GLOBAL
Insight
WEEKLY

Wealth
Management

Perspectives from the Global Portfolio Advisory Committee

December 16, 2021

Where to from here

Jim Allworth – Vancouver, Kelly Bogdanova – San Francisco & Frédérique Carrier – London

As economies and markets settle into the post-COVID world, investors will have to adjust to different dynamics that are setting the tone for the coming year and beyond. Our 2022 Outlook explores these and other key investment themes.

The two-year-old COVID-19 pandemic has left its imprints on society, yet markets have been rather resilient. For 2022, we anticipate another good year for equities as long as the U.S. and global economies can avoid recessions.

Our team of analysts and strategists in the U.S., Canada, Europe, and Asia recently published the Global Insight 2022 Outlook, which sets forth RBC Wealth Management's views on the economy, equities, and fixed income, as well as forecasts for currencies and commodities. We also address two defining topics: the green energy transition and China's economic evolution.

Over the next year, we think the path of markets will largely be determined by the path of major economies:

- The U.S. and global economies should deliver above-trend growth once again in 2022, albeit at a less robust and possibly bumpier pace due to lingering COVID-19, inflation, supply chain, and labor market pressures.
- Currently, all six of the major U.S. leading economic indicators we follow are signaling that this expansion has further to run. Recession risks are quite low. Powerful tailwinds are pushing forward the U.S. and most developed economies.
- Inflation, which has spread to all regions, is one of the key challenges facing policymakers.
- Central banks will aim to right-size policy support in 2022, and the process of dialing back accommodation with rate hikes and other measures will be about finding the right balance.
- Uncertainties about inflation and the pace of rate hikes could generate market volatility at times.

Following are highlights from the 2022 Outlook *(clicking on the section titles will take you directly to each feature article)*:

Equity investing for the next 10 years

Until well into 2023 we think the trajectory of the world's major economies will be shaped by the remaining effects of COVID-19 stimulus and the normal progression of the business cycle. This phase should be good for corporate earnings and equities. Credit conditions are very "easy," excess savings and pent-up demand should keep households spending, inventories are low and need to be rebuilt, and strong capital spending should persist.

Could the Fed and other central banks spoil the party? Yes—eventually. But before that happens, monetary conditions would have to transition from "easy," what we have now, all the way to "tight," which is some considerable distance down the road.

The next edition of Global Insight Weekly will be published on January 6, 2022.

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.

Beyond 2023, the COVID-19 policy-driven effects should quickly wane, leaving growth of the labor force and increases in productivity to drive the economic bus. This points to an extended period of slow GDP growth—perhaps slower than in the decade following the financial crisis. That, in turn, points to a period of intense corporate competition and even greater corporate concentration. Equities can be rewarding in such an environment. But owning the right ones and avoiding the challenged will be even more essential ingredients of success.

A different kind of debt mountain

Over the past two years, companies have binged on debt as the average coupon reached new lows. But corporate debt levels can't simply be looked at in isolation—it's all relative. Debt levels haven't strayed too far from long-term trends relative to GDP. Debt is up, but liquidity is improved with record cash on balance sheets, and interest costs are down. Companies could emerge from the pandemic in far better financial positions despite rising debt loads.

Investors should have exposure to both investment-grade and speculative-grade corporate bonds as part of a well-diversified bond portfolio. Over the near term, we see few credit risks for U.S. corporate bond markets, and little risk that the increased debt levels will act as the potential source of the next crisis.

Green energy transformation: Opportunities and realities

The green energy transformation could require a grand economic realignment, at least rivaling the industrial and information revolutions. There is little doubt in our minds that the transition could be a boon for companies involved with the multi-industry infrastructure buildout.

But there are practical challenges given the serious gaps between net-zero ambitions and potential outcomes. The estimated price tag for the transition is substantial, between $94 trillion to $300 trillion globally between now and 2050. Furthermore, it's unclear whether societies will tolerate the various lifestyle adjustments that could be needed to achieve governments' carbon reduction goals, particularly if the transition process is costly for households and disruptive at times.

