GLOBAL
Insight
WEEKLY

Perspectives from the Global Portfolio Advisory Committee

July 7, 2022

Mixed signals

Kelly Bogdanova – San Francisco

The risks of a U.S. recession appear to be rising. For equity market performance, the more important consideration is the degree to which the market has already factored in these risks. We weigh the data from several indicators and discuss why there's no "one-size-fits-all" market response to recessions.

Four events should set the tone for the U.S. equity market over the near term, in our view, and will likely determine whether the S&P 500's next move will be to consolidate, bounce, or decline further. The upcoming events are:

- The U.S. consumer inflation report on July 13;
- Q2 corporate earnings reporting season, starting in mid-July and running through much of August;
- The two-day Fed meeting, which will produce an interest rate decision on July 27; and
- The U.S. Q2 GDP report on July 28.

As these key dates approach, U.S. recession risks have risen further in just the past week. We provide perspective on this below.

We also address the bigger question for investors: Is a recession already largely factored into the U.S. market, especially in light of the significant selloff of the past six months? With the major indexes down roughly 20 percent to 30 percent, we think much of the weakness is likely priced in. But there are a number of important caveats to consider, as this is a unique business cycle with no analogues.

Recession risks are accelerating

Heightened recession risks are captured by the latest Atlanta Fed GDPNow estimate, which is pointing to a second straight quarter of negative U.S. GDP growth in Q2. (An important note: Two consecutive quarters of GDP declines is not the "official" definition of a recession according to the National Bureau of Economic Research [NBER], but it's one that many market participants embrace. Therefore, should another negative GDP quarter transpire, we think press headlines would shout "recession" regardless of whether the state of the economy matches the official definition.)

The GDPNow model is currently forecasting a 1.9 percent decline in Q2 GDP, although this estimate is subject to change as more data arrive. This forecast deteriorated significantly late last week following negative revisions to Q2 consumer spending and private domestic investment data. We view GDPNow as a useful running estimate of U.S. GDP because it incorporates the most relevant data released thus far during the quarter.

Complicating matters, the Bloomberg consensus of Wall Street economists is forecasting 2.6 percent GDP growth

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

Priced (in USD) as of 7/6/22 market close (unless otherwise stated). Produced: 7/7/22 4:27 pm ET; Disseminated: 7/7/22 5:30 pm ET
For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 7

in Q2—the opposite of what the Atlanta Fed's model is signaling. The consensus estimate has been near this level since mid-May; we think some economists may be slow to update their forecasts despite the fact that rhetoric about the economy has become more pessimistic. We can't remember such a wide gap between the GDPNow estimate and the consensus forecast (see chart).

What is our take on this mismatch and recession risks overall?

RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli points out there are indeed signs of material, broad-based economic slowing. He says this downturn will *feel* like a recession to most people, whether or not it is officially deemed one by the NBER. He does not believe the consumer segment will be spared; it represents the largest share of the economy. While Porcelli's base case forecast is still for a mid-cycle slowdown similar to the one that occurred from 1994 to 1995—a painful period that felt like a recession but wasn't accorded the official designation—he notes that an official recession is looking increasingly likely this cycle. If this turns out to be the case, Porcelli thinks it will be mild *unless* the Fed overtightens.

RBC Wealth Management's U.S. recession scorecard, which tracks seven important leading indicators of recession, has recorded some deterioration in just the past week. The all-important yield curve indicator has shifted to the yellow zone along with another indicator, and the manufacturing indicator has flipped from yellow to red. As a group, the seven indicators are still not signaling acute risks that a recession is imminent, but the trend has shifted notably since early June. Recession risks are now higher than before, as our most recent recession scorecard report explains.

