GLOBAL
Insight
WEEKLY

Wealth Management
RBC

Perspectives from the Global Portfolio Advisory Committee
September 30, 2021

Slow down, look around

Kelly Bogdanova – San Francisco

Given the tear it's been on since the pandemic lows, it shouldn't come as a surprise that the stock market would take a much-needed rest, even more so as it's navigating through some challenges. And while there could be more volatility ahead, we think the bull market can work through the headwinds and ultimately move higher.

The mood of the U.S. equity market has shifted lately from that of a charging bull to a resting bull.

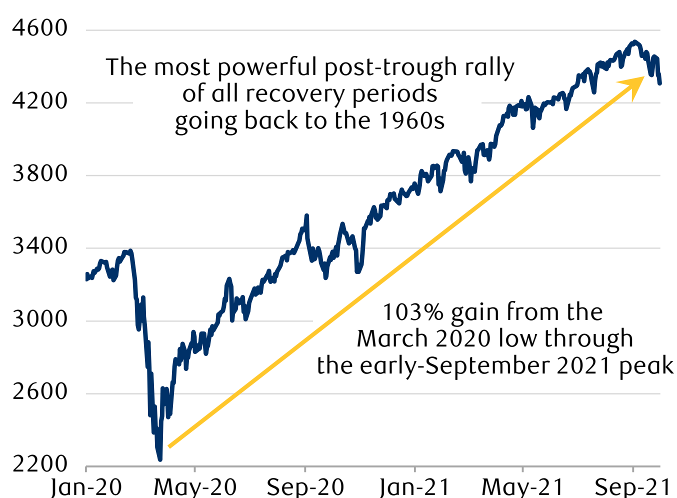
The S&P 500 surged 103 percent from the COVID-19 low back in March 2020 through early September 2021. This is by far the most powerful post-trough rally of all recovery periods during similar time frames going back to the 1960s. The next-best results were 61–62 percent rallies in 2009, 1982, and 1974.

Recently, the index has cooled off, pulling back 5.1 percent since Sept. 2, and has broken a seven-month winning streak while facing numerous headwinds, some of which are unique to the pandemic:

- Persistent COVID-related distortions on supply chains, energy prices, inflation, the labor market, and overall economic momentum;
- A number of Q3 earnings missteps and warnings due to the above issues by companies in a wide range of economically-sensitive (cyclical) industries;
- Angst about legislation in Washington on the debt ceiling, two large spending bills, and potential tax hikes on corporations and upper-income individuals;
- Jitters about Chinese GDP growth related to electricity rationing (including on the all-important industrial sector) caused by high coal prices and other factors, and lingering Evergrande and property market risks;
- The Fed's likely forthcoming policy shift to begin tapering asset purchases later this year, and the anticipation of rate hikes further out.

The U.S. market has come a long way in a short time

S&P 500 level since January 2020



Source - RBC Wealth Management, Bloomberg; data through 9/30/21

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

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For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

We think the market can ultimately work through these challenges—leading economic indicators are still flashing favorable signals—but there could be more volatility in coming weeks and months.

Washington wrangling

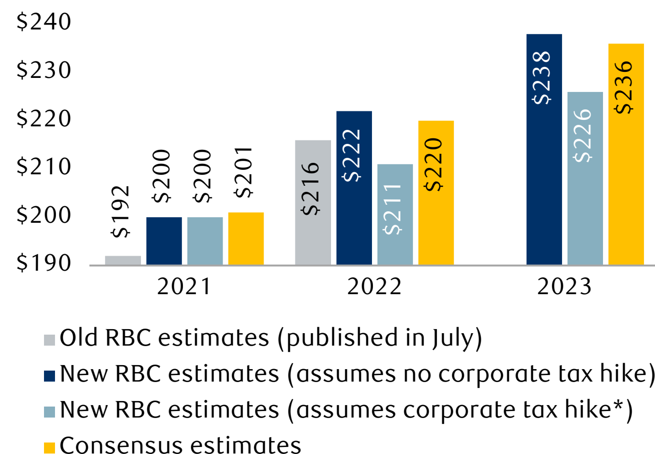
We don't want to seem dismissive about the debt ceiling—it's a real head-scratcher for a number of reasons, and the mounting federal debt continues to give us pause. Nevertheless, RBC Capital Markets, LLC's Chief U.S. Economist Tom Porcelli expects it to play out the way it has in the past. Drama should persist in the near term, and then he thinks Congress will agree to raise the debt ceiling in a timely manner such that it averts a self-inflicted crisis.

