GLOBAL
Insight
WEEKLY

Wealth
Management

Perspectives from the Global Portfolio Advisory Committee

June 2, 2022

Opportunities amidst volatility

Joseph Wu, CFA – Toronto

Uncertainty about the economy, inflation, and monetary policy has supercharged volatility in financial markets and, correspondingly, a repricing in valuations. Further downside cannot be ruled out until greater visibility arrives, but we believe valuations across a number of assets are starting to look relatively more enticing.

Growth anxieties

Incoming data continue to support the view of ongoing economic expansion, but growth momentum remains on a decelerating path, buffeted by the fluid Russia-Ukraine war, listless Chinese and European economies, and the Fed and other central banks pivoting assertively to tighten monetary policy and, in turn, financial conditions in the face of persistently high inflation.

We think the key question for investors is whether the current slowdown, particularly in the U.S., is an intra-cycle soft patch to be followed by renewed expansion—fairly common episodes in expansion cycles—or a precursor to a recession.

With healthy corporate balance sheets, ongoing strength in employment and wage growth, and households in solid financial shape with a sizable amount of excess savings that can tapped into to smooth spending, we believe the outlook for the largest components of the U.S. economy—personal consumption and business investment—is likely to remain adequately robust to sustain the expansion over the coming quarters. This, together with a relatively benign message from our recession scorecard, underpins our current assessment that U.S. recession risk, while present and rising, remains reasonably moderate on a 12-month horizon.

Nevertheless, we are cognizant that the risks to this sanguine view stemming from the headwinds mentioned above are building, which suggests to us that "end-of-cycle" worries are likely to persist until markets gain greater visibility on the path of inflation, Fed policy, and the durability of the current U.S. expansion.

More "income" in bonds

Bond markets have endured a bruising stretch over the past 12 months amid a rising rate environment, which has broadly pressured bond prices lower. Despite the understandable frustration associated with negative returns in bonds, we believe the recent rout in bonds comes with some potential positive aspects that investors should take into consideration.

First, as bond prices fall, their yields rise, so the recent selloff in bonds has meaningfully bolstered their expected returns. Thanks to the downward repricing, the yields on most major segments of the bond market have not only improved substantially compared to a year ago, but also climbed near or above their respective averages since 2002 (see top chart on the following page). Moreover, credit spreads—a measure of the additional yield compensation for credit risk over government bonds—have widened, pointing to enhanced excess return potential for corporate bonds.

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

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Priced (in USD) as of 6/1/22 market close (unless otherwise stated). Produced: June 2, 2022 1:52 pm ET; Disseminated: June 2, 2022 1:56 pm ET
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Second, now that bond yields have moved off historically low levels, relatively higher starting yields today can offer more of a cushion to weather further rises in rates, as well as help augment the ability for fixed income to act like a shock-absorbing diversifier in multi-asset portfolios during periods of equity market turbulence.

While the rising rate backdrop has resulted in short-term capital losses in bonds, the combination of considerably higher all-in yields and improved diversification capacity suggests to us that some value is starting to emerge in fixed income assets.