One size does not fit all

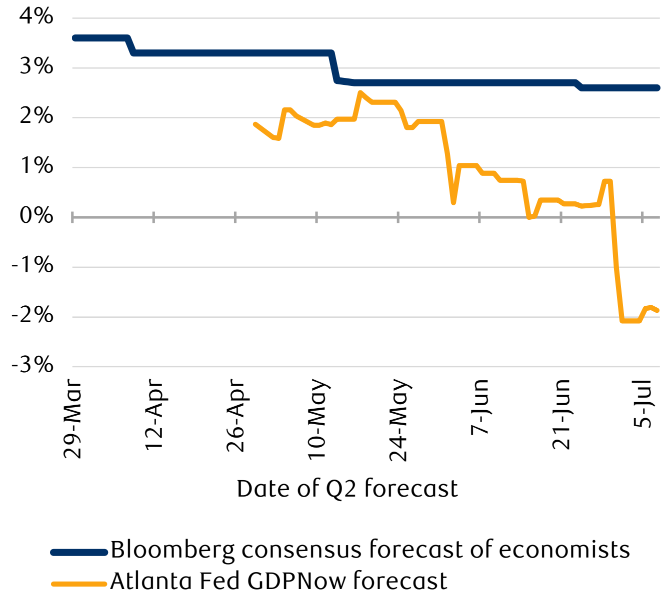
Regardless of whether a recession is already upon us, right around the corner, or could materialize within the next year or two, the bigger question for investors is: To what degree has the U.S. equity market already factored in a recession?

With the S&P 500 down almost 20 percent from its peak and some widely owned stocks within the index down much more, while the Nasdaq Composite and the small-cap Russell 2000 are both down almost 30 percent, we think much of the weakness has been priced in—as long as the Fed doesn't slam on the brakes too hard by raising interest rates much higher than is warranted, and as long as inflation doesn't linger at an elevated level for a long time.

An important point to consider when thinking about equity market behavior surrounding recessionary periods is that there is no single template—there is no "typical" recession, and there isn't much that can be considered

There is an unusually wide gap between GDP forecasts

Evolution of Q2 2022 GDP forecasts over time



Source - Bloomberg, Federal Reserve Bank of Atlanta; data through 7/7/22

typical market behavior associated with them. This is illustrated by the table on the following page and by other data:

- Market performance can vary widely during recessions. While the S&P 500's average decline was 32 percent surrounding the previous 13 recessions, magnitudes ranged from just 15 percent to 57 percent.
- Historically, there has not been a strong correlation between the duration of recessions and S&P 500 declines. One notably long recession was accompanied by a smaller-than-average market decline (1981); some recessions of roughly average length featured well-below-average declines (1948, 1953, 1960); and on other occasions, recessions of below-average length ushered in big market declines (2001, 2020).
- Likewise, the depth of recessions (in terms of peak-to-trough GDP losses) has not consistently correlated with the magnitude of market declines.
- There is one very visible pattern in the historical data, however. In all but one of the previous recessions since 1937, the equity market troughed before the recession officially ended. This reinforces a point we make repeatedly: Attempting to time the market bottom is usually a fruitless exercise. The market typically bottoms well before the economic clouds part, often when headlines and investor sentiment are still rather negative.
- Corporate profit declines and valuation trends during recession periods have often played roles in shaping market performance. These are important aspects of

S&P 500 corrections surrounding recessions

	Decline details			Recession-related details		
Recession dates	Market peak date	Days to bottom	Decline %	Recession length (months)	Did the market bottom before the recession ended?	No. of months from market bottom to end of recession
May 1937 – June 1938	3/10/37	386	-54%	14	Yes	3.0
Nov. 1948 – Oct. 1949	6/15/48	363	-21%	12	Yes	5.1
July 1953 – May 1954	1/5/53	252	-15%	11	Yes	9.1
Aug. 1957 – April 1958	7/15/57	99	-21%	9	Yes	5.0
April 1960 – Feb. 1961	8/3/59	449	-14%	11	Yes	4.0
Dec. 1969 – Nov. 1970	11/29/68	543	-36%	12	Yes	6.1
Nov. 1973 – March 1975	1/11/73	630	-48%	17	Yes	6.1
Jan. 1980 – July 1980	2/13/80	43	-17%	7	Yes	4.1
July 1981 – Nov. 1982	11/28/80	622	-27%	17	Yes	4.1
July 1990 – March 1991	7/16/90	87	-20%	9	Yes	6.1
March 2001 – Nov. 2001	3/24/00	929*	-49%	9	No	N/A**
Dec. 2007 – June 2009	10/9/07	517	-57%	19	Yes	4.1
Feb. 2020 – April 2020	2/19/20	33	-34%	3	Yes	1.0
Average		**381**	**-31.8%**	**11.5**	—	**4.8**

