GLOBAL
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Perspectives from the Global Portfolio Advisory Committee
March 10, 2022

Economic stakes of the Russia-Ukraine conflict

Kelly Bogdanova – San Francisco

As the economic front expands with sanctions, we look at the investment ramifications, including a potential "growth scare" and what that could mean for equity markets.

After dropping sharply a couple weeks ago, North American developed equity markets have attempted to stabilize of late, but volatility persists amid the crisis in Ukraine. Market participants continue to take note of the negotiations between Russia and Ukraine and multiple discussions between various leaders.

Sanctions and counter-sanctions are also garnering attention—and should—especially as they pertain to commodity prices, which have jumped meaningfully so far this year, as the chart illustrates.

For equity markets, the relevant question is: where do all of the sanctions leave economic and corporate earnings growth, inflation, and profit margins? We think there is now a much wider range of potential outcomes than there was before the crisis began.

But it's notable that, thus far, not all nations are going along. China, India, Turkey, Brazil, Mexico, Israel, Saudi Arabia, Egypt, other Middle Eastern countries, and Central Asian nations, among others, are choosing not to implement sanctions of their own against the world's largest commodity producer. Most of these countries have strategic partnerships with Russia in various areas.

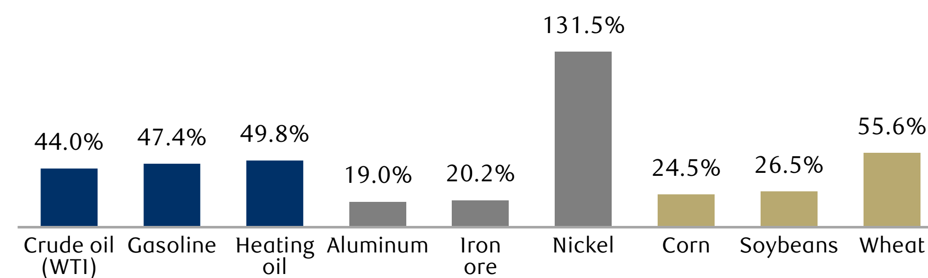
Russia has yet to formally roll out its package of counter-sanctions and administrative actions against countries that have imposed sanctions, although this should happen soon enough.

From our vantage point, the Ukraine crisis is starting to morph into an economic war between the West and Russia, with many other nations preferring to stand on the

The sanctions campaign

The collective West has implemented "sanctions from hell" against Russia (a phrase coined by a U.S. senator years ago) in a very unified and resolute manner—effectively blockading Russia from Western countries—with more sanctions likely coming from the U.S. and allies outside the EU.

YTD performance of select energy, metals, and agriculture commodities



Source - RBC Wealth Management, Bloomberg; commodities futures prices from U.S. and London exchanges; data as of 9:54 pm ET, 3/9/22

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

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sidelines—although all nations are bound to be negatively impacted in one way or another given the upward pressure on commodity prices.

Regardless of how developments in Ukraine unfold, we think most sanctions will be in place for a long time. The origins of this crisis go back decades, as we wrote in our recent special report before events escalated.

Inflation blowback?

Major central banks acknowledge the sanctions will make it more difficult to fight what already had been a challenging inflation environment, and this will likely put additional pressure on households.

According to a study by the U.S. Congress Joint Economic Committee—an entity that has historically done some good research, in our view—even before the Ukraine crisis began, the average cost of inflation for American households was $385 per month relative to January 2021. There is little doubt in our minds that the sanctions will further increase the costs associated with inflation in the U.S., and those costs could end up being higher in Europe. Sanctions can constrain supply chains and act as an indirect “tax” on commodity prices, which filters into the prices of multiple goods and services.

The consequences of higher prices for energy, metals and chemicals/gases used in the industrial and technology sectors, and agriculture have yet to be fully fleshed out by economists—we think it’s just too early.

The agriculture component not only impacts Russian exports but also those of Belarus, a leading fertilizer producer. And, of course, the crisis in Ukraine will disrupt the planting season there. All three countries are major contributors to global food supplies. According to the UN, global food prices rose to a record level in February, climbing 20.7 percent year-over-year, even before the Ukraine conflict and sanctions reached acute levels.