While political maneuvering surrounding the very large $1 trillion infrastructure and $3.5 trillion budget bills continues to generate headlines, Porcelli does not believe their passage would materially boost economic growth. The total spending would likely be lower than the proposed amount, it would be spread out over many years, and potential corporate tax hikes could offset at least some of the stimulus. Lori Calvasina, head of U.S. equity strategy at RBC Capital Markets, LLC, said institutional investors (portfolio managers of mutual funds, pension funds, and hedge funds) view these bills as "show me" stories. Some companies would benefit from the infrastructure and/or green energy spending provisions, but the bills are not being seen as meaningful catalysts for overall earnings growth or the market.

Calvasina thinks the impact of a moderate corporate tax hike, such as raising the statutory rate from 21 percent to 25 percent (the consensus view), is largely factored into the market. While a hike of this magnitude is not yet officially reflected in the bottom-up consensus forecasts of analysts for 2022 and 2023, she believes institutional investors have generally built it into their earnings forecasts.

RBC Capital Markets has raised estimates, and is factoring in the possibility of a tax hike

RBC's annual EPS estimates for the S&P 500 versus consensus estimates



* Assumes a corporate tax hike of four percentage points, which would take the statutory rate from 21% to 25% beginning in 2022.

Source - RBC Capital Markets U.S. Equity Strategy; consensus estimates are Refinitiv I/B/E/S bottom-up data as of 9/24/21

Chain reactions

Supply chain issues are taking their toll, and have likely constrained Q3 economic and earnings growth. In terms of the market, Calvasina said a key problem is all of the uncertainty associated with this issue at the industry and company levels. The mounting number of Q3 earnings warnings is a signal that some management teams are having a difficult time coping with supply chain constraints, and institutional investors are becoming more skeptical about what management teams are actually saying about these challenges. Also, institutional investors don't have a clear sense about what will improve the situation or when it will happen. Calvasina expects supply chain pressures to recede as the COVID-19 pandemic loosens its grip, but she points out this is not a silver bullet, as other factors are at play.

At the very least, we expect more market volatility leading up to or during the Q3 earnings season due to headwinds related to supply chains, high energy input costs, inflation, and labor market constraints. It would not be surprising to us if the earnings beat rate falls short of the lofty levels achieved in the five preceding quarters and is punctuated by some high-profile earnings misses. The good news is that even those management teams that are struggling with supply chain challenges are still positive about customer demand.

More important than Q3 earnings trends is the longer-term path of earnings growth. Calvasina recently raised her S&P 500 annual earnings estimates, and has incorporated the corporate tax hike scenario, as the chart illustrates. If her 2022 earnings level is achieved, it would translate to 11 percent year-over-year growth without a corporate tax hike or 5.5 percent growth with the hike—not bad, in our view, considering this would come on top of the estimated 43 percent surge in earnings this year. Overall, Calvasina characterizes her new estimates as "conservative" and notes the potential for upside if corporate stock buybacks exceed her current expectations.

Structural support

It's not unusual for the market to take a much-needed rest following a strong run, especially after earnings growth peaks on a year-over-year basis—which we think occurred in the second quarter of this year.

Despite the unique COVID-related headwinds, leading economic indicators are still signaling that recession risks are nearly nonexistent, household fundamentals remain strong, and earnings growth should persist, at least at a moderate pace. Therefore, we continue to anticipate worthwhile market gains over the next 12 months, albeit with less robust returns than during the last 12 months.

