GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

September 9, 2021

Labor pains?

Atul Bhatia, CFA – Minneapolis

The labor market is swinging from a job shortage to a worker shortage. And with the expiration of federal benefits likely to kick start millions of job seekers, we see both positive and negative implications for the economy.

The U.S. had a record 10.9 million job openings at the beginning of August. Despite the large number of vacancies—and with total employment still 5.5 million below pre-pandemic levels—the economy added only 235,000 jobs last month, the slowest growth in seven months and lower than all estimates in a pre-release survey of economists conducted by Bloomberg.

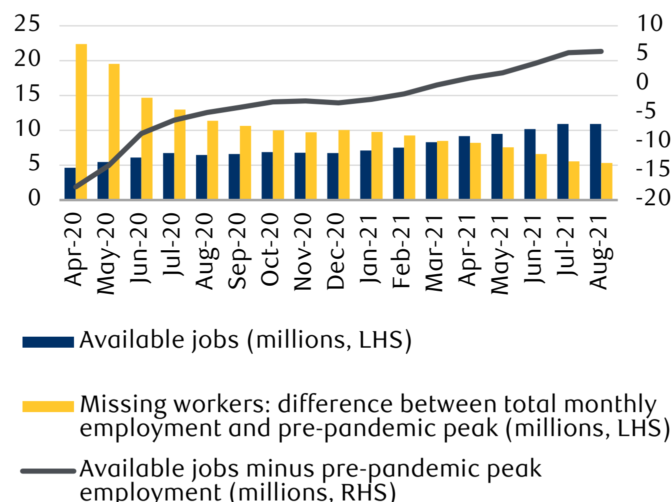
One possible explanation for the disconnect between employment growth and job vacancies is the impact of federal unemployment benefits. These pandemic relief measures—which expired earlier this week—included extending benefits to roughly seven million individuals not covered under state programs and $300/week supplemental payments to an additional three million recipients of traditional unemployment.

Critics contend the federal benefits created disincentives to work, leading to upward wage pressure and extended job vacancies. As these payments expire, there is some hope that vacancies will be filled at a faster rate in the coming months.

Our view is that this week's expiration will likely have a positive impact on near-term hiring. At the same time, the move is unlikely to be a panacea for the labor market, particularly when accounting for the indirect impact of the programs' termination. Supply chain issues, consumer decisions around drawing down savings, and pending fiscal and debt ceiling legislation are all likely to have a more significant impact on employment counts into year end.

Competitive pressure—particularly among the seven million individuals who no longer receive any government unemployment payments—is also likely to weigh on

Shifting imbalances: Labor market swings from job shortage to worker shortage



Source - RBC Wealth Management, Bloomberg; monthly data through 8/31/21

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

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wages, potentially cutting wage-price inflation and consumer spending.

Data supports a hiring bump

Back in June, nearly 20 states chose to reject federal funds and cut payments to unemployed workers early, with the stated goal of increasing employment as workers looked to replace lost income with wages.

The data largely supports their thesis. One academic study concluded that states without federal payments saw 25.9 percent of benefit recipients find a job in the months following the reduction of payments, compared to 21.5 percent in states with higher payouts. Since the study relied on banking data from lower-income households, the job creation impact of the benefit reductions may be overstated, but it is unlikely to be zero or negative.

Extrapolating to this week's policy expiration, we would expect approximately 500,000 additional positions to be filled in the coming months as a result of lost benefits.

Secondary impacts push against growth

Unfortunately, the rest of the math associated with the policy change is less helpful.

The same study that showed faster job creation in lower-benefit states also found an overall negative impact on household income and spending. For every eight individuals that lost benefits, only one found a job in the two months following the loss of benefits. The result was a $270 million increase in wages, but a $4 billion drop in consumer income—and a $2 billion drop in consumer spending—in the months following the change.

