GLOBAL
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Perspectives from the Global Portfolio Advisory Committee August 19, 2021

Pressure package: Downgrade Asia ex-Japan equities

Frédérique Carrier – London & Jasmine Duan – Hong Kong

A concerted effort by China to tighten the regulatory screws and a resurgence of COVID-19 in some Chinese provinces cloud the country's short-term outlook. Given its predominance in the region, we have downgraded our recommended equity positioning for Asia ex-Japan to Market Weight.

Zealous regulators

Over the past few months, a whirlwind of regulatory changes has swept across the business and investment landscape in China, putting pressure on Chinese equities. China's get-tough approach appears to be the new normal given the regulators' overarching socio-economic aims.

Maintain financial stability: In April, China's Ministry of Industry and Information Technology announced it would take measures to stabilize commodities prices, crack down on speculation, and encourage smelters and fabricators to hedge on futures markets. Regulators also issued provisions to bring FinTech companies firmly into the fold. This led Ant Group, Alibaba's FinTech giant, to announce it will restructure as a financial holding company to ensure its financial-related businesses are fully regulated.

China's move to safeguard against systemic risk started in earnest last year when regulators began tackling unbridled borrowing in the real estate sector, announcing a series of policies that included caps for debt ratios. The property market has been a major driver of economic expansion in China with real estate accounting for more than seven percent of Chinese GDP in 2020, and including other industries related to real estate brings the total contribution into the high teens, according to Evergrande Research.

Strengthen data security and user privacy protection: Concerns that Chinese digital giants were becoming too powerful and mishandling users' data—a concern echoed in the West regarding its own tech giants—have led the Chinese authorities to clamp down on the country's powerful tech firms.

For example, Ant Group will have to create a licensed personal credit reporting company as part of its efforts to strengthen protection of users' data.

Over the past 20 years, eager to modernize, authorities gave tech companies the space to grow and innovate. It is difficult to overstate the extent of China's achievement as a result, with close to 60 Chinese digital companies worth more than $10 billion.

Promote social equality: In an effort to reduce family living costs, in particular crippling education costs, Chinese authorities recently barred after-school tutoring companies from making a profit.

The education industry in China is massive, with revenues reaching $120 billion, as children compete fiercely to get into good schools and are heavily tutored at an exorbitant cost to parents.

This has created a headache for China, which is facing the demographic challenge of a rapidly aging population following its decades-long one-child policy. The steep

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

Priced (in USD) as of 8/19/21 market close, ET (unless otherwise stated). Produced: Aug. 19, 2021 3:08 pm ET; Disseminated: Aug. 19, 2021 4:55 pm ET
For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

education costs are making the Chinese hesitant to embrace the newly relaxed rules that encourage three children per family.

Other sectors have also been targeted, such as food delivery where the authorities decided to impose a minimum wage for workers.

Not out of the blue

While education sector reforms were widely anticipated, their extent, which made the sector virtually un-investable overnight, took markets by surprise and left many investors with the impression that the authorities are unpredictable. Mark Dowding, chief investment officer at BlueBay Asset Management, an RBC group company, points out that these moves are consistent with both the strategic objectives of China's 14th Five-Year Plan, which was unveiled in March 2021 and outlined the goal of increasing gross national income per capita, and the country's much-heralded aim of "stable and sustainable growth."

We believe other areas likely to attract regulators' attention include health care, online gaming, online insurance, and sectors related to the digital economy.

COVID-19 resurgence

Regulatory zeal is not the only headwind investors have to contend with. China is battling a COVID-19 outbreak, with the delta variant spreading across more than half the country's provinces and municipalities—including Beijing—many among the more affluent regions in China. Dowding surmises that China's current "zero COVID" strategy is coming under increased scrutiny as the delta wave is proving difficult to tame without taking aggressive action to close the economy.

Vaccines that use mRNA technology may become more widely available in China at the end of 2021, leaving policymakers in the unenviable position of having to balance the competing priorities of public health and the economy over the next few months. At this stage, Dowding thinks it remains unlikely that Chinese factory output should be materially impacted, though domestic demand could be dented.

Taking its toll

The COVID-19 resurgence is crimping China's economic growth. July retail sales were hit by the introduction of tough new restrictions to contain the outbreak. Consensus GDP growth forecasts, currently at 8.5 percent and 5.6 percent for 2021 and 2022, respectively, may well come under pressure from these measures and recent relentless flooding. The consensus earnings growth forecast for the MSCI China Index for 2021 is now 15 percent, down from 20 percent previously.

We believe monetary policy may become more flexible to support the economy. Already, the People's Bank of China

Greater China equities have been under pressure

MSCI Golden Dragon Index one-year price chart

Note: The MSCI Golden Dragon Index captures the equity performance of large-cap and midcap China securities.