UNITED STATES

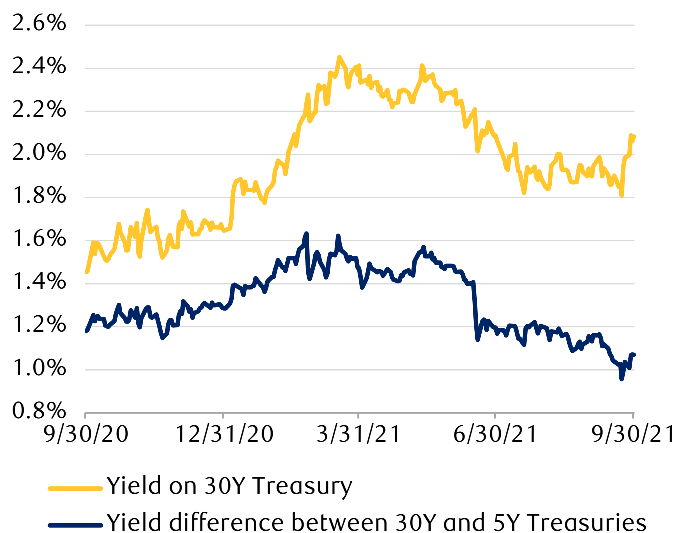
Atul Bhatia, CFA – Minneapolis

■ **The leaders of the Boston and Dallas Federal Reserve Banks unexpectedly resigned this week.** Neither of the moderately hawkish officials currently vote on monetary policy, although their successors will have voting roles in 2022 and 2023, respectively. In addition to those vacancies, four Fed governor positions are open or will be next year, including the Fed Chair role in February. **Personnel changes may introduce a slight shift in central bank rhetoric, but we expect the same broad policy outcome**: the Fed will begin reducing its monthly bond purchases this year and will evaluate rate hikes once that process concludes, likely in mid-2022.

■ **Congress faces an Oct. 1 deadline to avoid a partial government shutdown and an estimated Oct. 18 cutoff date to prevent a default by the U.S. government.** We expect the required legislation to pass in time and we see little realistic risk of a Treasury default. The path forward on fiscal measures is less clear—the infrastructure bill that passed with bipartisan support in the Senate may fail in the House due to the combined opposition of House Republicans and progressive Democrats. The broader, multitrillion-dollar Biden fiscal plan faces a potentially fatal challenge as conservative and progressive Democrats remain far apart; press reports indicate a potential $2 trillion difference in their respective hard limits on the size of any fiscal package.

■ **Treasury bond prices declined this week as markets continued to digest the likely timeline for Fed action.** Yields, which move inversely to prices, rose above 2.05% on government bonds maturing in 30 years, the highest level since late June. One notable difference from the early summer is that yields on shorter-maturity bonds have risen in lockstep with their longer counterparts. The result is a so-called flatter yield curve, typically a sign that markets are concerned about long-term growth. **We think the outcome of the current fiscal debate is likely to play an important role in Treasury market pricing**.

Absolute yields rise; relative rate recovery lags



Source - RBC Wealth Management, Bloomberg

CANADA

Sean Killin & Richard Tan, CFA – Toronto

■ **The Canadian federal election concluded in much the same way as it began, with the Liberals finding a successful outcome and the continuation of a minority government.** The Liberal government campaigned to create more affordable housing for Canadians, promising more supply in the coming years and by introducing new regulations around foreign ownership and anti-flipping taxes. On the other side of the ledger, the Liberals proposed a reduction in high-ratio mortgage insurance rates (i.e., down payments of less than 20%) and the development of a new tax-sheltered investment account for new homebuyers. In our opinion, the effort to curb the cost of home ownership through the former policy is offset somewhat by the latter policy's potential to generate greater housing demand, all else equal. Overall above-average savings rates, low interest rates, easy access to credit, and demand for larger spaces have propelled home prices higher over the past year. Heading into 2022, we believe it will be important to pay close attention to the housing market as the prospect of higher interest rates could weigh on housing valuations.

■ **Inflation is hitting Canadian consumers at the grocery store**, as pandemic-related disruptions that impacted food production and supply bottlenecks have yet to subside. According to a recent study published by Dalhousie University's Agri-Food Analytics Lab, Canadian food prices are up 5% over the past 12 months. This stands in contrast to numbers published by Statistics Canada showing food inflation at 2.7% over the same period. The study surveyed nearly 10,000 Canadians and concluded that the prices of meat products led the rise of inflation, increasing more than 10% in the past six months. Nearly 49% of survey respondents said they had curtailed their meat purchases as a result. According to Bloomberg, suppliers have also shrunk portion sizes, yet have maintained similar packaging and prices, in a strategy known as "shrinkflation." With inflation in Canada running meaningfully above the Bank of Canada's target, financial markets are currently pricing in possible rate hikes by the end of 2022.

