GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee December 2, 2021

# Omicron: A heavy dose of uncertainty

Joseph Wu, CFA – Toronto

The emergence of the highly-mutated COVID-19 omicron variant, coinciding with the upcoming arrival of winter, is casting a shadow on the macro outlook. As we await more concrete details about omicron, we believe a more robust arsenal in the battle against COVID-19 and a look back at the economic effects of each previous "variant of concern" (VOC) suggest any negative effects on markets are likely to be fleeting, albeit accompanied by unsettling volatility.

## Awaiting clarity

Omicron's arrival triggered a wave of risk aversion at the end of last week, underscored by a spike in volatility and sharp losses in equities and crude oil. According to the World Health Organization (WHO), omicron may be more transmissible than the delta variant and carries an unusually high number of mutations that may make it relatively more resistant to vaccines and increase reinfection risk.

Nevertheless, initial signs, based on limited data sets on vaccine efficacy and severity of health outcomes, seem promising. Public health officials in South Africa and Israel have observed that while omicron may be the most infectious variant to date, patients infected with newest variant have, so far, displayed only mild symptoms, particularly amongst the vaccinated cohort.

The emergence of another COVID-19 variant is undoubtedly a worrisome development that warrants investors' attention, but we think a wait-and-see approach is sensible as health experts undertake the initial fact-finding phase to determine whether omicron is more infectious, lethal, or resistant to vaccines than previous variants. A number of studies underway will likely help provide insights on these concerns in the weeks ahead.

## Strong arsenal available

It is important to note the substantial progress the world has made in tackling the fight against COVID-19 compared to a year ago, including: the broad availability of vaccines, an improving range of treatment options that could soon include oral antivirals (e.g., Pfizer's Paxlovid and Merck's Molnupiravir), and generally better preparedness of health care systems.

Vaccines, which teach the immune system what the virus looks like so our bodies can produce specific antibodies to combat that virus, arguably remain the most effective weapon against COVID-19. Vaccine makers have initiated clinical trials to determine the efficacy of their vaccines against omicron, with preliminary results expected over the next few weeks.

Encouragingly, if existing vaccines do not offer the same level of protection against serious illness, vaccine producers have indicated they should be able to tweak their vaccines to the new variant in fairly short order, with Pfizer and BioNTech, for instance, stating they "have taken

For perspectives on the week from our regional analysts, please see pages 4–5.

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actions months ago to be able to adapt the mRNA vaccine within six weeks and ship initial batches within 100 days in the event of an escape variant." Besides, high immunization rates across major economies could still be expected to provide at least some degree of protection against omicron (see chart).

## A look back

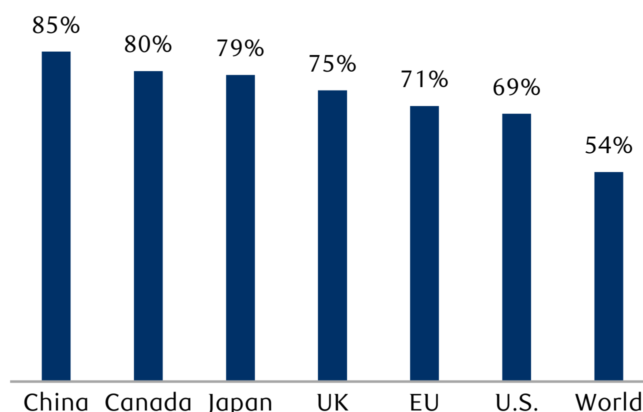
Omicron is not the first COVID-19 variant that financial markets have had to wrestle with, nor will it likely to be the last. Since the onset of the pandemic, the WHO has formally designated five COVID-19 strains (alpha, beta, gamma, delta, and omicron) as a VOC, broadly defined as demonstrating an increase in transmissibility, an increase in severity of disease, or a decrease in effectiveness of public health and social measures or available diagnostics, vaccines, and therapeutics.