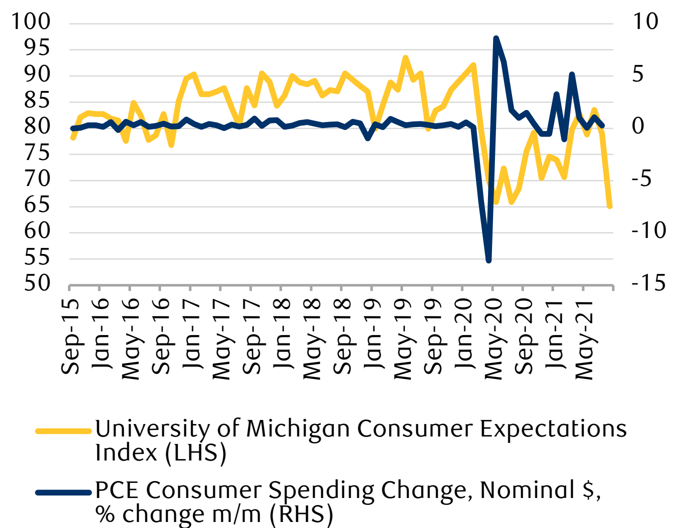
The nationwide loss of benefits is likely to see a similar dynamic at play. Even the more optimistic estimates on the Street see only an incremental gain of 1.5 million jobs between now and year end; any wage gains from that increase are likely to be more than offset, however, by the complete loss of income to seven million individuals. Based on the experience in the states that cut benefits early, these households may end up reducing spending by as much as $8 billion, a decline in demand that could impact corporate hiring plans in the future.

Timing for a reduction in household spending is not ideal; economists across Wall Street have recently been cutting estimates for Q3 2021 GDP growth on a combination of COVID-19 impacts and reduced consumption. Bloomberg Economics, for instance, now sees the economy growing by five percent this quarter, down from its prior estimate of seven percent.

Longer term

We believe there are other reasons to be cautious on the economy's ability to absorb seven million workers in the near term. First, there are ongoing pandemic impacts, with the delta variant disrupting hospitality and travel in particular. Second, hiring managers face significant

Unfortunate timing: Declining consumer confidence and spending meet benefit drop-off



Source - RBC Wealth Management, Bloomberg; monthly data through 8/31/21

skills and geographic mismatches with the available labor pool. Finally, supply chain disruptions are leading to new layoffs, including the ongoing chip shortage that is causing major curtailments in auto production.

These challenges highlight the limited role that unemployment benefits play in the larger labor market. Consumer comfort with in-person shopping and having goods to sell are more important constraints, in our view, and the child care implications of schools reopening for in-person education are likely to provide a bigger near-term boost to worker availability.

Policy impacts

For the Fed, we believe the dip in hiring in August is unlikely to significantly delay the start of reducing its bond purchases, a process known as tapering; when COVID-19 case counts drop and assuming federal stimulus ramps up, the Fed is likely to see sufficient job gains to bring it to the tapering starting line. If job growth slows further, the central bank may delay, but one weak month is unlikely to shift the view of policymakers on the need to begin reducing bond purchases.

Instead, the Fed is more likely to be influenced by any drop in consumer spending and the anti-inflationary impact of containing wage growth. At the margin, the curtailment of unemployment benefits to millions of households should give the Fed more space to keep interest rates lower for an extended period, in our opinion. This would fit well with the central bank's position of detaching tapering and rate movements.

For both investors and policymakers, the labor market remains critical and challenging. The expiration of federal benefits is likely to kick start millions of job seekers, with both positive and negative implications for the economy.

