GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

January 6, 2022

Time for a tune-up?

Kelly Bogdanova – San Francisco

U.S. equities have been on a long winning streak, piling on gains year after year. While we see positive returns continuing in 2022, investors shouldn't fall prey to a "U.S. bias" as we think international stocks have favorable characteristics that argue for their inclusion in portfolios.

The U.S. equity market outperformed international markets once again in 2021, and this time by a wide margin.

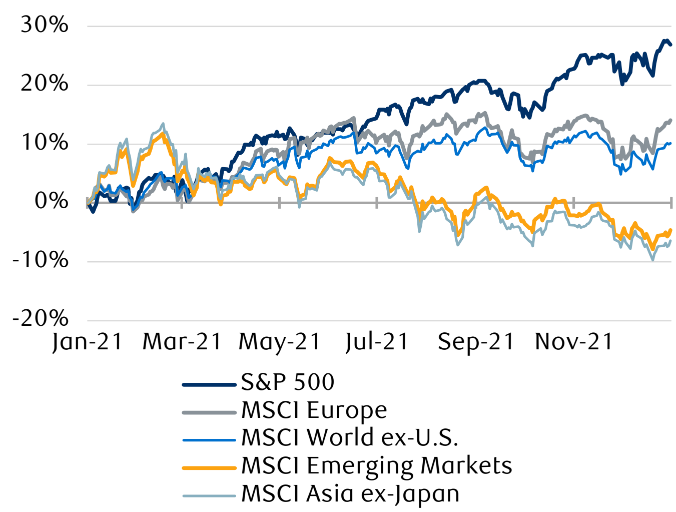
The S&P 500 sprinted higher by 26.9 percent for the year, not including dividends, while broad European and international indexes rose by 14.1 percent and 10.1 percent in dollar terms, respectively, and emerging markets and Asia outright declined, as the chart shows.

Last year, the S&P 500 benefited from its higher representation of growth stocks, including technology-oriented stocks in various sectors, compared to many indexes outside of the U.S.

When growth stocks began to outperform value in the spring of 2021, and then continued to rack up more gains, the U.S. market charged ahead of international markets.

The U.S. equity market outperformed significantly

Price performance of major global indexes in 2021



Source - RBC Wealth Management, Bloomberg; all data priced in U.S. dollars and through 12/31/21

Allocations askew?

The outperformance of U.S. large-capitalization stocks is actually nothing new. The S&P 500 has put together a multiyear winning streak that began in 2011, when measured by five-year rolling returns, a standard methodology for evaluating long-term market and individual stock trends.

Such a multiyear move can throw portfolio allocations out-of-whack if left unattended. It naturally has the effect of boosting the allocation to U.S. equities at the expense of international. This can lead to a "U.S. bias" in portfolios—not just for American investors (here, we refer to this as a portfolio having a "home bias"), but also for investors in other regions who have allocations to U.S. equities.

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

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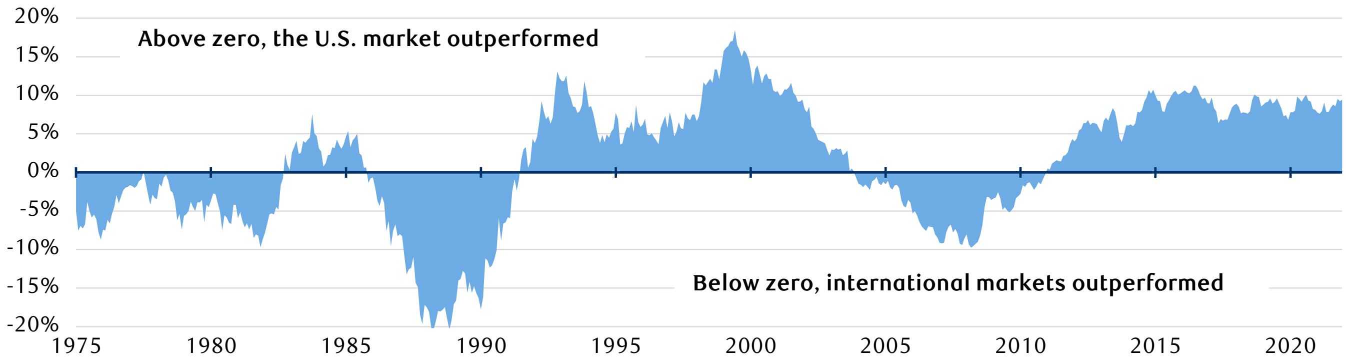
U.S. and international markets tend to move in multiyear cycles

Relative performance of U.S. S&P 500 versus international developed markets based on five-year rolling returns*



*Relative performance represents the S&P 500 Index's returns minus international developed markets' returns (MSCI World ex-U.S.).
Source - RBC Wealth Management, Bloomberg; monthly data from 1/31/75 – 12/31/21

As S&P 500 gains have piled on year after year and were further stoked in 2021, U.S. allocations may have become larger than intended.