Although each of the previous four variants had differing degrees of impact on the economy and, by extension, equity markets, their negative effects on markets have tended to be reasonably short-lived, albeit accompanied by unnerving volatility (see chart on following page). Judging by the sharp whipsawing in risk sentiment this week, following last Friday's (Nov. 26) selloff, markets look like they are behaving in a similar pattern as previous variants—a spasm in downside turbulence as investors price in short-term economic headwinds from renewed targeted lockdown/travel restrictions, followed by a growth rebound as these restrictions are gradually lifted.

## Thinking through the potential economic impact

Omicron's economic impact depends on transmissibility, severity of disease outcomes and, importantly, the extent of vaccine evasion. But if the past is any indication of the future, the most probable outcome of this new variant will likely be a delay in the path toward full

### Percentage of population that has received at least one dose of COVID-19 vaccine




Source - RBC Wealth Management, Our World in Data; data through 11/30/21

economic reopening. The upshot is that any near-term economic weakness is likely be offset by stronger growth in subsequent quarters as COVID-19 fears fade and economies resume the path of normalization.

Moreover, in a scenario where the economic impact from omicron turns out to be much worse than expected, it seems likely to us that policymakers would step in to counteract the economic fallout, with governments returning to their playbook of bolstering consumers and businesses through various fiscal spending measures and central banks keeping ultra-easy monetary policy settings in place for longer to buttress the economy.

Thus, beyond the near term, we remain constructive on the world economy on a 12-month horizon, as we see the expansion firmly supported by durable pillars of healthy household balance sheets, strong business investment, and continued support by fiscal/monetary stimulus. An expanding economy should help corporate earnings

### Global equity returns following key dates for previous COVID-19 variants

| | | MSCI All Country World Index: Forward price returns | | | |
|---|---|---|---|---|---|
| Date | WHO label | 1 month | 3 months | 6 months | 12 months |
| May 1, 2020 | Beta documented | 7.4% | 15.3% | 15.1% | 46.7% |
| Sep. 1, 2020 | Alpha documented | -3.5% | 6.2% | 13.9% | 26.4% |
| Oct. 1, 2020 | Delta documented | -3.0% | 13.8% | 19.8% | 25.4% |
| Nov. 1, 2020 | Gamma documented | 13.4% | 18.4% | 27.4% | 35.8% |
| Dec. 18, 2020 | Alpha and beta designated as variants of concern | 2.5% | 5.2% | 10.3% | 15.4% |
| Jan. 11, 2021 | Gamma designated as variant of concern | 3.2% | 5.5% | 9.9% | – |
| May 11, 2021 | Delta designated as variant of concern | 3.0% | 5.1% | 7.7% | – |
| | **Median** | **3.0%** | **6.2%** | **13.9%** | **26.4%** |

Source - RBC Wealth Management, Bloomberg, World Health Organization; data through 11/30/21

maintain an upward trend into next year, providing fundamental support for equities.

## Caution warranted, but keep perspective

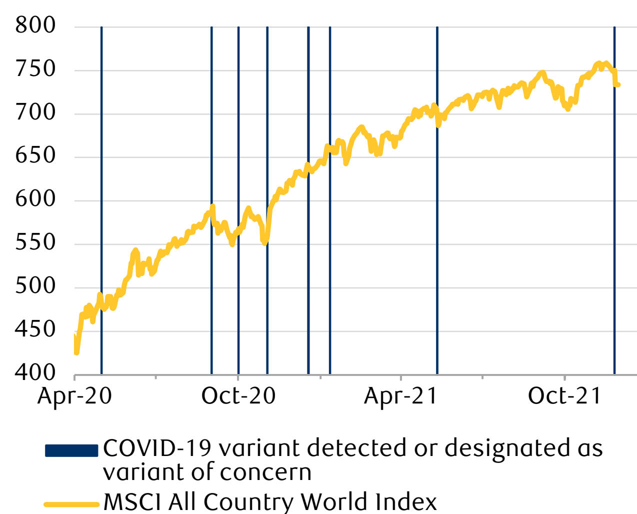
The discovery of the omicron variant has clearly complicated the macro outlook by introducing a greater degree of downside risks to growth in the near term; however, we would resist the temptation to jump to conclusions as more concrete information is needed to parse the variant's potential economic implications.