Economic scars could be a growth scare

Due to the knock-on effects of high commodity prices, the global and U.S. economies could be facing what the RBC Capital Markets U.S. Equity Strategy team is terming a “growth scare.” In this sort of scenario economic growth is put at risk, stoking fears among market participants of either very slow growth or recession, but in the end a recession is avoided and economic growth resumes at a normal pace over time.

Since 2009 when the global financial crisis occurred, growth scares have happened four times, negatively impacting the equity market: (1) the European debt crisis in 2010, (2) the U.S. debt downgrade in 2011, (3) the industrial recession in 2015–2016, and (4) during the Fed’s first quantitative tightening procedure and when the U.S. and China were engaged in a trade tussle in 2018.

The S&P 500 declined 17.3 percent, on average, during these four episodes, according to RBC Capital Markets. The chart shows the S&P 500’s path one year before and one year after the market hit bottom. It took 147 days, on average, for the market to work through the growth scare, before reaching the trough level (indicated by the vertical orange bar on the chart).

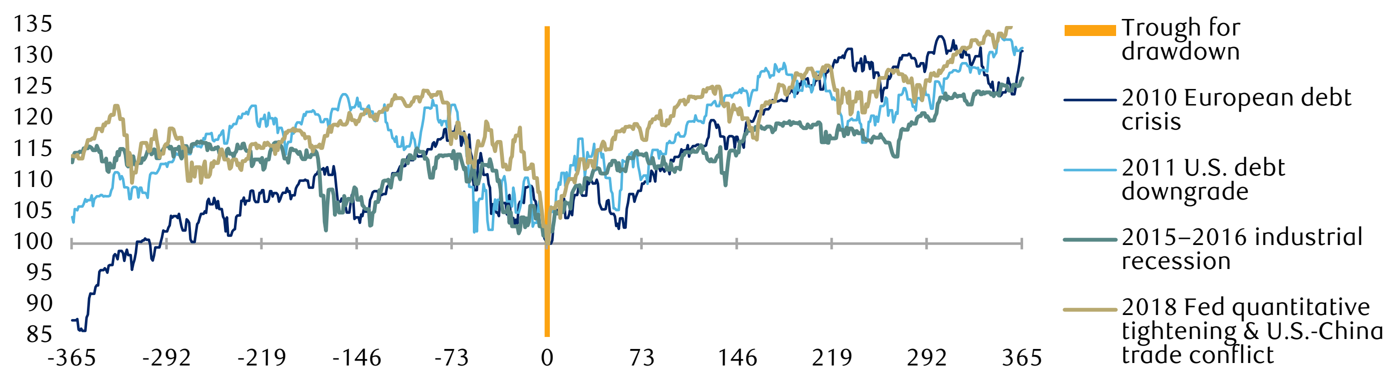
What’s notable is that after the troughs, in each instance the market built on its gains one month, three months, six months, and 12 months later. The S&P 500 was higher by 30.9 percent, on average, 12 months after it troughed.

If this crisis ends up resulting in an economic growth scare—instead of a recession—history indicates that there could be more bumps along the way with additional downside, and the turbulence could last a number of months, but that over the medium term, economic conditions should sort themselves out.

Thus far, none of our seven U.S. leading economic indicators of recession have budged—they are all still flashing green, which signals expansion. We will continue to closely monitor these indicators and others given the crisis situation and the wide range of potential outcomes.

How the market handled previous “growth scares”

S&P 500 performance when GDP growth was threatened but avoided recession (since 2010)



Source - RBC Capital Markets U.S. Equity Strategy, Bloomberg; vertical axis indexed at trough level = 100; horizontal axis shows one year preceding and after trough (in days)

UNITED STATES

Michael Roedl – Minneapolis

- **Selling pressure continues to mount for U.S. credit markets** led by intensified European geopolitical tensions and looming Federal Reserve rate hikes. In addition, new-issue and secondary supply is ramping higher with corporate borrowers rushing to tap the market in anticipation of higher interest rates. As of today's (March 10) intraday trading, investment-grade (IG) corporate bonds are down over 7% year to date, while credit spreads are about 50 basis points wider since the beginning of the year. From a yield perspective, levels reached 3.36% on March 9, the highest level since April 2020. We remain neutral to underweight IG credit as we believe Treasury yields have room to climb higher as the Fed attempts to combat inflation. That said, despite headwinds from the Russia-Ukraine conflict, we do not expect immediate credit concerns for U.S. bond issuers as indicated by historically low high-yield default rates.