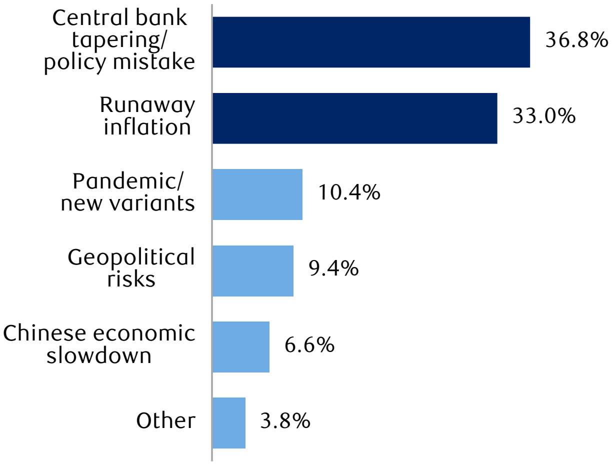
For now, we would focus on green energy transition investment opportunities that are likely to find their way to market in the next 5–10 years and are not as dependent on substantial, coordinated long-term government subsidies or private sector investments that have yet to be designated, or may not fully pan out.

Xi-ism faces the challenges of China's economic evolution

Demographic and productivity challenges that emerged 10 years ago in China are likely to slow GDP growth to 3.5 percent in the 2040s, according to the World Bank.

Central banks, inflation seen as the key risks for stocks in 2022

Survey question: What is the biggest downside risk to your main scenario?



Source - Bloomberg News survey of 106 asset managers worldwide between Dec. 3 and Dec. 13, 2021

The policy response has been broad. In its 14th Five-Year Plan, the government shifted emphasis away from unbridled pro-capitalistic growth to broader, more stable growth. It announced deleveraging and de-risking as one of its five core tasks for 2021. It coordinated a regulatory crackdown that will dent profitability initially but could reduce corporate concentration, and encourage competition. Finally, it is redirecting funds from infrastructure spending into productivity-improving investments, and the plan called for $621 billion for research and development in 2021, the largest allocation of any country in the world.

We see three key investment implications. We expect a greater appeal of domestic brands as conspicuous consumption is discouraged; a diminished outlook for industrial commodities due to reduced emphasis on infrastructure and the deleveraging effort; and another long stretch of tech-driven spending as productivity-enhancing investment by China is likely to encourage developed economies to respond.

Outlook for 2022 by asset class, region

This article provides a brief summary of investment guidance for 2022 for the U.S., Canadian, UK/European, and Asian equity and fixed income markets, along with forecasts for currencies and commodities.

We anticipate worthwhile global equity returns amid moderate earnings growth, supported by above-average GDP growth and strong consumer and business capital spending. Major central banks seem set to begin raising interest rates, yet equity markets typically perform well surrounding the first rate hike. We recommend starting the year with a moderate Overweight position in equities.

UNITED STATES

Alan Robinson – Seattle

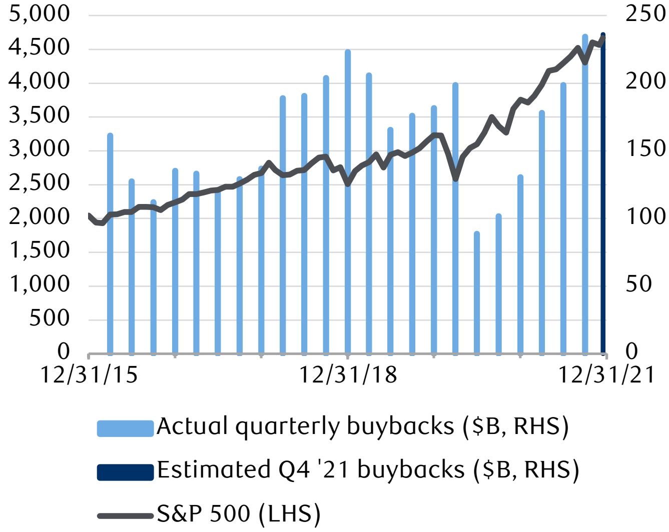
- **U.S. stocks regained their recent highs during the week**, as caution ahead of the Federal Open Market Committee meeting gave way to **risk-on behavior following the Fed's updated guidance**. The central bank signaled an acceleration in the reduction of bond purchases, allowing the program to conclude in March 2022 and opening the window for the first interest rate hike soon after.