Reflecting on the wide range of potential outcomes, we expect the prevailing market backdrop of heightened volatility to persist until better clarity arrives, with particular emphasis on data points pertaining to vaccine efficacy and illness severity of the novel variant. Until then, economically-sensitive assets—such as stocks and commodities—could remain vulnerable to further downside pressure as investors demand a higher risk premium to account for the elevated uncertainty.

In the interim, as we mentioned above, tremendous headway has been made in shoring up the arsenal in the COVID-19 battle. This, together with the recent history of market resilience demonstrated during previous episodes of variants of concern, suggests to us that the adverse short-term effects inflicted by the new COVID-19 variant on the economy and markets are likely to be temporary. The likely net impact of short-term speed bumps in the economic expansion due to the omicron variant is to push more growth into H2 2022 from H1.

For multi-asset portfolios, we continue to recommend a moderately Overweight stance in equities on a 12-month time frame, while making sure the fixed income portfolio is positioned with an adequate layer of "safety"—high quality bonds and cash—to counteract a larger equity weight, as well as cushion against the prospect of uncomfortable market volatility stemming from pandemic developments.

**Equities have been resilient through previous COVID-19 variants**




Source - RBC Wealth Management, Bloomberg; data through 11/30/21

## UNITED STATES

Atul Bhatia, CFA – Minneapolis

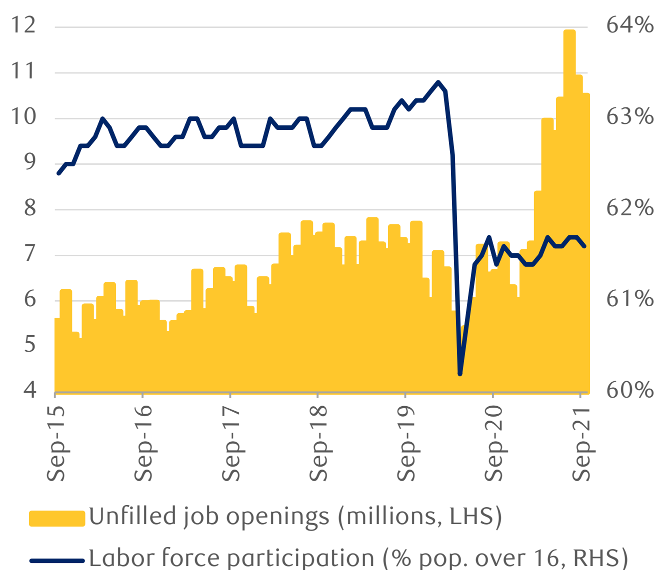
■ **Recently re-nominated Fed Chair Jerome Powell struck an unexpectedly hawkish tone in Congressional testimony this week**. He abandoned the "transitory" label for inflation—citing surprisingly high levels of price increases and an elevated risk of continued upward price pressures—and said it was appropriate for the Fed to consider cutting its bond purchase program more aggressively. Powell also said price stability was likely necessary to secure future employment gains, undercutting the major remaining theoretical argument in favor of extremely accommodative monetary policy. The market reaction to Powell's comments was swift, with interest rate futures moving to reflect at least two, possibly three, rate hikes by the end of 2022. Two months ago, markets were pricing in a high probability of just one rate hike next year.