Source - RBC Wealth Management, Bloomberg; daily data through 8/17/21

(PBoC) cut the reserve requirement ratio, or the amount of cash banks must hold as reserves, by 0.5 percentage points in mid-July, thus effectively freeing up some one trillion yuan ($154 billion) to support interbank liquidity and financial markets. Further PBoC action will likely depend on future economic data, in our view.

In the short term, we believe that lower equity inflows will weigh on the renminbi. But on a six- to 12-month horizon, the imminent inclusion of Chinese bonds in the FTSE World Government Bond Index should continue to attract foreign capital, in our opinion, and underpin the currency. RBC Capital Markets recently revised its year-end USD/CNY estimate to 6.45 (previously 6.40) and expects the currency to barely appreciate in 2022, to reach 6.35 at the end of next year.

Downgrading our stance

The combination of Chinese regulatory zeal and the increased threat from the delta variant has led us to reduce our longstanding recommended allocation to Asia ex-Japan equities to Market Weight from Overweight. We believe this is an appropriate stance given valuations have come down and are below historical averages. The MSCI China Index is currently trading at 13.9x the 2021 consensus earnings estimate versus its five-year average of 15.7x while the MSCI AC Asia ex Japan Index is at 14.5x current year earnings versus its five-year average of 16.2x.

The key signals we are watching for before considering a more positive stance include: major FinTech companies fully complying with regulatory requirements; Chinese companies resuming their onshore and offshore IPO plans; major digital platforms announcing measures to improve social benefits for workers; and leading tech companies opening up their systems or services to each other.

UNITED STATES

Ben Graham, CFA – Minneapolis

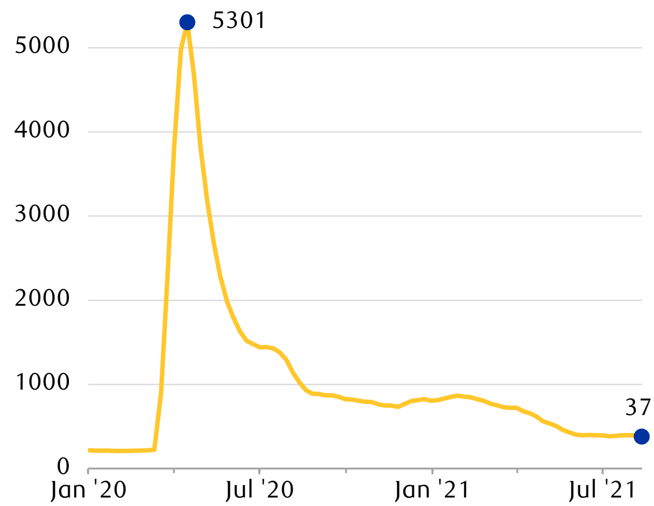
- **U.S. equities have modestly declined thus far this week**, marking a small move off of recent all-time highs. While no major index has fallen more than 5%, the Russell 2000 has retreated more than other headline indexes. The Nasdaq has declined slightly more than the S&P 500 and Dow Jones Industrial Average, underscored by value stocks barely outperforming growth. Health Care and Utilities—two of the three worst-performing sectors this year—showed a resurgence this week and are the only sectors higher so far. Energy has been the worst-performing sector by a clear margin, while other cyclical sectors such as Industrials, Materials, and Financials are lagging as well.

- **Earnings season has shifted to retail and late reporters this week**, and indications from these companies showed an ongoing earnings recovery, with somewhat murky guidance going forward as they attempt to navigate supply chain constraints, slowing (yet still growing) consumer spending patterns, and a resurgence of COVID-19 via the delta variant. Despite these current and ongoing headwinds, retail bellwethers such as Walmart, Target, and Home Depot beat consensus analyst expectations by 13%, 4%, and 2%, respectively. With nearly 97% of the S&P 500 having reported Q2 results, EPS are on track to grow 87% y/y with 84% of companies exceeding expectations.

- **Weekly economic data was mixed with retail sales and housing starts disappointing.** The headline number for the former declined 1.1%, worse than the consensus expectation of a 0.3% contraction, while the latter declined 7.0% m/m to 1.53 million, 80,000 less than the consensus expectation. However, employment data remained indicative of an ongoing recovery as weekly initial claims, at 348,000, hit the lowest level since the pandemic started. The four-week average also hit new lows over the past 17 months after a mid-July hiccup pushed the average higher for a short time, and employment data broadly highlights the healing that has occurred on that front in the economic recovery battle.