- **The U.S. labor market continues to gain strength** as indicated by robust nonfarm payrolls and unemployment edging lower. Last week's nonfarm payrolls report showed the addition of 678,000 jobs, the largest increase since July 2020. According to the U.S. Labor Department, rising payrolls were broad-based across numerous sectors of the economy. Unemployment fell to 3.8% from 4.0% in the prior reading. In our view, healthy labor market conditions will likely keep the Fed on track toward tighter monetary policy action throughout the year.

- **Treasury yields have traded across a broad range over the past two weeks** as investors digest the Russia-Ukraine conflict, severe inflation prints, and expected upcoming rate hikes. That said, the municipal market, also considered a historically low-risk asset class, has lagged Treasury returns after munis were among the top performing fixed income sectors in 2021. While muni yields have been on a constant rise this month, cheaper Muni/Treasury yield ratios have followed. As of data compiled on March 7, 10-year muni/Treasury yield ratios widened to over 94%, marking the highest level since November 2020, as shown in the chart. As a result, we believe muni investors can find relatively attractive entry points, but we suggest targeting higher-quality issuers as credit spreads for higher-risk assets remain compressed.

10-year Muni/Treasury ratio at its highest level since November 2020

Source - RBC Wealth Management, Bloomberg; daily data through 3/7/22

CANADA

Matt Altro & Richard Tan, CFA – Toronto

- **Global energy prices remained volatile over the past week** driven in part by rising tensions in the conflict between Russia and Ukraine. West Texas Intermediate crude oil futures surged to about $130 per barrel (bbl) and have since settled below the $110/bbl level but are still roughly 45% higher year to date. Not surprisingly, the Energy sector in Canada has been a net beneficiary of recent events and has been a relative outperformer in 2022. Outside of Russia's invasion of Ukraine, we believe the environment remains supportive for energy producers as the oil supply struggles to meet demand. However, we think it's clear that an element of geopolitical risk premiums is now embedded into oil prices. As a result, we continue to favour senior energy producers with strong balance sheets while emphasizing the importance of managing the weights of individual positions.

- **The global agriculture market experienced sharp rallies in both crop and fertilizer prices on the back of recent events**. In aggregate, Russia and Ukraine account for approximately 14% of global wheat supplies and 5% of global corn supplies and, therefore, we think the ongoing conflict should drive further tightness on the supply side of the equation. In terms of input costs, namely fertilizers, Russia accounts for approximately 20% of global potash exports and 10% of global phosphate exports. Overall, we think the reduction in Russian and Ukrainian crop supplies should result in stronger global farm economics and add support for the increased fertilizer input costs. Fertilizer prices are still below the record levels seen in 2008, and RBC Capital Markets believes farmers can theoretically absorb another 25%–50% increase in input costs before reaching demand destruction.

EUROPE

Frédérique Carrier & Rufaro Chiriseri, CFA – London

- **The European Commission proposed REpowerEU, a three-step plan to reduce energy dependence on Russia**. In contrast to the U.S., which announced an import ban on Russian oil, the EU's plan involves a more

