. Already, the World Bank has trimmed its 2021 GDP growth forecast for the region from +4.4% to +4.0%.

- The U.S. and China remain at odds from a geopolitical standpoint—a situation we expect to persist for years to come. On the trade side, however, data suggests **the U.S. and China are shipping goods to each other at the fastest pace in years**. Monthly two-way trade, which tumbled in February of last year amid shutdowns at Chinese factories, rebounded over the past year to new records, according to official Chinese data. To provide some context, **exports from South Korea and Taiwan to the U.S. have also risen over the same period, underscoring the strength of U.S. demand**. Observers believe the trading boom between the U.S. and China can continue, with China purchasing millions of tons of U.S. farm goods and U.S. consumers still shopping and importing in record amounts.

- **Australia and New Zealand Banking Group (ANZ AU)** on Monday became the first domestic bank to say it would **return up to US$1.11 billion to shareholders** by buying back its stock starting in August. According to Reuters, continued strength in the Australian economy had assured the lender that it was largely unscathed from the pandemic, with ANZ adding that it would consider returning more capital in the future.

Booming trade flows between U.S. and China

Value of China's exports to the U.S. (USD millions)



Source - RBC Wealth Management, General Administration of Customs People's Republic of China, Bloomberg; monthly data from 7/31/01–6/30/21

MARKET Scorecard

Data as of July 22, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,367.48	1.6%	16.3%	33.3%	46.3%
Dow Industrials (DJIA)	34,823.35	0.9%	13.8%	28.9%	28.2%
Nasdaq	14,684.60	1.2%	13.9%	37.2%	79.0%
Russell 2000	2,199.48	-4.8%	11.4%	47.6%	42.4%
S&P/TSX Comp	20,097.52	-0.3%	15.3%	24.3%	21.7%
FTSE All-Share	3,991.48	-0.6%	8.7%	16.1%	-2.7%
STOXX Europe 600	456.53	0.8%	14.4%	22.2%	17.7%
EURO STOXX 50	4,059.05	-0.1%	14.3%	20.4%	16.3%
Hang Seng	27,723.84	-3.8%	1.8%	10.6%	-2.3%
Shanghai Comp	3,574.73	-0.5%	2.9%	7.2%	23.8%
Nikkei 225	27,548.00	-4.3%	0.4%	21.1%	28.6%
India Sensex	52,837.21	0.7%	10.7%	39.5%	38.9%
Singapore Straits Times	3,159.26	0.9%	11.1%	21.8%	-5.9%
Brazil Ibovespa	126,146.70	-0.5%	6.0%	21.0%	21.4%
Mexican Bolsa IPC	50,240.51	-0.1%	14.0%	34.2%	21.9%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.272%	-19.6	35.8	67.5	-77.5
Canada 10-Yr	1.196%	-19.3	51.9	68.7	-28.9
UK 10-Yr	0.566%	-15.0	36.9	44.6	-14.2
Germany 10-Yr	-0.426%	-21.9	14.3	6.4	-8.0
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.42%	0.7%	-0.9%	-0.7%	18.9%
U.S. Investment-Grade Corp	1.98%	0.8%	-0.5%	1.2%	26.4%
U.S. High-Yield Corp	3.91%	0.2%	3.8%	11.5%	21.9%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,806.54	2.1%	-4.8%	-3.5%	26.8%
Silver (spot $/oz)	25.40	-2.8%	-3.8%	10.5%	55.2%
Copper ($/metric ton)	9,318.00	-0.4%	20.2%	43.3%	55.4%
Oil (WTI spot/bbl)	72.06	-1.9%	48.5%	72.2%	28.2%
Oil (Brent spot/bbl)	73.62	-2.0%	42.1%	66.2%	16.4%
Natural Gas ($/mmBtu)	4.00	9.5%	57.4%	137.8%	72.9%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	92.8590	0.5%	3.2%	-2.2%	-4.5%
CAD/USD	0.7959	-1.3%	1.3%	6.8%	4.4%
USD/CAD	1.2563	1.3%	-1.3%	-6.4%	-4.2%
EUR/USD	1.1771	-0.7%	-3.6%	1.7%	5.0%
GBP/USD	1.3766	-0.5%	0.7%	8.1%	10.3%
AUD/USD	0.7382	-1.5%	-4.1%	3.4%	4.9%
USD/JPY	110.1900	-0.8%	6.7%	2.8%	2.2%
EUR/JPY	129.7000	-1.6%	2.8%	4.6%	7.3%
EUR/GBP	0.8550	-0.3%	-4.3%	-5.9%	-4.8%
EUR/CHF	1.0821	-1.3%	0.1%	0.6%	-1.7%
USD/SGD	1.3597	1.1%	2.8%	-1.9%	-0.1%
USD/CNY	6.4707	0.2%	-0.9%	-6.8%	-6.0%
USD/MXN	20.1161	0.9%	1.0%	-10.1%	5.6%
USD/BRL	5.2041	4.7%	0.1%	37.7%	39.1%

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.

Examples of how to interpret currency data: CAD/USD 0.79 means 1 Canadian dollar will buy 0.79 U.S. dollar. CAD/USD 1.3% return means the Canadian dollar rose 1.3% vs. the U.S. dollar year to date. USD/JPY 110.19 means 1 U.S. dollar will buy 110.19 yen. USD/JPY 6.7% return means the U.S. dollar rose 6.7% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 7/22/21

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As of June 30, 2021

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Sell [Underperform]	51	3.61	4	7.84

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