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

- **The British pound declined to a 2021 low of 1.34 to the U.S. dollar. Counterintuitively, this coincided with the UK 10-year bond yield jumping above 1%**, from a low of 0.47% in August, as markets reacted to hawkish comments from Bank of England Governor Andrew Bailey. The fact that the pound and rates are moving in opposite directions probably signals markets are concerned about the potential for monetary policy tightening to cause a slowdown in activity at a time when fiscal stimulus is being curtailed and both energy prices and taxes are increasing.

- **RBC Capital Markets surmises the pound may be starting to behave like an emerging market currency**, with wider spreads reflecting increasing credit risk (as opposed to cyclical strength) and resulting in a higher risk premium in the currency. RBC Capital Markets points to the large financial imbalances that existed in the UK even before the COVID-19-induced fiscal stimulus, and warns that the pound's behaviour could be an early indicator of **markets starting to look more critically at funding needs and reliance on foreign capital**.

- **The STOXX Europe 600 Index touched a two-month low amid the sharp rise in long-term interest rates.** Technology stocks led the selloff, while Energy and Financials outperformed. Banks are the biggest beneficiaries of rising yields and a steepening yield curve; they are the best performing sub-sector in the region YTD, with a total return of more than 30%. We see scope for banks' outperformance to continue, given the prospect for yields to move higher in the short term.

- ASML, Europe's biggest tech firm by market capitalisation, provided an update on its long-term outlook and raised its financial guidance. The manufacturer of semiconductor capital equipment (e.g., lithography, metrology, and inspection systems) sees industry **megatrends**, such as cloud computing, 5G, and artificial intelligence, **fuelling growth across the semiconductor industry** and enabling a strong growth opportunity for the company over the next decade. The company expects this to support an annual revenue growth rate of around 11% between 2020 and 2030.

ASIA PACIFIC

Jasmine Duan – Hong Kong

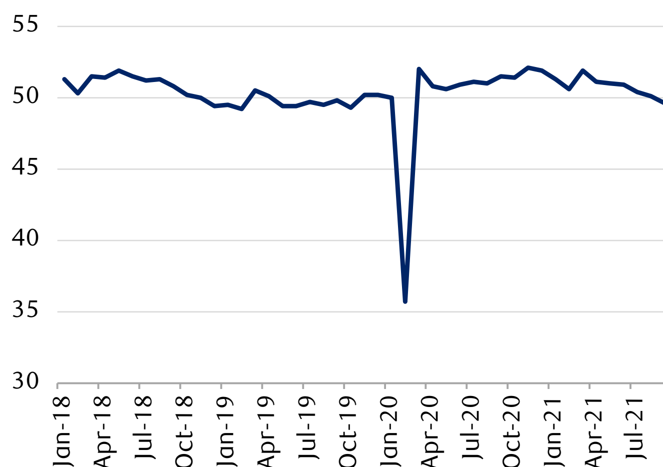
- **At least 20 provinces in China have implemented power usage restrictions.** Companies in industries that consume significant amounts of electricity are required to reduce production, and some companies are required to move production to weekends and nighttime to avoid using large amounts of power during peak hours. There are several reasons behind the power shortages, which include strong export demand and manufacturing activities as the global economy has reopened, supply constraints due to high coal prices, lackluster hydropower generation this year, and local governments needing to meet year-end energy-consumption and energy-intensity reduction targets.

- The market expects the power shortages will last into Q4 2021. **Upstream industries** and industries that consume large amounts of electricity **are likely to feel a direct impact on production** in the short term. **The impact to downstream manufacturers**, such as semiconductor, tech hardware, and auto companies, **should be manageable** for now. We will monitor how the situation develops in the next few weeks.

- **China's economic growth in Q3 and Q4 could be affected by the power shortages.** The official Manufacturing Purchasing Managers' Index (PMI) for September may already show us some early signs of the impact, as it fell to 49.6, below the consensus forecast of 50.0. This is the lowest reading since March 2020. We expect economists to lower their forecasts of China's GDP growth for this year and next year.

- **Fumio Kishida** has won the Liberal Democratic Party's presidential election and **is set to become the next prime minster of Japan** after the one-year term of former Prime Minister Yoshihide Suga. The market does not anticipate major changes in the overall macro policy framework. But Kishida supports lifting COVID-19 restrictions and **wants to put together an economic stimulus package worth trillions of yen before the end of the year**. Investors expect the Bank of Japan will likely maintain its 2% inflation target.