Notes: The 1945 recession is excluded as there was no clear stock market pullback around it. * Surrounding the recession in March 2001 – Nov. 2001, the pullback statistics are based on a March 2000 peak and Oct. 2002 low; the market hit an initial low in Nov. 2001, which was retested and surpassed in 2002. ** The market didn't bottom until 10 months after the recession ended; this data is not included in the average calculated for this column.

Source - RBC Capital Markets U.S. Equity Strategy, Haver Analytics, RBC Wealth Management

the economic cycle that we plan to address in coming weeks as we approach corporate earnings season.

Stay tuned for updates

The slew of important economic, corporate, and monetary policy events that will occur in the near term will likely determine the U.S. equity market's next move, in our view.

If some of these events prove to be disappointing and recession probabilities rise further, we think there could be a longer bout of volatility and some more downside for equities.

Conversely, if the preponderance of news is at least "less bad" than it has been lately and signals that some of the worst aspects of the current down-cycle may be passing, the market could get a much-needed reprieve and even bounce noticeably over the near term.

For additional thoughts on the market's potential path beyond the upcoming events—including a discussion of two specific scenarios tied to inflation and Fed policy—see the recent article on prospects for equity markets, part of our 2022 Midyear Outlook report.

UNITED STATES

Alan Robinson – Seattle

- **U.S. stocks have pulled away from their recent lows during the holiday-shortened week** as traders weighed whether the year-to-date declines in the market already reflected peak bearishness surrounding this year's likely economic slowdown. Trading volumes were relatively light as is typical at the start of July in the pre-earnings season summer lull.

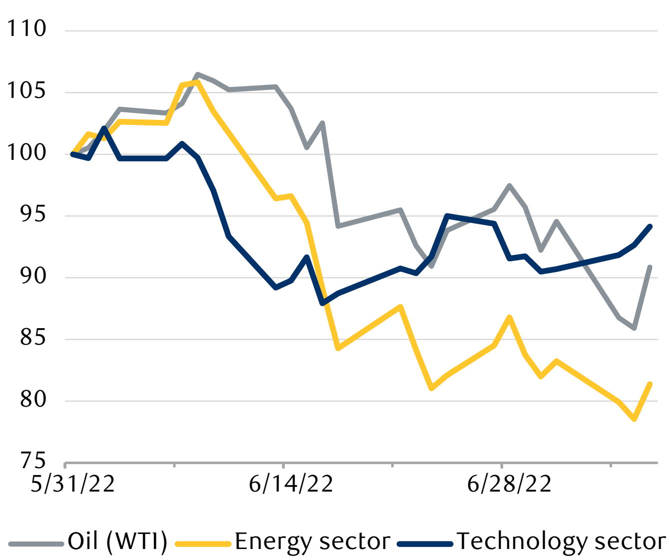
- **Banks will open earnings season, and they may provide a roadmap to the direction of the broad market** as analysts hone their earnings forecasts. **RBC Capital Markets, LLC Large Cap Bank Analyst Gerard Cassidy highlighted two potential positive developments** in his earnings preview for the sector. He expects net interest income to strengthen from prior quarters as interest rates rise, and he expects loan growth for his coverage universe to hit 9.2% y/y with credit quality remaining robust. However, he thinks earnings from capital markets and investment banking businesses may be down sharply.