- **The overall tone of the meeting was the most hawkish we've seen since the recession**, with the committee's median forecast implying three rate hikes in 2022 and another three in 2023. Fed Chair Jerome Powell made it clear that recent inflation increases already warranted rate hikes, and that a continuation of the labor market's improvement towards maximum employment is all that's needed to trigger the next rate hike cycle.

- So why did stocks rally after the meeting? We think there are a couple of reasons. First, the Fed's dramatic pivot acknowledged the reality of **changing data and shifting market expectations**, thereby reducing the perceived risks of policy missteps down the line. Secondly, the spotlight on the strength of the economy and the labor market refocused investors on **longstanding bullish themes**, including negative real interest rates and the consensus expectation for 9% S&P 500 earnings growth in 2022. In combination, we think this triggered a "Fear Of Missing Out" on a potential year-end rally.

- **Corporate stock buybacks have ramped up during the current quarter even as markets continued their volatile trading patterns**, with tech giants Oracle (ORCL) and Broadcom (AVGO) announcing new $10 billion buyback authorizations in their earnings reports. Data from S&P Dow Jones indicate quarterly stock buybacks are likely to reach all-time highs this quarter, with the pace of increases coming back into line with pre-pandemic trends (see chart). In our view, this suggests stocks will have solid support as we enter 2022. While recent commentary in CNBC and the Wall Street Journal has noted an increase in insider stock sales, we attribute this to year-end factors and anticipation of pending changes in tax laws.

Quarterly stock buybacks at record level, no signs of slowing



Source - RBC Wealth Management, S&P Dow Jones estimates, FactSet; data through 12/15/21

CANADA

Sean Killin & Richard Tan, CFA – Toronto

- **Canada's inflation rate remained unchanged in November** from a month prior, holding at 4.7% y/y. As expected, headline CPI was primarily propped up by energy and food prices. Energy prices continued to rise as increasing demand drove the price of gasoline 43.6% above its November 2020 level. RBC Economics expects gasoline to track lower into December as demand moderates due to the risk associated with the omicron variant. Food prices also rose 4.4%, the fastest acceleration since 2015. Expansion in the Core CPI measure, which excludes highly volatile inputs such as energy and food, was slightly lower at 3.1% y/y. **Roughly half of the annualized Core CPI growth is tied to rising costs associated with automobile or home ownership**. Inflation has also broadened, with 58% of the consumer basket seeing price increases of greater than 2%. All this comes as the Bank of Canada renews its five-year Monetary Policy Framework, reaffirming a 2% inflation target heading into 2022 and incorporating key labour market components into its policy approach.

- **RBC Capital Markets revised its 2022 estimate for West Texas Intermediate crude oil** to $76.75, from its previous forecast of $81.00. Meanwhile, the 2023 estimate was adjusted higher to $84.75, from $71.00. In short, RBC Capital Markets believes the environment remains constructive for global energy prices, and is of the view that we're still in the early innings of a strong multi-year run. While increased scrutiny of environmental, social, and governance factors will likely continue to weigh on the energy complex, we also think **fundamentals among large-cap Canadian oil producers remain broadly attractive**. Canadian producers have strengthened their balance sheets on the back of robust commodity prices, and RBC Capital Markets expects them to generate free cash flow yields well in excess of their global peers' average. Going into next year, we believe producers are well positioned to ramp up return-of-capital programs via dividend increases and share repurchases.

EUROPE

Rufaro Chiriseri, CFA – London

- **The Bank of England (BoE)** has determined that there is no "value in waiting", with the Monetary Policy Committee (MPC) deciding to **raise interest rates by 0.15%**. The move caught the market by surprise given the recent omicron variant concerns cited by MPC members. That being said, we would argue the data are in favour of a hike. UK unemployment and inflation data released this week were stronger than the expectations in the MPC's November Monetary Policy Report (MPR). The most recent data show that demand for labour remains strong; job vacancies have risen to 1.2 million, up nearly 435,000 from pre-pandemic levels.