■ **The potential monetary policy shift was felt with varied effect across the yield curve**. The 2-year Treasury note saw the greatest reaction, with yields increasing by 0.07% to reach 0.55% in the two days following Powell's remarks. Prices actually rose on longer-maturity Treasuries in the same time period, pushing yields lower. We think multiple factors explain the continued demand for longer-maturity government bonds and lower-risk assets in general. One is uncertainty on the omicron variant, and another is the upcoming deadline for Congress to extend the debt ceiling. Earlier Fed action may also prompt the central bank to end the rate hike cycle at a lower level, helping cap longer-term bond yields. Finally, the strong outperformance of equity indexes relative to fixed income has likely created demand for bonds, as investors look to rebalance portfolios into year's end.

■ **November's jobs data, scheduled for release on Dec. 3, will be closely watched by investors for signs of growth in the pool of potential workers**. A rising labor force participation rate, particularly if combined with a large increase in payrolls, could signal a reduction in upward wage pressure. The Fed's Beige Book, a qualitative summary of economic conditions by district, highlighted labor shortages as a nationwide bottleneck to growth, so markets would likely welcome any indication of relief.

**Open positions, missing workers**

Markets look to labor force participation to control wages




Source - RBC Wealth Management, U.S. Bureau of Labor Statistics, Bloomberg; monthly data through 9/30/21

## CANADA

Sean Killin & Richard Tan, CFA – Toronto

■ **The Canadian banks reported Q4 2021 earnings this week**, and results were mixed relative to consensus expectations. Starting with the positives, loan growth generally improved across personal and commercial banking, partially offset by compression in net interest margins. Provisions for credit losses were also favourable, driven by an improving credit environment. With respect to return of capital, as expected, the banks increased dividends and announced plans to commence buyback activities following the lifting of regulatory restrictions. One potential wrinkle came in the form of weaker-than-expected contributions from the banks' capital markets divisions; however, we're not overly concerned given that deal flow has been extremely robust year to date, including mergers and acquisitions as well as a number of new initial public offerings. Heading into 2022, we believe the setup for banks remains constructive on the back of a rising rate environment, healthy economic growth, and valuations that remain fair to attractive in our view.

■ **Canadian GDP grew by an annualized 5.4% in Q3, beating the 2% gain implied by preliminary monthly GDP data** but not keeping pace with the 6.8% increase in hours worked during the quarter. Third-quarter GDP growth was largely attributed to robust consumer spending, which grew by 17.9%, as households were generally in favourable financial positions with an elevated savings rate of 11%, leaving consumers with ample purchasing power. Household disposable income also rose by 7.2% in Q3, driven by higher wages rather than by government payouts. The rollback of pandemic restrictions led spending on services to rise 27.8%, with notable gains in the accommodation and food services sector. Canada's **commodity-heavy exports** also contributed to the expansion after a sharp decline in Q2, whereas exports associated with motor vehicle production fell on semiconductor supply issues. **The GDP contraction in Q2 has been revised downward, and is now reported at -3.2% vs. -1.1% previously**.

## EUROPE

Frédérique Carrier – London

- As widely expected, **a three-way coalition government agreement was announced in Germany** after two months of negotiations. For the key posts, the center-left Social Democrats' leader and current Finance Minister Olaf Scholz is set to become chancellor, replacing Angela Merkel; while center-right Free Democrats' leader Christian Lindner will likely head the finance ministry; and the center-left Green Party leader Annalena Baerbock is poised to head the foreign ministry.

- The coalition, the first of its kind to lead the country, emphasizes the fight against climate change, including **an exit from coal by the end of the decade as well as greater investment in green and digital technologies**. In addition, a liberal social agenda, fostering social equality, and faster naturalization of immigrants are also key priorities.

- As for fiscal policy, both domestically and vis-à-vis Europe, **the coalition agreement points to some wriggle room with respect to levels of indebtedness** in the aftermath of a systemic crisis—though this is not quantified. The lack of detail on this issue suggests an ongoing debate.

- One notable initiative is **increasing the minimum hourly wage to €12**, beyond the previously planned increase to €10.45. Should this policy be implemented, it could set a precedent for labour negotiations.