China Manufacturing PMI



Source - RBC Wealth Management, Bloomberg; monthly data since January 2018

MARKET
Scorecard

Data as of September 30, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,307.54	-4.8%	14.7%	28.1%	44.7%
Dow Industrials (DJIA)	33,843.92	-4.3%	10.6%	21.8%	25.7%
Nasdaq	14,448.58	-5.3%	12.1%	29.4%	80.6%
Russell 2000	2,204.37	-3.1%	11.6%	46.2%	44.7%
S&P/TSX Comp	20,070.25	-2.5%	15.1%	24.5%	20.5%
FTSE All-Share	4,058.96	-1.2%	10.5%	23.7%	-0.1%
STOXX Europe 600	454.81	-3.4%	14.0%	26.0%	15.7%
EURO STOXX 50	4,048.08	-3.5%	13.9%	26.8%	13.4%
Hang Seng	24,575.64	-5.0%	-9.8%	4.8%	-5.8%
Shanghai Comp	3,568.17	0.7%	2.7%	10.9%	22.8%
Nikkei 225	29,452.66	4.9%	7.3%	27.0%	35.4%
India Sensex	59,126.36	2.7%	23.8%	55.3%	52.9%
Singapore Straits Times	3,086.70	1.0%	8.5%	25.1%	-1.1%
Brazil Ibovespa	110,979.10	-6.6%	-6.8%	17.3%	6.0%
Mexican Bolsa IPC	51,385.55	-3.6%	16.6%	37.2%	19.5%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.494%	18.5	58.1	81.0	-17.0
Canada 10-Yr	1.509%	29.3	83.2	94.8	14.8
UK 10-Yr	1.022%	30.8	82.5	79.3	53.4
Germany 10-Yr	-0.199%	18.4	37.0	32.3	37.2
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.57%	-0.9%	-1.6%	-0.9%	18.0%
U.S. Investment-Grade Corp	2.12%	-0.9%	-1.2%	1.9%	25.5%
U.S. High-Yield Corp	3.97%	0.0%	4.6%	11.3%	22.8%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,757.58	-3.1%	-7.4%	-6.8%	19.4%
Silver (spot $/oz)	22.20	-7.1%	-15.9%	-4.5%	30.6%
Copper ($/metric ton)	9,174.00	-3.7%	18.4%	37.6%	61.1%
Oil (WTI spot/bbl)	75.03	9.5%	54.6%	86.5%	38.8%
Oil (Brent spot/bbl)	78.52	7.6%	51.6%	91.7%	29.2%
Natural Gas ($/mmBtu)	5.92	35.3%	133.2%	134.3%	154.1%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	94.2480	1.8%	4.8%	0.4%	-5.2%
CAD/USD	0.7890	-0.5%	0.5%	5.1%	4.5%
USD/CAD	1.2674	0.5%	-0.4%	-4.8%	-4.3%
EUR/USD	1.1578	-2.0%	-5.2%	-1.2%	6.2%
GBP/USD	1.3474	-2.0%	-1.4%	4.3%	9.6%
AUD/USD	0.7228	-1.2%	-6.1%	0.9%	7.1%
USD/JPY	111.2400	1.1%	7.7%	5.5%	2.9%
EUR/JPY	128.8000	-0.9%	2.1%	4.2%	9.3%
EUR/GBP	0.8593	0.1%	-3.9%	-5.3%	-3.1%
EUR/CHF	1.0791	-0.2%	-0.2%	0.0%	-0.8%
USD/SGD	1.3579	1.0%	2.7%	-0.5%	-1.7%
USD/CNY	6.4448	-0.2%	-1.3%	-7.2%	-9.8%
USD/MXN	20.6139	2.7%	3.5%	-6.8%	4.5%
USD/BRL	5.4478	5.7%	4.8%	44.2%	31.1%

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 0.78 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 111.24 means 1 U.S. dollar will buy 111.24 yen. USD/JPY 7.7% return means the U.S. dollar rose 7.7% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 9/30/21

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As of June 30, 2021

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Rating	Count	Percent	Count	Percent
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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