- **Results for the Energy sector are also likely to be closely monitored this earnings season**. Since the price of oil closed at a peak on June 8, Energy stocks have fallen more quickly than the commodity. This may be a reflection of longer-term concerns over oil company earnings as high current oil prices encourage a switch to alternative energy sources. It may also reflect concerns that a global recession may further reduce demand for oil. But the fact that other cyclical sectors such as Technology have performed relatively well since that peak (see chart) suggests to us that Energy stock weakness may be a passing phase. A few global oil companies have previewed their results already, and none of the commentaries appear unduly alarming so far.

- **Ahead of the monthly jobs report due tomorrow, U.S. trade data released today offered hope for a positive Q2 2022 GDP print**. The trade deficit, which had contributed to negative GDP growth in Q1 2022, bounced back sharply in May, as exports outpaced imports thanks, partly, to foreign ports reopening.

Oil stocks have underperformed the commodity as global growth concerns build

Relative performance



Source - RBC Wealth Management, FactSet; daily data as of 12:00 pm ET 7/7/22

CANADA

Luis Castillo & Simon Jones – Toronto

- Canada's GDP grew 0.3% m/m in April, led by robust growth in high-contact service industries and the oil & gas extraction sector. However, there are signs that growth may be slowing, with Statistics Canada's preliminary estimate for May showing the economy likely contracted 0.2% m/m. **With inflation, labour shortages, and rising interest rates beginning to take a toll on economic growth, RBC Economics revised its economic forecasts and now expects a moderate contraction in the Canadian economy in 2023**. The Bank of Canada (BoC) has so far shown no intention of slowing its current monetary tightening pace and appears willing to endure the economic pain necessary to tame elevated levels of inflation. Since peaking in mid-June, Canadian short-to-mid-term rates have fallen by 30–50 basis points (bps), as the bond market's focus shifts towards a potential economic slowdown.

- The BoC's Business Outlook Survey showed firms remain optimistic about future sales growth, but an increasing number of businesses expect growth to decelerate over the next 12 months as demand normalizes. As has been the case for many months, **labour shortages and supply chain disruptions continue to act as a constraint on firms' ability to meet demand**. To contend with these challenges, many companies plan to increase spending on equipment to improve productivity, and hiring intentions also remain widespread. **However, the tightness in the labour market has meant employers have to pay higher wages to attract and retain talent**, costs they expect to pass along to consumers in the form of higher prices. These signs of excess demand, coupled with the recent rise in consumer inflation expectations, likely means that an aggressive policy stance remains appropriate for the BoC and we expect the central bank will increase the policy rate by at least 50 bps at next week's meeting.