- All parties now need to approve the coalition agreement. Once this occurs, the new government could be sworn in over the next few weeks. **Its top priority will likely be to contain the COVID-19 virus** which is ravaging parts of the country.

### Asia benchmark trading near one-year low

MSCI AC Asia Pacific Index

Source - RBC Wealth Management, Bloomberg; daily data through 12/1/21

- The November preliminary IHS Markit Eurozone **Purchasing Managers' Indexes for both Manufacturing and Services beat consensus expectations** and exceeded the prior month's levels. We believe this strong momentum is likely to fade somewhat over the next few months, due to new restrictions being put in place to contain the virus.

- In our view, although economic growth may be dented somewhat in the short term, **the euro area should be able to generate above-average growth next year** as the supply chain shortages constraining it ease during the year and as fiscal stimulus is maintained while as monetary policy remains loose.

## ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **Asia Pacific equity markets traded broadly lower this week,** with the MSCI AC Asia Pacific Index trading near the lowest level since November 2020 as traders continued to assess the potential economic impact of the omicron variant and the Federal Reserve's efforts to keep inflation in check. Japan was among the worst performers in Asia on Thursday, after the government dropped a plan for a blanket halt to all new incoming flight reservations.

- **China's property downturn is expected to continue into H2 2022**, with average home prices estimated to fall 1.0% as tight credit policies and a looming property tax dampen demand, a Reuters poll of 14 analysts and economists showed. Home prices are now expected to rise 2.6% in 2021, down from the 3.5% forecast in the prior poll published in August. On the demand side, property sales by floor area are forecast to fall 16% in H1 2022, compared with a 27.7% rise in H1 2021. For now, we expect authorities to largely stick with policies aimed at taming the housing market, even as they fine-tune regulations, including marginal loosening of credit policies.

- On Wednesday, **China's securities regulator denied a media report that China will ban variable interest entities (VIEs) from listing overseas**. The regulator's statement came after Bloomberg published a report saying China is planning to ban companies from going public on foreign stock markets through VIEs, closing a loophole used by the country's tech industry to raise capital from overseas investors.

- **Concerns surrounding the future of VIEs helped push Alibaba Group's ADR to a four-year low**. Other factors weighing on the share price include regulatory scrutiny over some of its biggest growth drivers—fintech, data, online advertising, and content—and the recent earnings miss and softer guidance.