UNITED STATES

Ben Graham, CFA – Minneapolis

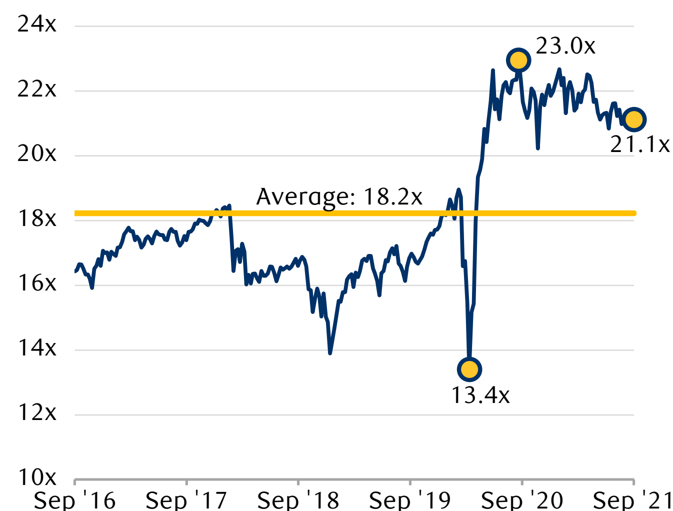
- **U.S. equities have moved modestly lower this week after setting new all-time highs as recently as last Thursday**. So far this week, the Nasdaq and S&P 500 are holding up similarly, with with the former down 0.8% and the latter down 0.9%. The Dow Jones Industrial Average, with its 1.4% decline, is worse, and the small-cap Russell 2000 is the worst performer of the major U.S. indexes, having declined 1.9%. Sector leadership is most evident in Utilities and Consumer Discretionary while laggards include the cyclical sectors of Energy, Materials, and Industrials.

- **Market valuations have come down modestly in recent months**, despite record equity levels, as earnings growth outpaces equity market appreciation. In 2021, the S&P 500 has climbed approximately 20% while earnings estimates, as measured by consensus, are indicative of 43% earnings growth this year and 10% next. The result is that valuations have declined modestly, although they remain well above historical averages. Currently, the S&P 500 trades at 21.1x next-twelve-month estimated earnings, above the five-year average of 18.2x and below the September 2020 high of 23.0x. The relatively clear path to ongoing earnings growth remains one of the best supports to equity markets should they encounter volatility in coming weeks to months.

- **Economically speaking, initial unemployment claims data was the highlight of the week**. Initial filings for the week of Sept. 3 surprised investors with a result that was much lower than expected. Weekly claims of 310,000, the lowest in the past 18 months, were well below expectations of 340,000. This assisted in pushing the four-week average to new lows and broadly underscores the healing that has occurred in the aftermath of the COVID-19 extremes.

Stocks modestly expensive despite slow decline over the last year

S&P 500 next-twelve-month price-to-earnings ratio



Source - RBC Wealth Management, FactSet; data through 9/9/21

CANADA

Luis Castillo & Simon Jones – Toronto

- The Bank of Canada's (BoC) monetary policy announcement proved uneventful, with both the overnight rate and the pace of quantitative easing (QE) purchases unchanged from prior meetings. However, the central bank did make an effort to address **June's surprisingly weak GDP data, acknowledging that supply chain disruptions are still restraining activity in a number of exporting sectors, especially automotive manufacturing**. The BoC has made its gradual removal of accommodative monetary policy contingent on the Canadian economy evolving according to the bank's projections, and weaker-than-expected GDP results could put the economy temporarily offside. However, the BoC remains ahead of most major central banks on the QE tapering front, in our view; while it has already announced its third QE taper (to CA$2 billion/week in asset purchases, from CA$5 billion/week), the U.S. Federal Reserve has only recently touched on the need to start.

- **Canadian housing market activity continued to moderate** towards more sustainable levels in August. Data released by municipal real estate boards showed sharp declines in resale activity in most major metropolitan areas compared to a year ago. Seasonal fluctuations and heightened borrowing standards were cited in some regions as contributing to the decline, but the limited supply of housing—particularly single-family dwellings—appeared to have the most significant impact. **Low inventories and fewer listings offset the softening demand, leaving market conditions incredibly tight**. RBC Economics sees this dynamic as supportive of prices in the near term, but expects the pace of increases to slow as consumer budgets shift towards consumption in response to the economy reopening. Nevertheless, the upward shift in the price level that has occurred since the onset of the pandemic has worsened already poor housing affordability in several markets across the country.

EUROPE

Frédérique Carrier – London

- **UK Prime Minister Boris Johnson announced a new tax to help pay for social care and health services**, which are burdened with large backlogs due to pandemic-related treatment delays. The government estimates the new 1.25% health and social care levy will amount

to £12 billion per annum, or approximately 0.5% of GDP, a significant increase that will hit employees and employers alike. These National Insurance Contributions increases will be effective from April 2022 and will become a separate levy in 2023. Taxes on dividend income will increase by 1.25 percentage points to 33.75% for higher-rate taxpayers, while additional-rate taxpayers, those with earnings of more than £150,000 per annum, will experience an increase to 39.35% from 2022–2023 onwards.