Benefits of an international mindset

Historical data signal that U.S. equity market dominance won't last forever.

Since 1975, U.S. versus international performance trends have moved in bunches. As the top chart illustrates, both groups jockeyed back and forth with the U.S. outperforming for a number of years, and then international stocks took the mantle and led the way. During this time, the U.S. recorded three dominant periods of outperformance and international stocks also enjoyed three instances of ascendance, all of which had varying magnitudes and durations.

While there is no bell that will ring when the performance shifts from U.S. back to international stocks again—and it's a fruitless exercise to attempt to precisely time the move—we think international stocks have favorable characteristics that argue for their inclusion in portfolios at least at a level near the long-term strategic recommended allocation:

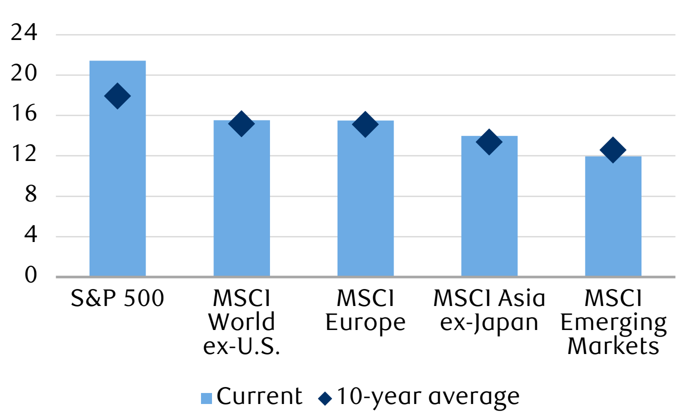
- Importantly, the valuation disparity between the two groups is much wider than usual. The large-cap S&P 500's price-to-earnings ratio is high and expensive. It trades at 21.4x the 2022 consensus earnings estimate compared to a 10-year average of 17.9x and an average of 17.5x since 1990. Various developed and emerging international markets appear more attractively valued, either trading near or below their 10-year averages, as the lower chart shows.
- International indexes tend to provide more exposure to value stocks, which currently have more inexpensive valuations than usual compared to growth segments of the global equity market.
- RBC Capital Markets sees evidence that U.S. stocks are "over-owned" compared to those in other regions—meaning, many portfolio managers around the world are holding a higher share of U.S. stocks than they normally do.
- U.S. profit margins seem more stretched and more vulnerable to declining than margins of international indexes, in our view.
- Developed markets outside of the U.S. have higher dividend yields: 2.59 percent for the MSCI World ex-U.S. compared to 1.29 percent for the S&P 500.

While we anticipate positive returns for the S&P 500 in 2022, and we would continue to *moderately* Overweight U.S. equities to start the year, at this stage, we do not recommend *significantly* overweighting U.S. exposure at the expense of international equities.

Now is a good time to review portfolio allocations and adjust them if needed. This can help ensure that there isn't too much of a bias toward U.S. equities and that for diversification purposes international stocks are represented at a level at least near the long-term strategic recommended allocation in global portfolios.

The U.S. market's valuation is above average whereas other markets are near or below average

Forward price-to-earnings ratios based on 2022 consensus forecasts vs. the 10-year average



Note: MSCI World ex-U.S. represents developed markets excluding the U.S.
Source - RBC Wealth Management, Bloomberg; data as of 1/5/22

UNITED STATES

Tyler Frawley, CFA – Minneapolis

- **U.S. equities are on track to open the year with mixed results, as the growth-versus-value trade has begun to dominate headlines once again**. Value is off to a relatively strong start, with the S&P 500 Value Index climbing 0.74% so far this week and the S&P 500 Growth Index falling 3.28%. The S&P 500 is down 1.47%, and while the Dow Jones Industrial Average has outperformed the Nasdaq, both are lower, falling 0.28% and 3.61%, respectively. Sector leadership is evident in Energy, which has returned 9.03% in the first week of the new year, and Financials, which has returned 4.17%. Real Estate is the worst-performing sector, returning -4.42%.