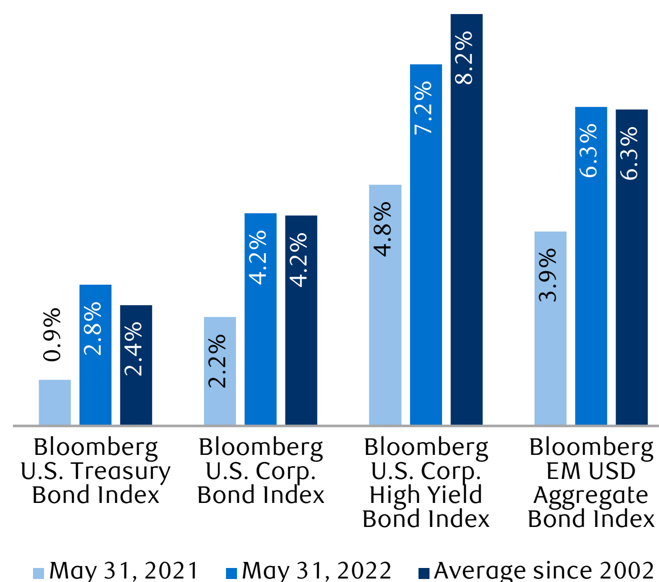
An equities markdown

Aside from emerging markets, forward 12-month earnings estimates for major markets have displayed impressive resilience, particularly for Canada's resource-heavy S&P/TSX Composite (see table). In stark contrast, the forward price-to-earnings (P/E) multiples investors are willing to pay for these expected earnings streams have declined sharply, as the backdrop of a global economy undergoing a slowdown and higher interest (discount) rates—which reduce the present value of future profit streams—have prompted investors to demand a higher risk premium to own equities.

In an environment of heightened macro uncertainty, we think earnings delivery will be taking on added importance for equities. Our expectation for slower, but still positive, economic growth suggests that, despite a moderating growth rate, earnings are likely to be higher 12 months from now. Because the direction of stock markets typically aligns with profit trends (beyond the near term), a further expansion in earnings in coming quarters should provide some degree of fundamental support for share prices.

Yield profiles look increasingly reasonable

Index yield to maturity



Source - RBC Wealth Management, Bloomberg; data through 5/31/22

When in doubt, focus on earnings

	Consensus forward 12-month EPS estimate		Forward P/E		
Index	Current	Jan. 1, 2022	Current	Jan. 1, 2022	Long-term average
S&P 500	$238	$223	17.4x	21.4x	16.2x
S&P/TSX Composite	$1,642	$1,418	12.6x	15.0x	14.8x
MSCI EAFE	$161	$155	12.7x	15.1x	13.4x
MSCI EM	$94	$99	11.4x	12.4x	11.3x

Source - RBC Wealth Management, Bloomberg; data through 5/31/22

Emergent opportunities

Market corrections, while always unnerving, occur with regularity as a normal part of the investing cycle. Importantly, these phases of the cycle often provide opportunities for long-term investors to deploy capital at relatively more compelling prices that are beneficial to long-run outcomes.

While we believe investors should remain nimble in light of a wider range of outcomes for the economy and corporate earnings over the next 12 months, if our view that the current slowdown will likely unfold as a "growth scare" is correct, then valuations across a number of asset markets are starting to look quite appealing.

We think the bottom line is that risk-reward for equities and bonds look considerably more attractive than even a few months ago. This is markedly the case for riskier corporate credit such as high-yield bonds, whose volatility-adjusted expected return potential is arguably competitive with equities.

UNITED STATES

Alan Robinson – Seattle

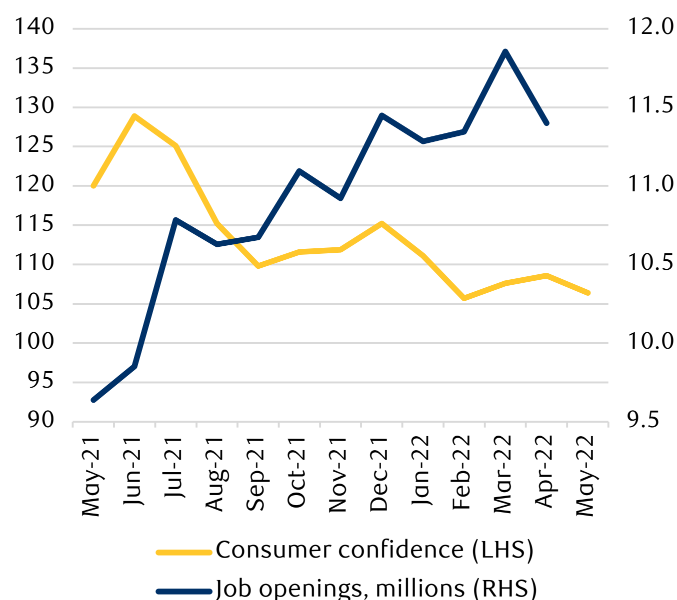
■ **U.S. stocks looked for direction during the holiday-shortened week as traders weighed the implications of the end-of-May rally.** Market bulls pointed to tentative signs of a peak in inflation together with recent softening of high-frequency indicators as evidence the Fed's recent rate hikes are already having an effect, implying fewer additional hikes will be needed. Easing supply chain pressure and moderate upgrades to earnings forecasts underpin this outlook. Conversely, the more negative view is that the recent bounce was simply a bear market rally and only a temporary reprieve given that persistent inflation pressure may prompt the Fed to push interest rates too high.