- **The UK will thus experience substantial fiscal tightening over the next six months**. About a third of the £60 billion in fiscal stimulus measures announced in the last budget are being withdrawn at the end of September, according to RBC Capital Markets, through the ending of the furlough and self-employed income support schemes, the end of the stamp duty holiday, and withdrawal of the £20 per week universal credit uplift. This is occurring at a time when personal income tax allowances are being frozen from April 2022. **2021 will be remembered as the year the UK tax burden rose to a 70-year high**.

- **The European Central Bank (ECB) announced it will reduce modestly the amount of its monthly asset purchases under the Pandemic Emergency Purchase Programme (PEPP)**. The ECB reiterated the reduction is not the beginning of a continuous process to reduce its bond buying as it could increase the pace again should financial conditions worsen. The decision to extend the date of the PEPP beyond March 2022 and details regarding its smaller Asset Purchase Programme purchases were postponed until its next meeting in December.

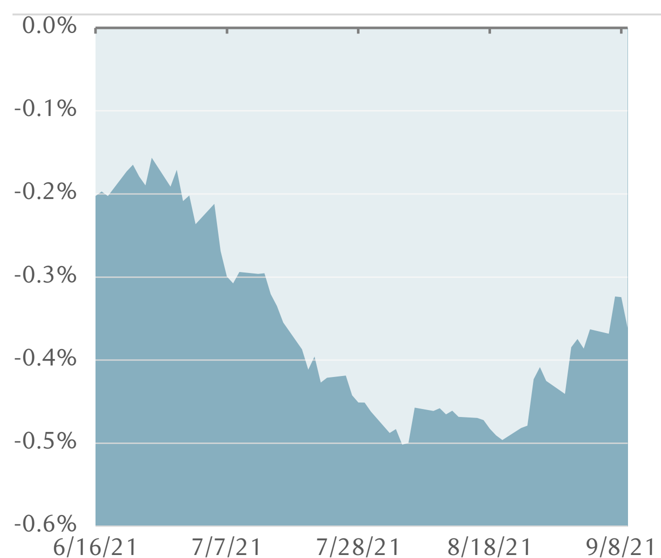
ASIA PACIFIC

Jasmine Duan – Hong Kong

- **On Sept. 8, Chinese authorities ordered gaming companies, which included Tencent (700 HK) and NetEase (9999 HK), to strictly implement the play-time restrictions on minors**, and they must not provide any online game account rental and transaction services to minors in any shape or form. The companies should also remove "obscene and violent content" and avoid "unhealthy tendencies, such as money-worship and effeminacy." **The development sent Chinese Tech stocks lower**, with the Hang Seng TECH Index down 4.5% on Thursday. The Tech stock correction comes after recent buying by bargain hunters, which had delivered a short-

A rapid rise in yields could push the ECB to act

German 10-year Bund yield since June



Source - RBC Wealth Management, Bloomberg; data through 9/9/21

term rebound. However, investors' reaction towards the situation shows **market sentiment is still fragile, and any news regarding a regulatory reset could still trigger a market correction**, in our view.

- **China's Producer Price Index (PPI) rose 9.5% y/y in August**, faster than the 9% gain in July. The Consumer Price Index (CPI) grew 0.8% y/y, following a 1% increase in the previous month. We believe the rally in commodity prices has been a major driver of the surge in the PPI. However, the gains in the PPI did not pass through to the CPI, which remained subdued due to lackluster demand, falling food prices, and COVID-19 containment measures. The future trend of the **price transmission from producer prices to consumer prices will be one of the important factors affecting China's monetary policy decisions**, in our view.

- **Japan will extend the COVID-19 state of emergency** in 19 areas including Tokyo and Osaka until Sept. 30 as infections from the delta variant strain the medical system. The extension comes after **Prime Minister Yoshihide Suga announced his resignation** following a drop in public support as he struggled to contain a record surge in cases. His replacement will face the task of balancing efforts to contain the virus against the need to reopen the economy.