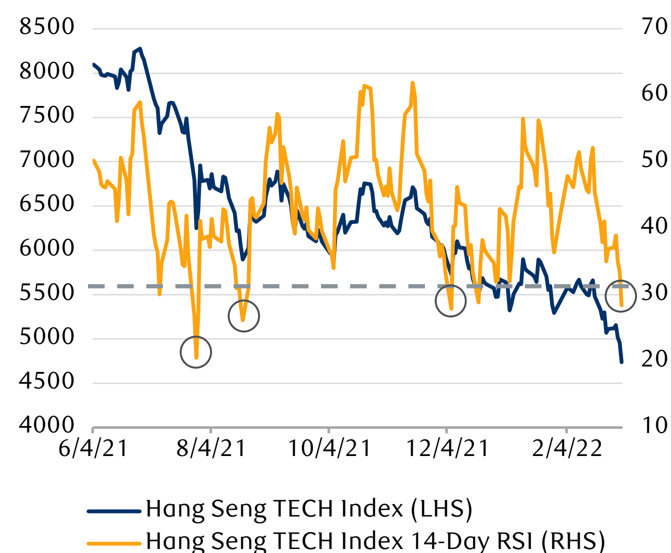
gradual approach given its heavy reliance on Russian energy. It aims to:

- Reduce Russian energy imports by 65% over the remainder of this year, and completely before 2030, through a combination of purchasing non-Russian liquefied natural gas, raising energy efficiency, accelerating the rollout of wind and solar, as well as reducing demand by encouraging consumers to lower the temperature in their homes by 1%.
- Increase gas reserves to 90% of capacity vs. 30% currently, by Oct. 1 of each year so as to improve the system's resiliency.
- Provide aid as a short-term measure to soften the impact of higher energy prices on vulnerable consumers and businesses. Price regulation and a windfall tax on energy suppliers are other suggestions.

■ The plan is ambitious and reflects the severity of the situation. With few viable alternatives to Russian energy in the short term, energy prices will most likely remain elevated. The plan is being discussed at the EU summit (March 9–10) in Versailles along with the EU's strategic priorities on defense and security, and their funding. Common borrowing, as was used for the €750 billion pandemic recovery fund, is likely to be an option.

■ **The European Central Bank (ECB) kept interest rates unchanged at its Thursday meeting and unexpectedly accelerated the reduction in asset purchases**. The market interpreted the decision as hawkish, and bond yields rose in response, especially in Italy with yields jumping by 0.25% to 1.93%, a level last seen in February.

Hang Seng TECH Index drops into oversold territory



Source - RBC Wealth Management, Bloomberg; daily data through 3/4/22

Markets are now pricing in a 0.25% hike by October, brought forward from December prior to the meeting.

■ **ECB President Christine Lagarde stated that the war in Ukraine is a meaningful upside risk to inflation**, and the latest ECB forecasts show substantial 2022 revisions, with inflation now expected to reach 5.1% y/y from 3.2% y/y, but growth is expected to slow to 3.7% y/y from 4.2% y/y. The ECB's forward guidance states that adjustments to interest rates will occur "some time" after asset purchases cease and rate hikes will be gradual.

ASIA PACIFIC

Emily Li & Jasmine Duan – Hong Kong

■ **China announced a GDP growth goal of "about 5.5%" for 2022**, at the high end of economists' estimates. China takes its annual growth target very seriously, as evidenced by the fact that since 1998 it has only slightly missed the annual growth target by 0.1 percentage point twice—in 2014 and 2015. Given the challenging domestic and external environment, we expect more policy support to come to help achieve the target. Meanwhile, China's export growth moderated in the first two months of the year; however, exports and imports rose by 16.3% y/y and 15.5% y/y, respectively. Foreign trade saw a somewhat stable start, but the external environment has added uncertainty to the outlook.

■ **China's technology stocks are back in oversold territory**, with a gloomy outlook that suggests the selloff may not be done. Last Friday, an 8% plunge sent the Hang Seng TECH Index into the oversold zone for the first time in more than two months, as investors sold tech stocks amid earnings shocks and the escalating conflict in Ukraine. According to Bloomberg, some of the country's biggest technology firms, including Tencent (700 HK) and Xiaomi (1810 HK), have dropped to or near oversold territory. History shows the index has risen by an average of 2.8% in the week after dropping into the oversold zone. However, even as technical indicators look more favorable, investors will have to bear with the risks of a weak earnings outlook.

■ **China plans to set up a financial stability fund and adopt measures to keep housing prices stable**, as policymakers ramp up efforts to prevent systemic risks. In his annual work report, Premier Li Keqiang said, "A fund for ensuring financial stability will be established, and market- and law-based ways will be used to defuse risks and potential dangers." Li also said China will explore new models for housing development, including encouraging rentals along with purchases. Regulators have recently eased a year-long cap on home loans and called upon the largest bad-debt managers to join restructuring of weak developers.