■ Recent commentary from major U.S. retailers including Walmart, Gap, and Target suggests **inflation in goods prices may have hurt demand**. Overall retail inventories grew by $45 billion in the latest quarter, up 26% from a year ago. But as consumers pivot from spending on goods to services, this glut of merchandise may prompt summer discounts and take the heat off inflation.

■ Energy prices have also been a major driver of inflation this quarter. **Oil rallied to almost $120 per barrel at the start of the week** after European leaders imposed an embargo on two-thirds of the oil imported from Russia. Typically, embargoed commodities usually find buyers elsewhere, but additional restrictions on shipping insurance imply a lot of this supply may remain off the market. In response, OPEC raised its output target by 648,000 barrels/day in both July and August after pressure from oil-consuming nations.

■ **Economic data during the week was mixed, with reasonably upbeat corporate sentiment data offset by weakening consumer confidence.** A slight slowdown is likely in the monthly jobs report scheduled for Friday (June 3), according to consensus views, but the Job Openings and Labor Turnover Survey (JOLTS) report released June 1 showed job availability remains near record highs (see chart). We believe this solid but moderating economic picture should allay fears of a more serious downdraft for stocks as the year progresses.

Consumer confidence declining even as jobs remain plentiful



Source - RBC Wealth Management, FactSet, The Conference Board, U.S. Bureau of Labor Statistics; consumer confidence data through May 2022, job openings through April 2022

CANADA

Matt Altro & Richard Tan, CFA – Toronto

■ **Inflation continues to run hot**, with Canada's Consumer Price Index rising 6.8% y/y in April, marking the fastest pace in 30 years. Notably, groceries and gasoline climbed 9.7% and 36.3%, respectively, further increasing the pinch on the consumer's wallet. In a continued effort by the Bank of Canada (BoC) to fight what feels like ever-weakening purchasing power, **interest rates were hiked another 50 basis points (bps)** on Wednesday. This move matches the magnitude of the hike from the last policy meeting but avoided what seemed like a possible 75 bps hike, easing some negative sentiment on the ability of the BoC to control the current inflationary environment. Aggressive actions of this nature have not been used in over 20 years, and are in response to the need to move quickly to avoid any potential entrenchment of long-lasting inflation expectations.

■ **The Big Six Canadian banks reported Q2 earnings that beat consensus expectations**, supported by rising interest rates, solid loan growth, and benign credit risks. On the interest rate front, aggressive monetary measures from global central banks enabled the entire group to benefit from margin expansion. Loan growth was also solid, growing 3.5% sequentially, driven by strength in commercial lending and offset by some softness in mortgage originations. Credit provisions were the star of the show, in our opinion, as all banks with the exception of one opted to release reserves back into earnings, citing low credit risk conditions and healthy capital levels. To top things off, **the majority of the banks announced dividend increases** with an average hike of roughly 4%. All else equal, this was a solid showing for the Canadian banks, in our view, and RBC Capital Markets is still forecasting mid-single-digit earnings growth through 2023. This in conjunction with an average dividend yield of 4% makes for a solid total-return profile, in our opinion.

EUROPE

Rufaro Chiriseri, CFA – London

- **Euro area inflation accelerated to an all-time high** and ahead of the consensus estimate to 8.1% y/y, with energy prices surging by 39.2% y/y in May. Core inflation, which excludes volatile food and energy prices, rose from 3.6% y/y to 3.8% y/y.