MARKET
Scorecard

Data as of September 9, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,493.28	-0.7%	19.6%	32.2%	50.9%
Dow Industrials (DJIA)	34,879.38	-1.4%	14.0%	24.8%	30.0%
Nasdaq	15,248.25	-0.1%	18.3%	36.9%	88.5%
Russell 2000	2,249.13	-1.1%	13.9%	47.3%	47.6%
S&P/TSX Comp	20,705.27	0.6%	18.8%	26.4%	25.5%
FTSE All-Share	4,055.82	-1.3%	10.4%	20.8%	2.0%
STOXX Europe 600	467.57	-0.7%	17.2%	26.5%	21.1%
EURO STOXX 50	4,177.11	-0.5%	17.6%	25.6%	19.5%
Hang Seng	25,716.00	-0.6%	-5.6%	5.1%	-3.6%
Shanghai Comp	3,693.13	4.2%	6.3%	13.5%	22.1%
Nikkei 225	30,008.19	6.8%	9.3%	30.3%	40.8%
India Sensex	58,305.07	1.3%	22.1%	52.7%	57.0%
Singapore Straits Times	3,071.70	0.5%	8.0%	22.9%	-2.4%
Brazil Ibovespa	115,360.90	-2.9%	-3.1%	13.9%	11.8%
Mexican Bolsa IPC	51,395.06	-3.6%	16.6%	42.1%	20.5%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.295%	-1.3	38.2	59.5	-34.8
Canada 10-Yr	1.172%	-4.4	49.5	57.6	-18.1
UK 10-Yr	0.736%	2.2	53.9	49.9	14.5
Germany 10-Yr	-0.361%	2.2	20.8	10.1	22.4
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.45%	-0.1%	-0.8%	-0.2%	18.9%
U.S. Investment-Grade Corp	2.02%	-0.2%	-0.5%	2.3%	26.4%
U.S. High-Yield Corp	3.83%	0.2%	4.7%	10.6%	23.0%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,794.17	-1.1%	-5.5%	-7.8%	19.7%
Silver (spot $/oz)	24.04	0.6%	-9.0%	-10.9%	33.5%
Copper ($/metric ton)	9,226.50	-3.2%	19.1%	36.5%	59.4%
Oil (WTI spot/bbl)	68.14	-0.5%	40.4%	79.1%	17.8%
Oil (Brent spot/bbl)	71.26	-2.4%	37.6%	74.7%	13.9%
Natural Gas ($/mmBtu)	5.01	14.4%	97.2%	108.1%	93.7%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	92.5250	-0.1%	2.9%	-0.8%	-5.9%
CAD/USD	0.7896	-0.4%	0.5%	3.8%	4.0%
USD/CAD	1.2666	0.4%	-0.5%	-3.7%	-3.8%
EUR/USD	1.1823	0.1%	-3.2%	0.2%	7.0%
GBP/USD	1.3836	0.6%	1.2%	6.4%	12.1%
AUD/USD	0.7366	0.7%	-4.3%	1.1%	7.3%
USD/JPY	109.7300	-0.3%	6.3%	3.3%	2.3%
EUR/JPY	129.7300	-0.1%	2.8%	3.5%	9.5%
EUR/GBP	0.8545	-0.5%	-4.4%	-5.9%	-4.5%
EUR/CHF	1.0837	0.3%	0.2%	0.6%	-1.1%
USD/SGD	1.3428	-0.2%	1.6%	-1.7%	-2.7%
USD/CNY	6.4554	-0.1%	-1.1%	-7.0%	-9.4%
USD/MXN	19.9455	-0.6%	0.2%	-6.6%	1.9%
USD/BRL	5.2236	1.4%	0.5%	38.2%	27.5%

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 0.78 means 1 Canadian dollar will buy 0.78 U.S. dollar. CAD/USD 0.5% return means the Canadian dollar rose 0.5% vs. the U.S. dollar year to date. USD/JPY 109.73 means 1 U.S. dollar will buy 109.73 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 9/9/21

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Hold [Sector Perform]	575	40.69	173	30.09
Sell [Underperform]	51	3.61	4	7.84

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