MARKET Scorecard

Data as of March 9, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,277.88	-2.2%	-10.2%	10.4%	55.8%
Dow Industrials (DJIA)	33,286.25	-1.8%	-8.4%	4.6%	39.6%
Nasdaq	13,255.55	-3.6%	-15.3%	1.4%	66.7%
Russell 2000	2,016.29	-1.6%	-10.2%	-10.2%	53.5%
S&P/TSX Comp	21,493.23	1.7%	1.3%	15.6%	48.1%
FTSE All-Share	3,999.43	-3.8%	-5.0%	4.4%	19.9%
STOXX Europe 600	434.45	-4.1%	-10.9%	3.3%	28.0%
EURO STOXX 50	3,766.02	-4.0%	-12.4%	-0.5%	27.3%
Hang Seng	20,627.71	-9.2%	-11.8%	-28.3%	-17.6%
Shanghai Comp	3,256.39	-5.9%	-10.5%	-3.1%	10.6%
Nikkei 225	24,717.53	-6.8%	-14.2%	-14.8%	25.5%
India Sensex	54,647.33	-2.8%	-6.2%	7.1%	53.4%
Singapore Straits Times	3,195.38	-1.4%	2.3%	2.8%	14.8%
Brazil Ibovespa	113,900.30	0.7%	8.7%	2.3%	32.3%
Mexican Bolsa IPC	53,911.76	1.0%	1.2%	14.5%	39.2%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.950%	12.5	44.0	42.3	140.9
Canada 10-Yr	1.902%	8.9	47.6	45.5	136.5
UK 10-Yr	1.526%	11.6	55.5	79.9	136.7
Germany 10-Yr	0.216%	8.1	39.3	51.7	107.2
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	2.48%	-0.8%	-4.0%	-2.7%	-4.2%
U.S. Investment-Grade Corp	3.36%	-1.9%	-7.1%	-3.6%	-3.7%
U.S. High-Yield Corp	6.05%	-1.3%	-5.0%	-0.3%	12.6%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,992.29	4.4%	8.9%	16.1%	18.6%
Silver (spot $/oz)	25.78	5.4%	10.6%	-0.6%	51.5%
Copper ($/metric ton)	10,160.75	2.4%	4.3%	15.5%	84.0%
Oil (WTI spot/bbl)	108.70	13.6%	41.2%	69.8%	249.2%
Oil (Brent spot/bbl)	112.64	11.5%	44.8%	66.8%	227.8%
Natural Gas ($/mmBtu)	4.53	2.8%	21.4%	70.1%	154.6%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	98.0070	1.3%	2.4%	6.6%	3.3%
CAD/USD	0.7809	-1.0%	-1.3%	-1.3%	7.0%
USD/CAD	1.2807	1.0%	1.3%	1.3%	-6.5%
EUR/USD	1.1077	-1.3%	-2.6%	-6.9%	-3.3%
GBP/USD	1.3187	-1.7%	-2.5%	-5.1%	0.5%
AUD/USD	0.7322	0.8%	0.8%	-5.1%	11.2%
USD/JPY	115.8600	0.7%	0.7%	6.8%	13.2%
EUR/JPY	128.3400	-0.5%	-2.0%	-0.6%	9.6%
EUR/GBP	0.8400	0.5%	-0.2%	-2.0%	-3.6%
EUR/CHF	1.0263	-0.2%	-1.1%	-7.1%	-3.1%
USD/SGD	1.3582	0.2%	0.7%	1.1%	-1.9%
USD/CNY	6.3176	0.1%	-0.6%	-2.9%	-9.1%
USD/MXN	20.9043	2.1%	1.8%	-1.4%	0.6%
USD/BRL	5.0117	-2.7%	-10.1%	-13.7%	6.1%

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 -1.3% return means the Canadian dollar fell 1.3% vs. the U.S. dollar year to date. USD/JPY 115.86 means 1 U.S. dollar will buy 115.86 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 3/9/22 market close

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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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