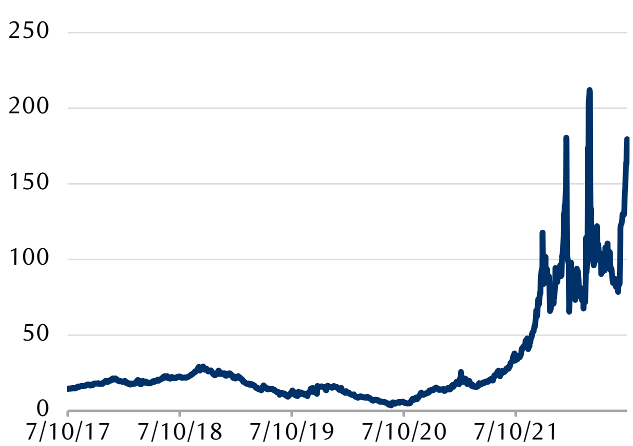
EUROPE

Frédérique Carrier – London

- **The energy crisis in Europe has intensified** as gas flows from Russia are down by close to two-thirds so far this year. Over the past few months, the continent has been working to reduce its dependence on Russian gas, and is now receiving close to one-third of all worldwide exports of liquefied natural gas (LNG). Moreover, coal-fired power plants are restarting and the planned closure of some nuclear reactors has been postponed.
- Despite these efforts, **it is looking increasingly likely that Europe will have to ration gas in the autumn**. Gas storage, currently at 60% capacity, according to IntelliNews, is likely to struggle to reach the target of 85% in October.
- If supply cannot be increased, demand will have to adjust. There is evidence that **high prices are already causing demand destruction.** Rationing for large users, such as chemical, glass, steel, and construction companies, appears increasingly likely.
- **How drastic the rationing may be and whether it is extended to households will likely depend on two factors out of Europe's hands**: winter temperatures and the extent to which China bounces back from COVID-19 lockdowns and diverts LNG shipments away from Europe. An extraordinary meeting of EU27 energy ministers will convene on July 26 to discuss how the bloc will cope with the energy crisis in the winter months.
- **The consensus estimate of 2023 European GDP has been falling steadily since the Russia-Ukraine war broke out, but the current consensus still foresees relatively sprightly growth of 1.85%**. It is likely to be revised down further as a recession in Europe in the winter months appears increasingly difficult to avoid.
- **The UK, meanwhile, faces a political crisis. A widespread loss of confidence in Prime Minister Boris Johnson** led to more than 50 ministerial resignations within 36 hours, the most in Britain's political history, and **Johnson reluctantly resigned**. There is no clear frontrunner to replace him. Most potential candidates would likely usher in a period of flexible fiscal policy, with the Bank of England having to increase interest rates, in our view—which would likely underpin the pound. By contrast, should fiscally conservative former Chancellor of the Exchequer Rishi Sunak become prime minister, we would expect more fiscal austerity.
- Other risks could impact the pound, in our view, including the relationship with the EU and the yawning current account deficit now at 8% of GDP, the prospect of a Scottish independence referendum, and a possible general election.

European natural gas prices spike again

Netherlands TTF natural gas forward one month (EUR/MWh)



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

ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **Asia Pacific equity markets have been mixed this week**, with most ASEAN countries trading lower and Japan, India, and New Zealand at the other end of the spectrum.
- According to a Bloomberg report, **the Bank of Japan will likely raise its inflation forecasts and lower its GDP growth forecasts for the year** on the back of rising costs and the heavy impact on Japan's manufacturing sector from China's pandemic lockdowns. We think these potential adjustments will likely reinforce the central bank's commitment to its easy monetary policy to support the economy.
- **The White House is reviewing its tariff policies on Chinese imports**, with options including cutting some of the existing tariffs, according to a Reuters report. The review comes as the first tranche of Section 301 tariffs on US$34 billion of goods expired on July 6. Another tranche on US$16 billion of goods will expire on Aug. 23, and a third, on approximately US$100 billion of goods, will expire on Sept. 4. Politicians supporting a cut argue that lowering the levies could help to lower record high inflation. However, U.S. Trade Representative Katherine Tai, an opponent of a cut said, "The China tariffs are, in my view, a significant piece of leverage—and a trade negotiator never walks away from leverage."
- **Samsung Electronics Co. (005930 KS) reported better-than-feared revenue growth (+21% y/y)**. Revenue expectations were low heading into reporting season as investors were concerned about the impact of weakening consumer demand and rising materials costs for chipmakers, especially after the grim outlook by U.S. rival Micron Technology (MU US) last week. The stronger numbers also helped lift the share prices of other Asia chipmakers today. That said, operating profit came in softer than anticipated, reflecting margin pressures from rising inflation. According to Samsung, operating profit growth slowed to its lowest level in more than two years, with 14 trillion won (US$10.7 billion) for the three months ended June 30.