- **A spike in the 10-year Treasury yield has had a noticeable impact on equities to start the year**. After closing out 2021 at 1.51%, the 10-year Treasury yield has risen by 21 basis points (bps) in January and is now at 1.72%, nearing its highest level since April 2021. With this, we have begun to see a rotation out of growth sectors such as Technology and Health Care and into sectors traditionally viewed as more value-oriented, including Energy and Financials. We saw a similar dynamic play out in early 2021, when the 10-year Treasury yield climbed from 0.92% at the beginning of the year to 1.74% by the end of March; over the same period, the S&P 500 Value Index outperformed the S&P 500 Growth Index by more than 8%, before reversing course throughout the rest of the year as yields fell. However, with the Federal Reserve expecting three rate hikes in 2022, we think rates are likely to remain elevated as monetary policy continues to tighten.

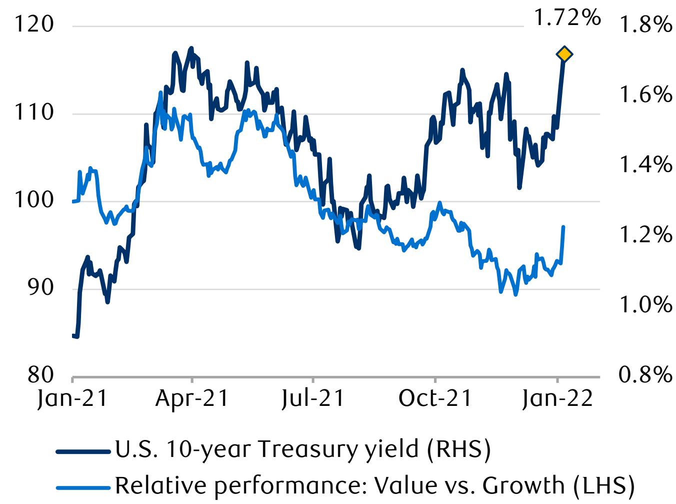
- **U.S. economic activity remains relatively strong**, with this week's 207,000 initial unemployment claims staying well below the five-year average of 241,000 prior to the pandemic. Other economic activity indicators are generally favorable as well, with the ISM Manufacturing and Services Purchasing Managers' Indexes registering 58.7 and 62.0, respectively, indicating **expansion in both the manufacturing and services sectors compared to last month**.

CANADA

Luis Castillo & Simon Jones – Toronto

- It's been a busy start to the year for the fixed income market, as **rates are being driven higher by the market expectation that a milder omicron variant is unlikely to derail the Bank of Canada's hiking plans for 2022**, despite surging case counts and the renewal of pandemic restrictions. For most of 2021, the investment narrative was driven by the prospect, and then the arrival, of higher inflation. Improvements in the economy have now reduced the need for further monetary accommodation, and while 2021 saw a great deal of debate about the timing of central bank rate hikes, 2022 is set to be the year when policy rates actually start to rise. **Rates have jumped across all maturities during the first week of January with a modest re-steepening bias (long-term yields rising faster than short-term yields)**. The yield on the benchmark 2-year Government of Canada bond has climbed more than 12 basis points (bps) while both the 10-year and 30-year bonds are more than 20 bps higher.

When yields spike, value tends to outperform growth



Note: Value and growth are represented by the S&P 500 Value and Growth indexes, respectively. The relative performance line is indexed to 100. As the relative performance line rises, value is outperforming
Source - RBC Wealth Management, FactSet; data through 1/6/22

- **Canada's manufacturing sector ended 2021 on a strong note with output, new orders, employment, and inventories all increasing in December**, according to IHS Markit's Canada Manufacturing Purchasing Managers' Index (PMI). The index remained firmly in expansionary territory in December at 56.5, but declined modestly relative to November's reading of 57.2. While demand for Canadian manufactured goods remained elevated in both domestic and international markets, **supply disruptions and staffing shortages constrained output growth**, weighing on the headline figure. Respondents also reported that material shortages stemming from these supply disruptions continued to exert upward pressure on input costs, leading some firms to raise prices. However, despite these pandemic-related headwinds, respondents were optimistic that production growth would be supported by robust consumer demand in 2022.