- In the face of higher inflation, **the European Central Bank (ECB) is preparing to lift interest rates for the first time in more than a decade** and the upcoming June policy meeting will be closely watched by the market. ECB President Christine Lagarde indicated the path to policy normalization starting with the end of bond purchases in June followed by the first 25 basis point (bps) rate hike in July to reach a policy rate of 0% by the end of Q3 2022. Conversely, a minority of ECB members are supporting an outsized interest rate hike of 50 bps due to surging inflation, while the majority favours a more modest 25 bps hike in July. Bond markets have reacted to the inflation data and hawkish comments, with German 10-year Bunds surging to 1.12% while Italian 10-year sovereign bonds rose to 3.14%. The market now expects around 112 bps of policy tightening for 2022.

- **In the UK**, the British Retail Consortium (BRC) survey, which tracks the price of basic goods sold in shops, showed that **fresh food prices are rising at their fastest pace in a decade**. The BRC said that fresh food prices in May surged by 4.5% y/y and overall shop-price inflation has reached an 11-year high of 2.85%, with little sign of this easing soon due to supply chain disruptions.

- While concerns around slowing growth in the UK recently plagued market expectations for more hikes this year, the market is now looking past the Bank of England's dovish stance. Yields rose this week, with **2-year Gilts surging to 1.6% from a low of 1.4% just last week and 10-year Gilts now firmly above 2% at 2.12%**. The market now expects the Bank Rate to reach 2.3% by year-end, implying a 25 bps hike at every policy meeting this year.

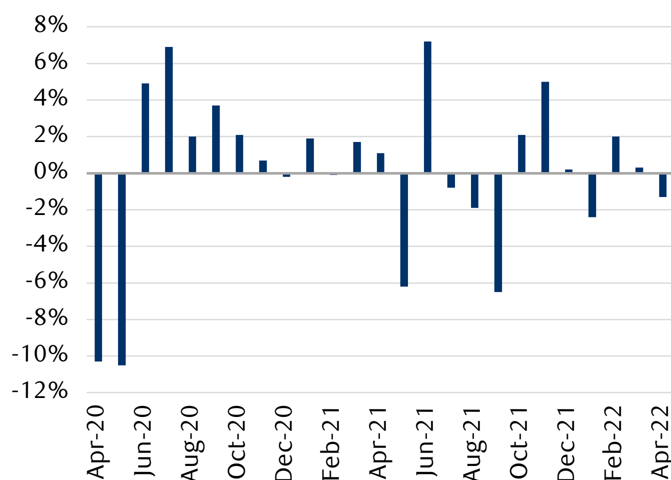
ASIA PACIFIC

Emily Li – Hong Kong

- **Japan's economic rebound has come under pressure as factory output fell** more than the consensus expected, partly due to COVID-19 lockdowns in China that have disrupted supply chains. According to Japan's Ministry of Economy, Trade and Industry, production in April dropped 1.3% m/m, with reduced output of memory chips, digging equipment, and cars among the items with the largest declines. Output fell 4.8% y/y and remains below the level

Japan factory output continues to face supply-side snarls

Japan Indices of Industrial Production (m/m)



Source - Japan's Ministry of Economy, Trade and Industry, RBC Wealth Management, Bloomberg; data through April 2022

in December. **We expect production to recover as the Chinese lockdown restrictions are removed** and China accelerates support for its economy, but the pace of the recovery for Japan's factories is uncertain.

- **The China Securities Regulatory Commission and Hong Kong's Securities and Futures Commission have agreed in principle to include exchange-traded funds (ETFs) in the stock connect scheme**. Under the scheme, investors from mainland China and Hong Kong can trade ETFs listed on each other's exchanges. Separately, China will further open its financial markets by allowing foreign institutional investors to trade bonds on its smaller exchange market. According to the People's Bank of China, qualified foreign institutional investors, such as central banks, sovereign funds, commercial banks, and pension funds, will be allowed to invest in bonds on the exchange market starting June 30.

- **The shares of Chinese e-commerce giant Alibaba Group Holding Ltd. (9988 HK) rallied for three consecutive trading days** after the company reported better-than-expected Q1 2022 revenue growth of 9% y/y last Friday. The impact from COVID-19 lockdowns was less than investors had feared. CEO Daniel Zhang said the company would pursue higher-quality expansion, ensure cost optimization, maintain a strong balance sheet, and continue to expand its ability to build cloud and digital infrastructure for customers. We expect the **logistics disruption and a weak consumption appetite will contribute to a relatively flat Q2 for China's e-commerce platforms**.