## MARKET
# Scorecard

Data as of December 2, 2021

| Equities (local currency) | Level | MTD | YTD | 1 yr | 2 yr |
|---|---|---|---|---|---|
| S&P 500 | 4,577.10 | 0.2% | 21.9% | 24.8% | 47.0% |
| Dow Industrials (DJIA) | 34,639.79 | 0.5% | 13.2% | 15.9% | 24.7% |
| Nasdaq | 15,381.32 | -1.0% | 19.3% | 24.6% | 79.5% |
| Russell 2000 | 2,206.33 | 0.3% | 11.7% | 20.0% | 37.2% |
| S&P/TSX Comp | 20,762.03 | 0.5% | 19.1% | 19.6% | 22.3% |
| FTSE All-Share | 4,063.89 | 0.9% | 10.6% | 11.3% | 0.7% |
| STOXX Europe 600 | 465.44 | 0.5% | 16.6% | 18.8% | 16.1% |
| EURO STOXX 50 | 4,108.02 | 1.1% | 15.6% | 16.7% | 13.3% |
| Hang Seng | 23,788.93 | 1.3% | -12.6% | -10.3% | -10.0% |
| Shanghai Comp | 3,573.84 | 0.3% | 2.9% | 3.6% | 24.3% |
| Nikkei 225 | 27,753.37 | -0.2% | 1.1% | 3.6% | 18.0% |
| India Sensex | 58,461.29 | 2.4% | 22.4% | 31.0% | 43.3% |
| Singapore Straits Times | 3,092.11 | 1.7% | 8.7% | 10.0% | -3.0% |
| Brazil Ibovespa | 104,466.20 | 2.5% | -12.2% | -6.6% | -4.1% |
| Mexican Bolsa IPC | 50,927.38 | 2.5% | 15.6% | 16.6% | 19.7% |
| **Gov't bonds (bps change)** | **Yield** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. 10-Yr Treasury | 1.446% | 0.2 | 53.3 | 51.0 | -37.3 |
| Canada 10-Yr | 1.507% | -6.1 | 83.0 | 74.8 | -2.7 |
| UK 10-Yr | 0.811% | 0.2 | 61.4 | 45.7 | 7.2 |
| Germany 10-Yr | -0.369% | -2.0 | 20.0 | 15.0 | -8.8 |
| **Fixed income (returns)** | **Yield** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. Aggregate | 1.68% | 0.1% | -1.2% | -0.6% | 6.5% |
| U.S. Investment-Grade Corp | 2.29% | 0.1% | -0.9% | 0.0% | 9.8% |
| U.S. High-Yield Corp | 4.74% | 0.2% | 3.5% | 5.1% | 13.2% |
| **Commodities (USD)** | **Price** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| Gold (spot $/oz) | 1,768.69 | -0.3% | -6.8% | -3.4% | 20.9% |
| Silver (spot $/oz) | 22.40 | -1.9% | -15.2% | -7.1% | 32.4% |
| Copper ($/metric ton) | 9,492.00 | -0.2% | 22.5% | 23.8% | 61.9% |
| Oil (WTI spot/bbl) | 66.50 | 0.5% | 37.1% | 46.9% | 18.8% |
| Oil (Brent spot/bbl) | 70.27 | -0.4% | 35.7% | 45.6% | 15.3% |
| Natural Gas ($/mmBtu) | 4.11 | -10.0% | 62.0% | 47.9% | 76.6% |
| **Currencies** | **Rate** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. Dollar Index | 96.1400 | 0.2% | 6.9% | 5.5% | -1.8% |
| CAD/USD | 0.7809 | -0.2% | -0.6% | 0.9% | 3.9% |
| USD/CAD | 1.2807 | 0.2% | 0.6% | -0.9% | -3.8% |
| EUR/USD | 1.1301 | -0.3% | -7.5% | -6.7% | 2.0% |
| GBP/USD | 1.3302 | 0.0% | -2.7% | -0.5% | 2.8% |
| AUD/USD | 0.7094 | -0.5% | -7.8% | -4.3% | 4.0% |
| USD/JPY | 113.1700 | 0.0% | 9.6% | 8.4% | 3.8% |
| EUR/JPY | 127.8900 | -0.3% | 1.4% | 1.1% | 5.9% |
| EUR/GBP | 0.8495 | -0.4% | -4.9% | -6.3% | -0.8% |
| EUR/CHF | 1.0403 | -0.1% | -3.8% | -4.0% | -5.3% |
| USD/SGD | 1.3692 | 0.3% | 3.6% | 2.2% | 0.2% |
| USD/CNY | 6.3771 | 0.2% | -2.3% | -2.8% | -9.4% |
| USD/MXN | 21.2769 | -0.8% | 6.8% | 6.6% | 8.7% |
| USD/BRL | 5.6393 | 0.3% | 8.5% | 7.8% | 33.7% |

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 0.9% return means the Canadian dollar rose 0.9% vs. the U.S. dollar year to date. USD/JPY 127.89 means 1 U.S. dollar will buy 127.89 yen. USD/JPY 9.6% return means the U.S. dollar rose 9.6% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 12/2/21

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As of September 30, 2021

| | | | Investment Banking Services Provided During Past 12 Months | |
|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
| Buy [Outperform] | 800 | 56.58 | 341 | 42.62 |
| Hold [Sector Perform] | 562 | 39.75 | 172 | 30.60 |
| Sell [Underperform] | 52 | 3.68 | 3 | 5.77 |

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