EUROPE

Faisal Manji, Frédérique Carrier, &
Thomas McGarrity, CFA – London

- **It did not take long for European bond bears to wake up from their holiday hibernation**. In only a handful of 2022 trading days **government bond yields have moved substantially higher**, with the German 10-year

Bund almost reaching positive territory for the first time since April 2019. Europe took its cue from the U.S. where Wednesday's release of hawkish minutes from the Fed's December meeting only reinforced the apparent reality check that an unwinding of ultra-loose monetary policy is imminent.

- **Tighter financial conditions will be particularly unwelcome in continental Europe**, in our view, where only last month the European Central Bank (ECB) announced an increase to its regular asset purchase program, which is designed to keep financial conditions supportive. We think the ECB will stay dovish in 2022, but policy divergence from other major central banks could present challenges.

- Amid the sharp move up in government bond yields since the middle of last month, **cyclical value sectors**—such as Banks, Basic Resources, Autos, and Energy—**have notably outperformed**, while growth (e.g., Technology and Health Care) and defensive sectors (e.g., Utilities) have underperformed.

- **In the UK, inflation fears have intensified** after a British Chambers of Commerce survey revealed that 58% of the near 5,500 participating companies are set to increase prices in the next three months. The survey indicated the highest-ever level of concern about inflation from UK businesses since its inception in 1989.

- **In Italy, it was announced that the electoral process for a president will start on Monday, January 24**. This is the first European political risk event of the year, the second being the French presidential election in April.

- **The Italian presidential election may have important implications for the government**, since Prime Minister Mario Draghi has suggested he would be interested in the role of president. If he were to become president, it **could trigger early parliamentary elections. This would risk delaying structural reforms as well as potentially upsetting the disbursement of the EU's pandemic recovery fund**. With the difference between Italian 10-year bond yields and their German counterpart towards the low end of their range since the end of the 2008 financial crisis, financial markets do not seem positioned for political uncertainty in the euro area's third-largest economy.

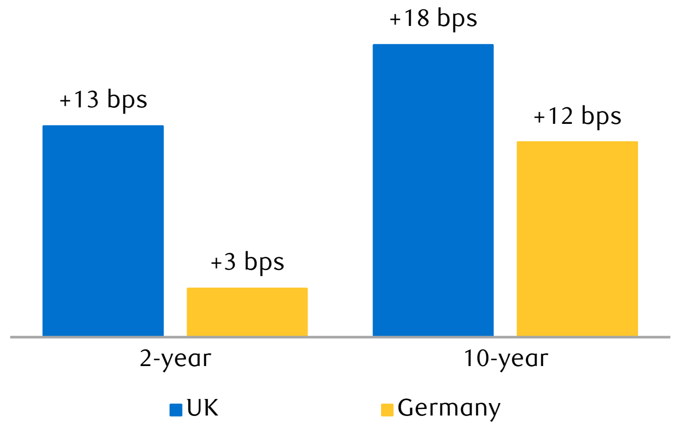
ASIA PACIFIC

Jasmine Duan – Hong Kong

- **A fresh round of selling hit Asian stocks on Thursday as the risk of accelerated Fed rate hikes sparked a broad equity decline**. Japan's benchmark Nikkei 225, plunging 2.9%, slid the most in the region. The Hang Seng TECH Index fell for three trading days before gaining some ground on Thursday afternoon. Chinese Internet giant Tencent (700 HK) cut its stake in Singapore's Sea Ltd. (SE) by selling US$3 billion of shares. This comes less than a month after Tencent said it would hand out more than US$16 billion of JD.com (JD/9618 HK) stock as a one-time dividend. The surprise move was seen as being in response to Beijing's push to curb antitrust behavior and open up closed ecosystems. According to an unsubstantiated Bloomberg report, Tencent may be planning to reduce its holdings in other Chinese big tech names, which we believe partly led to the tech stocks' slump this week.

European government bond yields leap higher in 2022

Year-to-date change in basis points (bps)



Source - RBC Wealth Management, Bloomberg; data through 1/6/22

- **The value of new homes sold by China's largest real estate companies fell annually for the first time since at least 2016 and declined further in December**. According to China Real Estate Information Corp., the 100 largest developers in China sold homes worth RMB 11.1 trillion (US$1.7 trillion) in 2021, down 3.5% from 2020. December's sales were up 32% compared with November, but still fell 35% y/y. Falling income from contracted sales makes it harder for developers to repay bondholders, especially as the government is encouraging companies to prioritize completing existing projects and paying workers over debt repayments.