- Looking at inflation, **CPI rose to 5.1% y/y in November** from 4.2% y/y in October—above the 4.8% consensus estimate and the November MPR's forecast of around 4.5%. Previous MPR forecasts had inflation peaking at 5% in Q2 2022, before falling back towards the BoE's 2% target over the medium term. BoE Governor Andrew Bailey now expects inflation to top 6% in the coming months.

- The MPC meeting minutes emphasized that **a stronger case for monetary tightening is now required given the heightened inflation pressure**. The minutes did not suggest an urgency for further rate hikes in the coming months, but indicated the committee would continue to judge the inflation risk over the forecast period. We expect two further hikes, in Q1 and Q3 2022, to reach a 0.75% bank rate in 2022.

- The European Central Bank (ECB) said its Pandemic Emergency Purchase Programme (PEPP) will end in March 2022, as expected; however, **the expansion of the Asset Purchase Programme (APP) is below RBC Capital Markets' expectations** of €400 billion to €500 billion in total to run until at least the end of December 2022. The APP will be boosted in Q2 and Q3 2022, with purchases set at €40 billion and €30 billion, respectively. The ECB cited the need to avoid a "brutal transition" as the rationale for boosting Q2 and Q3 purchases before returning in Q4 to the current pace of €20 billion for "as long as necessary".

- The ECB's keenly eyed 2024 staff forecasts were significantly boosted, with inflation now seen at 3.2% in 2022, and 1.8% in 2023 and 2024. In line with our view, ECB President Christine Lagarde stated during the press conference that "**under present circumstances, it is very unlikely that we will raise interest rates in 2022.**" Due to lower bond purchases post-PEPP, we expect German Bund yields to rise from their current range-bound levels in the second half of 2022.

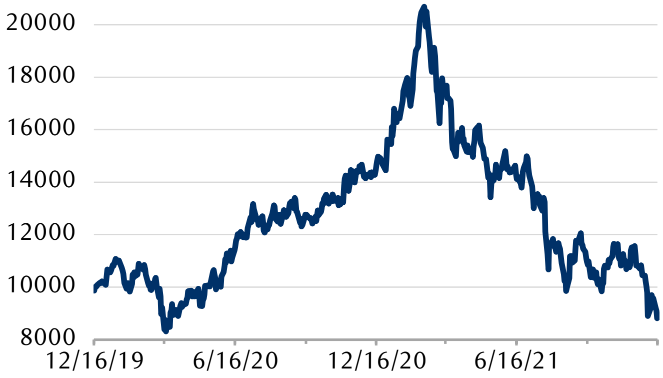
ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **Asia Pacific equity markets traded broadly lower during the week.** Hong Kong led the pack lower with the Hang Seng Index falling for five consecutive days. Shares of Chinese companies listed in the U.S. were not spared. The Nasdaq Golden Dragon Index is down close to 8% for the week to trade at its lowest level since March 2020. **The latest selloff was driven by news that the Biden administration is planning to hit more Chinese companies with investment and export sanctions.** According to a Financial Times report, the administration is looking at: (1) tightening rules on exports to Shanghai-based Semiconductor Manufacturing International Corp. (981 HK) and (2) placing more Chinese companies on the U.S. blacklist. This week's correction adds to the more than US$1 trillion wiped off the value of China Technology stocks since their February peak after Beijing launched a sweeping clampdown on areas ranging from digital finance and data security to online games and overseas listings.

- **The Singapore government introduced new cooling measures for the property market** for the first time since 2018. The government will raise additional stamp duties for buyers of second homes and foreigners purchasing private property, while also tightening loan limits for public housing apartments. The government will also increase the supply of public and private housing. Private home prices have risen by approximately 9% since the first quarter of last year, while the secondary market for public housing is also recovering sharply after a six-year decline, rising about 15% over that period. The government has decided to act now to "**reduce the risk of a self-reinforcing cycle of price increases**" that would impact affordability in the private and public housing markets. Observers do not expect the new measures to have a long-term impact given that locals make up the majority of buyers and continued to purchase homes even after the last round of cooling measures.