MARKET Scorecard

Data as of June 1, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,101.23	-0.7%	-14.0%	-2.4%	34.2%
Dow Industrials (DJIA)	32,813.23	-0.5%	-9.7%	-5.1%	28.8%
Nasdaq	11,994.46	-0.7%	-23.3%	-12.7%	25.6%
Russell 2000	1,854.82	-0.5%	-17.4%	-19.2%	32.0%
S&P/TSX Comp	20,713.72	-0.1%	-2.4%	3.7%	36.0%
FTSE All-Share	4,164.00	-0.9%	-1.0%	2.8%	22.0%
STOXX Europe 600	438.72	-1.0%	-10.1%	-2.5%	23.9%
EURO STOXX 50	3,759.54	-0.8%	-12.5%	-7.7%	22.1%
Hang Seng	21,294.94	-0.6%	-9.0%	-27.7%	-10.3%
Shanghai Comp	3,182.16	-0.1%	-12.6%	-12.2%	9.1%
Nikkei 225	27,457.89	0.7%	-4.6%	-4.7%	24.5%
India Sensex	55,381.17	-0.3%	-4.9%	6.6%	66.3%
Singapore Straits Times	3,244.00	0.4%	3.9%	1.8%	27.2%
Brazil Ibovespa	111,359.94	0.0%	6.2%	-13.2%	25.7%
Mexican Bolsa IPC	51,506.15	-0.5%	-3.3%	1.5%	39.3%
Gov’t bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	2.908%	6.3	139.8	130.1	224.9
Canada 10-Yr	2.976%	8.5	155.0	148.2	244.3
UK 10-Yr	2.155%	5.4	118.4	132.9	192.4
Germany 10-Yr	1.187%	6.5	136.4	136.5	158.9
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	3.38%	0.0%	-8.9%	-8.1%	-8.5%
U.S. Investment-Grade Corp	4.21%	0.0%	-11.9%	-10.1%	-7.0%
U.S. High-Yield Corp	7.09%	0.0%	-8.0%	-5.3%	8.6%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,847.22	0.5%	1.0%	-2.8%	6.2%
Silver (spot $/oz)	21.84	1.4%	-6.3%	-21.7%	19.3%
Copper ($/metric ton)	9,445.50	0.0%	-3.0%	-7.7%	73.0%
Oil (WTI spot/bbl)	115.26	0.5%	49.7%	70.2%	225.2%
Oil (Brent spot/bbl)	115.83	-5.7%	48.9%	64.9%	202.3%
Natural Gas ($/mmBtu)	8.76	7.5%	134.7%	182.1%	393.5%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	102.5620	0.8%	7.2%	14.2%	4.8%
CAD/USD	0.7901	-0.1%	-0.1%	-4.6%	7.2%
USD/CAD	1.2657	0.1%	0.2%	4.9%	-6.7%
EUR/USD	1.0653	-0.8%	-6.3%	-12.8%	-4.3%
GBP/USD	1.2493	-0.9%	-7.7%	-11.7%	0.0%
AUD/USD	0.7179	0.0%	-1.2%	-7.4%	5.6%
USD/JPY	130.1400	1.1%	13.1%	18.9%	21.0%
EUR/JPY	138.6300	0.4%	5.9%	3.7%	15.7%
EUR/GBP	0.8529	0.1%	1.4%	-1.2%	-4.3%
EUR/CHF	1.0261	-0.3%	-1.1%	-6.4%	-4.1%
USD/SGD	1.3749	0.4%	1.9%	4.0%	-2.3%
USD/CNY	6.6862	0.2%	5.2%	4.8%	-6.2%
USD/MXN	19.7008	0.2%	-4.0%	-1.3%	-10.6%
USD/BRL	4.8113	1.6%	-13.7%	-6.6%	-10.3%

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.

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Source - Bloomberg; data as of 6/1/22 market close

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Hold [Sector Perform]	569	39.03	172	30.23
Sell [Underperform]	48	3.29	3	6.25

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