U.S. jobless claims resume their decline from COVID-19 highs

Weekly initial jobless claims, four-week average (thousands)



Source - RBC Wealth Management, FactSet; data through 8/19/21

CANADA

Sean Killin & Arete Zafiriou – Toronto

- **Canadian housing market activity cooled in July.** According to the Canadian Real Estate Association, home resales fell 3.5% m/m to an annualized rate of 584,200 units, the fourth consecutive monthly decline following a peak of 811,300 in March. The number of newly listed homes for sale saw an even larger drop of 8.8% m/m. The decline in new listings was widespread across most regions, with the exception of a few local markets including Winnipeg and Saskatoon. Although sales appear to be returning closer to pre-pandemic levels, **home prices remain elevated** as supply-demand conditions continue to favour sellers. The MLS Home Price Index increased 0.6% m/m and 22.2% y/y in July, after rising at an annual rate of 24.4% in June. **RBC Economics believes we may be approaching a local high** and expects national prices to moderate early next year, with prices in some regions decreasing before then.

- **Canada's Consumer Price Index rose 0.6% (3.7% annualized) in July** on a month-by-month basis, **exceeding economists' average estimate of 0.29%**. This is the fourth consecutive month that inflation has been above the Bank of Canada's target range of 1%–3%. Inflation has not hit this level since 2011, and has not been above it since 2003. According to Bloomberg, the average of core inflation readings (a strong barometer of underlying price pressures) rose 2.47% in July, the biggest increase since the impacts of the financial crisis in 2009. These inflationary conditions are a hot topic in the run-up to the federal election on September 20, as political parties make affordability a key campaign issue. **The Governor of the Bank of Canada forecasts inflation creeping up to 3.9% in Q3 2021** before cooling down towards the end of the year.

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

- **Having eked out 10 straight record highs up to last Friday's (August 13) close, the STOXX Europe 600 Index retreated 2% during the week.** Under the surface, market moves were decidedly risk-off, with defensives notably outperforming and only the Health Care and

Utilities sectors in the green. Cyclicals significantly underperformed, particularly miners that sold off as iron ore futures sharply declined on the back of China pushing ahead with curbs to steel production, as well as Chinese growth indicators' data for July (e.g., industrial production and fixed asset investment) coming in below consensus expectations across the board, raising demand concerns for commodities. Luxury stocks also sold off sharply following reports in the Chinese state media that the government has called for changes in its policies related to wealth distribution and "common prosperity," including tackling social inequality and excessive incomes.

- **BHP Group made two notable announcements alongside its full-year results.** The company is set to **exit oil and gas**, with its Petroleum business being spun out and entering into a merger with Woodside Petroleum, the Australian-listed oil and gas exploration and production group. BHP stated the transaction "allows for greater allocation of capital to future facing commodities or shareholder returns". BHP also announced it intends to **unwind its dual-listed company structure**, and shift its primary listing to Australia's stock exchange. The move requires 75% approval from the shareholders of both the respective UK and Australian listed shares. If approved, it would result in BHP, one of the biggest companies listed in the UK, exiting the UK's FTSE 100 index.

- **The release of UK inflation numbers raised eyebrows** with July's Consumer Price Index reading at a much-below-consensus 2% y/y increase, down from a 2.5% y/y increase in June. Clothing and footwear returning to a more typical seasonal pattern of sales, and cheaper package holidays and hospitality as the sector reopened were the main drivers, but were also short-term factors in RBC Capital Markets' view. Headline inflation is likely to pick up in coming months and could reach a level close to the Bank of England's projected 4% by year's end. In 2022, with global shortages easing, RBC Capital Markets believes inflation is likely to retreat. RBC Capital Markets expects a first rate hike of 0.15% in May 2022, followed by another 0.25% increase in November.

ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **Asia Pacific equity markets have traded broadly lower during the week, led by Hong Kong and Taiwan.** The Hang Seng Index looks likely to retest the recent low seen in the final week of July. China internet stocks weighed on the local bourse again following reports that China is studying separate proposals to further ensure the rights of drivers who work for online companies, and to step up oversight of the livestreaming industry. According to a Bloomberg estimate, **Beijing's recent crackdowns on the tech sector wiped about US$1 trillion of market value from Chinese shares** listed globally last month as the regulatory scrutiny quickly expanded from antitrust and e-commerce concerns to private tutoring, data security, and online content. Notwithstanding the weak performance of China internet stocks, we remain constructive on Hong Kong equities overall on the back of improving macro factors and undemanding valuations.

China Internet stocks weighing on Hang Seng Index

Hang Seng Index closing price (HKD)

Source - RBC Wealth Management, Bloomberg; daily data through 8/19/21

- **Tencent Holdings (700 HK) reported Q2 FY2021 earnings** (+13% y/y adjusted net profit, +20% y/y revenue) **that were broadly in line with consensus estimates**. Despite those respectable results, the company's share price fell as management warned investors to brace for more regulatory curbs on China's tech sector. "In the near future, more regulations should be coming," President Martin Lau told analysts. "This should be expected because the regulation has been quite loose over an industry like the internet, considering its size and the importance."