MARKET
Scorecard

Data as of July 6, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,845.08	1.6%	-19.3%	-11.5%	20.9%
Dow Industrials (DJIA)	31,037.68	0.9%	-14.6%	-10.2%	18.1%
Nasdaq	11,361.85	3.0%	-27.4%	-22.5%	8.9%
Russell 2000	1,727.55	1.1%	-23.1%	-24.0%	19.7%
S&P/TSX Comp	18,729.66	-0.7%	-11.7%	-7.7%	19.5%
FTSE All-Share	3,910.80	-0.8%	-7.1%	-3.7%	12.4%
STOXX Europe 600	407.34	0.0%	-16.5%	-10.7%	9.7%
EURO STOXX 50	3,421.84	-1.0%	-20.4%	-15.6%	2.1%
Hang Seng	21,586.66	-1.2%	-7.7%	-23.1%	-18.0%
Shanghai Comp	3,355.35	-1.3%	-7.8%	-5.0%	0.7%
Nikkei 225	26,107.65	-1.1%	-9.3%	-8.9%	14.9%
India Sensex	53,750.97	1.4%	-7.7%	1.7%	47.3%
Singapore Straits Times	3,103.66	0.0%	-0.6%	-2.7%	15.4%
Brazil Ibovespa	98,718.98	0.2%	-5.8%	-21.1%	-0.2%
Mexican Bolsa IPC	47,722.29	0.4%	-10.4%	-4.6%	26.0%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	2.930%	-8.3	142.0	158.2	225.4
Canada 10-Yr	3.189%	-3.4	176.3	187.3	264.1
UK 10-Yr	2.092%	-13.7	112.1	145.8	189.1
Germany 10-Yr	1.206%	-13.0	138.3	147.4	163.7
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	3.57%	1.0%	-9.5%	-9.8%	-9.9%
U.S. Investment-Grade Corp	4.58%	0.9%	-13.6%	-14.0%	-11.3%
U.S. High-Yield Corp	8.87%	0.2%	-14.0%	-12.9%	-0.4%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,738.68	-3.8%	-4.9%	-3.2%	-2.6%
Silver (spot $/oz)	19.20	-5.3%	-17.6%	-26.6%	5.1%
Copper ($/metric ton)	7,657.75	-7.2%	-21.4%	-17.5%	24.8%
Oil (WTI spot/bbl)	98.53	-6.8%	28.0%	34.3%	142.5%
Oil (Brent spot/bbl)	99.98	-12.9%	28.5%	34.1%	132.0%
Natural Gas ($/mmBtu)	5.56	2.4%	49.0%	52.8%	203.6%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	107.0710	2.3%	11.9%	15.7%	10.7%
CAD/USD	0.7667	-1.3%	-3.1%	-4.5%	3.8%
USD/CAD	1.3042	1.3%	3.2%	4.7%	-3.7%
EUR/USD	1.0185	-2.9%	-10.4%	-13.9%	-9.9%
GBP/USD	1.1920	-2.1%	-11.9%	-13.6%	-4.6%
AUD/USD	0.6779	-1.8%	-6.7%	-9.6%	-2.8%
USD/JPY	135.9200	0.1%	18.1%	22.9%	26.6%
EUR/JPY	138.4300	-2.7%	5.8%	5.8%	14.0%
EUR/GBP	0.8544	-0.8%	1.6%	-0.3%	-5.6%
EUR/CHF	0.9887	-1.2%	-4.7%	-9.5%	-7.2%
USD/SGD	1.4049	1.0%	4.1%	4.3%	0.9%
USD/CNY	6.7080	0.1%	5.5%	3.5%	-4.4%
USD/MXN	20.6590	2.7%	0.6%	3.1%	-7.6%
USD/BRL	5.4265	3.2%	-2.7%	4.4%	1.3%

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.

Examples of how to interpret currency data: CAD/USD 0.76 means 1 Canadian dollar will buy 0.76 U.S. dollar. CAD/USD -3.1% return means the Canadian dollar fell 3.1% vs. the U.S. dollar year to date. USD/JPY 135.92 means 1 U.S. dollar will buy 135.92 yen. USD/JPY 18.1% return means the U.S. dollar rose 18.1% vs. the yen year to date.

Source - Bloomberg; data as of 7/6/22 market close

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As of June 30, 2022

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Outperform]	851	58.41	290	34.08
Hold [Sector Perform]	560	38.44	169	30.18
Sell [Underperform]	46	3.16	6	13.04

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