Nasdaq Golden Dragon China Index trading near lowest level since March 2020



Source - RBC Wealth Management, Bloomberg; daily data through 12/15/21

MARKET Scorecard

Data as of December 16, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,668.67	2.2%	24.3%	26.1%	46.3%
Dow Industrials (DJIA)	35,897.64	4.1%	17.3%	19.0%	27.1%
Nasdaq	15,180.43	-2.3%	17.8%	19.9%	72.2%
Russell 2000	2,152.46	-2.1%	9.0%	10.2%	30.5%
S&P/TSX Comp	20,739.78	0.4%	19.0%	18.1%	21.6%
FTSE All-Share	4,122.09	2.4%	12.2%	11.2%	-1.5%
STOXX Europe 600	476.56	2.9%	19.4%	20.3%	14.1%
EURO STOXX 50	4,201.87	3.4%	18.3%	18.6%	11.4%
Hang Seng	23,475.50	0.0%	-13.8%	-11.3%	-14.7%
Shanghai Comp	3,675.02	3.1%	5.8%	9.1%	23.1%
Nikkei 225	29,066.32	4.5%	5.9%	8.6%	21.4%
India Sensex	57,901.14	1.5%	21.3%	24.1%	41.4%
Singapore Straits Times	3,128.80	2.9%	10.0%	8.9%	-2.4%
Brazil Ibovespa	108,326.30	6.3%	-9.0%	-8.1%	-3.2%
Mexican Bolsa IPC	51,384.06	3.4%	16.6%	17.3%	15.8%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.426%	-1.9	51.3	51.0	-44.6
Canada 10-Yr	1.344%	-22.4	66.7	61.5	-29.1
UK 10-Yr	0.757%	-5.2	56.0	48.5	-6.5
Germany 10-Yr	-0.348%	0.1	22.1	21.9	-7.1
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.76%	-0.4%	-1.7%	-1.4%	5.9%
U.S. Investment-Grade Corp	2.36%	-0.4%	-1.4%	-0.7%	8.7%
U.S. High-Yield Corp	4.52%	1.0%	4.4%	5.1%	12.6%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,798.66	1.4%	-5.3%	-3.5%	21.8%
Silver (spot $/oz)	22.46	-1.6%	-14.9%	-11.3%	31.8%
Copper ($/metric ton)	9,214.50	-3.2%	18.9%	17.9%	48.8%
Oil (WTI spot/bbl)	72.38	9.4%	49.2%	51.4%	20.2%
Oil (Brent spot/bbl)	74.60	5.7%	44.0%	46.0%	14.2%
Natural Gas ($/mmBtu)	3.78	-17.2%	49.0%	41.3%	61.6%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	95.9840	0.0%	6.7%	6.1%	-1.1%
CAD/USD	0.7826	0.0%	-0.3%	-0.3%	3.0%
USD/CAD	1.2778	0.0%	0.4%	0.3%	-2.9%
EUR/USD	1.1329	-0.1%	-7.3%	-7.1%	1.7%
GBP/USD	1.3322	0.2%	-2.5%	-1.4%	-0.1%
AUD/USD	0.7182	0.8%	-6.7%	-5.2%	4.3%
USD/JPY	113.7100	0.5%	10.1%	9.9%	3.8%
EUR/JPY	128.8300	0.4%	2.1%	2.1%	5.5%
EUR/GBP	0.8504	-0.2%	-4.8%	-5.8%	1.8%
EUR/CHF	1.0417	0.0%	-3.7%	-3.5%	-4.9%
USD/SGD	1.3635	-0.2%	3.1%	2.6%	0.7%
USD/CNY	6.3683	0.1%	-2.4%	-2.5%	-8.9%
USD/MXN	20.8269	-2.9%	4.6%	4.8%	10.0%
USD/BRL	5.6873	1.1%	9.4%	11.8%	40.1%

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 0.3% return means the Canadian dollar fell 0.3% vs. the U.S. dollar year to date. USD/JPY 113.71 means 1 U.S. dollar will buy 113.71 yen. USD/JPY 10.1% return means the U.S. dollar rose 10.1% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 12/16/21

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As of September 30, 2021

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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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