- **The Reserve Bank of New Zealand's plan to raise interest rates this week was thwarted after the first COVID-19 case in six months was discovered in Auckland on Wednesday.** The country is now under its strictest form of lockdown (Level 4). Auckland will be in lockdown for seven days, while the rest of the nation will be locked down for three days. In view of the latest COVID-19 development, the central bank has decided to hold rates at 0.25%.

MARKET Scorecard

Data as of August 19, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,405.80	0.2%	17.3%	30.5%	50.7%
Dow Industrials (DJIA)	34,894.12	-0.1%	14.0%	26.0%	33.5%
Nasdaq	14,541.79	-0.9%	12.8%	30.5%	81.7%
Russell 2000	2,132.42	-4.2%	8.0%	35.6%	41.3%
S&P/TSX Comp	20,215.36	-0.4%	16.0%	21.9%	24.0%
FTSE All-Share	4,064.14	0.8%	10.6%	19.5%	3.2%
STOXX Europe 600	467.24	1.2%	17.1%	26.4%	25.0%
EURO STOXX 50	4,124.71	0.9%	16.1%	24.3%	22.4%
Hang Seng	25,316.33	-2.5%	-7.0%	0.5%	-3.7%
Shanghai Comp	3,465.56	2.0%	-0.2%	1.7%	20.2%
Nikkei 225	27,281.17	0.0%	-0.6%	18.0%	32.7%
India Sensex	55,629.49	5.8%	16.5%	44.1%	48.7%
Singapore Straits Times	3,086.97	-2.5%	8.6%	20.5%	-1.3%
Brazil Ibovespa	117,164.70	-3.8%	-1.6%	16.2%	17.8%
Mexican Bolsa IPC	51,099.36	0.5%	16.0%	31.0%	29.2%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.240%	1.8	32.7	56.0	-36.6
Canada 10-Yr	1.129%	-7.4	45.2	54.8	-5.8
UK 10-Yr	0.538%	-2.7	34.1	30.2	6.8
Germany 10-Yr	-0.489%	-2.8	8.0	-1.7	15.9
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.43%	-0.3%	-0.8%	-0.3%	19.0%
U.S. Investment-Grade Corp	2.01%	-0.5%	-0.4%	2.2%	26.5%
U.S. High-Yield Corp	4.11%	-0.3%	3.7%	10.1%	21.7%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,780.48	-1.9%	-6.2%	-7.7%	19.0%
Silver (spot $/oz)	23.24	-8.8%	-12.0%	-12.9%	37.7%
Copper ($/metric ton)	9,024.00	-7.0%	16.5%	34.7%	57.1%
Oil (WTI spot/bbl)	63.69	-13.9%	31.3%	48.4%	13.3%
Oil (Brent spot/bbl)	66.88	-12.4%	29.1%	47.4%	12.0%
Natural Gas ($/mmBtu)	3.86	-1.4%	52.1%	59.2%	74.7%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	93.5630	1.5%	4.0%	0.7%	-4.9%
CAD/USD	0.7797	-2.8%	-0.7%	3.1%	3.9%
USD/CAD	1.2826	2.8%	0.8%	-3.0%	-3.7%
EUR/USD	1.1677	-1.6%	-4.4%	-1.4%	5.4%
GBP/USD	1.3635	-1.9%	-0.3%	4.1%	12.4%
AUD/USD	0.7148	-2.7%	-7.1%	-0.5%	5.7%
USD/JPY	109.7700	0.0%	6.3%	3.4%	2.9%
EUR/JPY	128.1800	-1.6%	1.6%	2.0%	8.5%
EUR/GBP	0.8564	0.3%	-4.2%	-5.3%	-6.3%
EUR/CHF	1.0728	-0.2%	-0.8%	-1.0%	-1.4%
USD/SGD	1.3647	0.8%	3.2%	-0.4%	-1.6%
USD/CNY	6.4949	0.5%	-0.5%	-6.4%	-7.9%
USD/MXN	20.1704	1.5%	1.3%	-8.8%	1.5%
USD/BRL	5.4211	4.0%	4.3%	43.5%	33.0%

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 0.77 means 1 Canadian dollar will buy 0.77 U.S. dollar. CAD/USD -0.7% return means the Canadian dollar fell 0.7% vs. the U.S. dollar year to date. USD/JPY 109.77 means 1 U.S. dollar will buy 109.77 yen. USD/JPY 6.3% return means the U.S. dollar rose 6.3% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 8/19/21

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As of June 30, 2021

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Buy [Outperform]	787	55.70	318	40.41
Hold [Sector Perform]	575	40.69	173	30.09
Sell [Underperform]	51	3.61	4	7.84

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