- **The China Caixin Services Purchasing Managers' Index (PMI) saw a bounce to 53.1 in December from 52.1 in November**. The overall December PMI figures, official and Caixin, suggest to us that the growth slowdown is stabilizing. **Chinese Premier Li Keqiang urged larger cuts on taxes and fees to support the economy**. We think there could be some policy fine-tuning going forward. However, we don't expect a decisive shift to a pro-growth policy stance.

MARKET Scorecard

Data as of January 6, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,696.05	-1.5%	-1.5%	25.3%	44.7%
Dow Industrials (DJIA)	36,236.47	-0.3%	-0.3%	17.5%	26.2%
Nasdaq	15,080.87	-3.6%	-3.6%	18.4%	66.2%
Russell 2000	2,206.37	-1.7%	-1.7%	7.2%	32.7%
S&P/TSX Comp	21,072.20	-0.7%	-0.7%	18.2%	23.2%
FTSE All-Share	4,235.63	0.7%	0.7%	9.7%	0.7%
STOXX Europe 600	488.16	0.1%	0.1%	20.1%	17.2%
EURO STOXX 50	4,324.81	0.6%	0.6%	19.8%	15.3%
Hang Seng	23,072.86	-1.4%	-1.4%	-16.7%	-18.3%
Shanghai Comp	3,586.08	-1.5%	-1.5%	1.0%	16.3%
Nikkei 225	28,487.87	-1.1%	-1.1%	5.3%	22.8%
India Sensex	59,601.84	2.3%	2.3%	23.7%	46.5%
Singapore Straits Times	3,184.30	1.9%	1.9%	11.2%	-1.1%
Brazil Ibovespa	101,561.00	-3.1%	-3.1%	-14.7%	-13.1%
Mexican Bolsa IPC	53,055.31	-0.4%	-0.4%	16.4%	19.2%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.721%	21.1	21.1	68.6	-8.8
Canada 10-Yr	1.701%	27.5	27.5	94.4	11.4
UK 10-Yr	1.156%	18.5	18.5	91.3	38.8
Germany 10-Yr	-0.061%	11.6	11.6	45.9	22.6
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.91%	-1.1%	-1.1%	-1.9%	4.2%
U.S. Investment-Grade Corp	2.49%	-1.4%	-1.4%	-1.1%	6.8%
U.S. High-Yield Corp	4.39%	-0.4%	-0.4%	4.8%	12.0%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,790.84	-2.1%	-2.1%	-6.7%	14.4%
Silver (spot $/oz)	22.20	-4.8%	-4.8%	-18.7%	22.3%
Copper ($/metric ton)	9,708.25	-0.3%	-0.3%	20.9%	58.8%
Oil (WTI spot/bbl)	79.46	3.2%	3.2%	56.9%	25.6%
Oil (Brent spot/bbl)	82.05	5.5%	5.5%	51.1%	19.1%
Natural Gas ($/mmBtu)	3.81	2.2%	2.2%	40.4%	78.5%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	96.2420	0.6%	0.6%	7.5%	-0.4%
CAD/USD	0.7857	-0.7%	-0.7%	-0.4%	1.9%
USD/CAD	1.2727	0.7%	0.7%	0.4%	-1.8%
EUR/USD	1.1296	-0.7%	-0.7%	-8.4%	0.9%
GBP/USD	1.3531	0.0%	0.0%	-0.6%	2.7%
AUD/USD	0.7166	-1.3%	-1.3%	-8.2%	3.3%
USD/JPY	115.8500	0.7%	0.7%	12.4%	6.9%
EUR/JPY	130.8700	0.0%	0.0%	3.0%	7.9%
EUR/GBP	0.8348	-0.8%	-0.8%	-7.8%	-1.8%
EUR/CHF	1.0406	0.3%	0.3%	-3.9%	-4.0%
USD/SGD	1.3608	0.9%	0.9%	3.3%	0.9%
USD/CNY	6.3830	0.4%	0.4%	-1.2%	-8.5%
USD/MXN	20.5057	-0.1%	-0.1%	4.4%	8.8%
USD/BRL	5.6856	2.0%	2.0%	7.3%	39.9%

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 -0.7% return means the Canadian dollar fell 0.7% vs. the U.S. dollar year to date. USD/JPY 115.87 means 1 U.S. dollar will buy 115.87 yen. USD/JPY 0.7% return means the U.S. dollar rose 0.7% vs. the yen year to date.

Source - Bloomberg; data as of 16:35ET 1/6/22

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As of December 31, 2021

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Sell [Underperform]	55	3.81	3	5.45

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