GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee August 4, 2022

Geopolitical heat

Kelly Bogdanova – San Francisco

As if investors didn't have enough concerns on their minds, rising geopolitical risks are adding an unwelcome wrinkle to the investment backdrop. While markets tend to absorb military clashes rather quickly, the world's complex web of trade and financial ties makes the associated economic clashes a greater source of risk.

Increased tensions between the U.S. and China over House of Representatives Speaker Nancy Pelosi's controversial trip to Taiwan have renewed concerns about the potential for geopolitical risks and military clashes to weigh on major developed equity markets.

Taiwan and the ongoing Russia-Ukraine conflict are not the only major sources of such risks, however.

In recent days, clashes have flared up in two regions where the U.S./NATO and Russia have opposing strategic interests: in the Balkans between Serbia and self-proclaimed Kosovo, and in the Caucasus between Armenia and Azerbaijan regarding the disputed territory of Nagorno-Karabakh (aka Artsakh). Amid the Ukraine crisis—which we view as a proxy conflict between NATO and Russia—it's not at all surprising to us that risks are rising in the Balkans and Caucasus.

In recent months, tensions have also escalated between Iran and Israel due to the potential for Iran to fully achieve nuclear weapons capabilities.

Markets typically shake off war shocks

Historically, military clashes have had limited impact on equity markets both in magnitude and duration—even when the U.S. and Soviet Union were embroiled in the dangerous Cuban Missile Crisis.

The S&P 500 fell 6.3 percent, on average, in 19 major post-WWII military conflicts or hostilities that we evaluated. While that level of decline is nothing to dismiss, it's well within the bounds of a typical, modest pullback in many scenarios that often confront markets, including those that have nothing to do with military risks.

Our study of previous geopolitical conflicts indicates the market's reaction lasted an average of only 29 days before it was able to climb back to even. This occurred despite the fact that many of the actual events lasted longer—sometimes much, much longer.

The Russia-Ukraine conflict is a textbook example. We estimate the S&P 500 began to price in the military hostilities after February 10, and the S&P 500 sank 7.4 percent soon thereafter. But the military operation's impact on the market had run its course by March 22

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

when the S&P 500 had recouped all of its lost ground from the initial hostilities. The U.S. market then went on to worry about domestic economic growth, inflation, and earnings growth, along with the Fed's aggressive rate hike cycle.

Certainly the Russia-Ukraine conflict could generate another equity market selloff if NATO escalates its involvement meaningfully and/or if the fighting spills beyond Ukraine's post-2014 boundaries to another country in the region. But for now, markets seem unfazed by the ongoing hostilities in Ukraine.

In general, when it comes to wars and serious geopolitical risks, our long-standing advice is that investors should assume that such events can push the equity market into a temporary five percent to 10 percent pullback or, in rarer cases, into a longer-lasting correction of greater magnitude. It's simply one of the many risks that go along with equity investing.

S&P 500 responses to select military interventions and hostilities since World War II

Events	Start date*	Trading days to trough	% change to trough	Trading days back to even
N. Korea invades S. Korea	Jun 25, 1950	15	-12.9%	56
U.S. spy plane shot down in USSR	May 7, 1960	2	-0.6%	4
Bay of Pigs invasion	Apr 15, 1961	6	-3.0%	14
Cuban Missile Crisis	Oct 16, 1962	6	-6.3%	13
Gulf of Tonkin Incident (Vietnam)	Aug 2, 1964	4	-2.2%	29
Lead-up to Six-Day War (June 6)	May 14, 1967	15	-5.6%	20
Tet Offensive (Vietnam)	Jan 29, 1968	25	-6.0%	46
Cambodian Campaign (Vietnam)	May 1, 1970	18	-14.9%	86
Yom Kippur War, Arab oil embargo	Oct 6, 1973	42	-16.1%	6 years^
Soviet-Afghan War	Dec 24, 1979	7	-2.3%	10
Intervention in Grenada	Oct 25, 1983	11	-2.8%	15
Lead up to intervention in Panama	Dec 15, 1989	2	-2.2%	8
Iraq invades Kuwait, oilfields seized	Aug 2, 1990	50	-15.9%	131
Lead-up to Gulf War (Desert Storm)	Jan 1, 1991	6	-5.7%	13
Intervention in Yugoslavia (Balkans)	Mar 24, 1999	3	-4.1%	11
U.S. spy plane captured in China	Apr 1, 2001	3	-4.9%	7
War in Afghanistan	Oct 7, 2001	1	-0.8%	3
Lead-up to Iraq War	Feb 5, 2003	24	-5.6%	28
Russia intervention in Ukraine	Feb 11, 2022*	17	-7.4%	27
Average of all 19 events		**14**	**-6.3%**	**29**

* The date attempts to capture any material pre-event equity market impact. Actual event start dates may differ.

^ Other economic and monetary policy factors negatively influenced the number of days it took the market to get back to even; this is not counted in the average number of trading days back to even.

Source - RBC Wealth Management, RBC Global Asset Management, Wikipedia, National Security Archive at George Washington University, U.S. Naval Institute

The economic battleground is another story

Military clashes are one thing, but the economic consequences associated with geo-economic clashes can be quite another. We think this needs to be considered in the context of Taiwan, and also what has played out recently with Russia.

We live in an era when unprecedented economic levers are being pulled in an attempt to prevent countries from taking certain actions or to punish countries for their behavior.

The U.S., UK, and EU have used these levers more and more frequently over the past two decades, culminating in thousands of sanctions against Russia, the world's largest commodity producer, and the seizing of hundreds of billions of dollars of the country's foreign currency reserves.

Western leaders and policymakers misjudged the potential impact of anti-Russia sanctions. They have damaged Russia's economy much less than what was intended, and they also have had a negative boomerang effect on the very countries that imposed the sanctions, especially on European economies and businesses.

The European energy crisis, which has been exacerbated by the anti-Russia sanctions and Russia's asymmetric responses to those sanctions, has yet to fully run its course. Winter is coming, and Russia has more economic counter-levers it could pull, including those outside of the natural gas sector. If the sanctions crisis persists and high energy and power prices linger for many months in Europe, not only could economic conditions in the region become more strained, we think Europe could be at risk of experiencing a wave of deindustrialization.

We believe that over time sanctions have the potential to bring forth greater risks for economies and financial markets than military clashes, especially when they are directed at countries that have critical linkages in the global economy.

In our view, this is where the bulk of the economic and market risks related to Taiwan are concentrated. If tensions continue to escalate between the U.S. and China in relation to Taiwan—regardless of whether a military conflict occurs on the territory—we think the risks of a damaging tit-for-tat sanctions war between the two economic giants could escalate meaningfully. And such a confrontation could impact America's allies if they follow along.

Markets tend to absorb military clashes rather quickly, but economic clashes have the potential to play out over many months or even years.

In its World Economic Outlook update in July 2022, the International Monetary Fund (IMF) stated the obvious. It warned that there are "serious medium term risks" that the world economy could become fragmented "into geopolitical blocs with distinct technology standards, cross-border payment systems, and reserve currencies." While the IMF cited the military hostilities in Ukraine as the source of this risk, we think they directly stem from the related sanctions war between the West and Russia.

If the U.S.-China confrontation regarding Taiwan escalates on the economic plane, we think geo-economic fragmentation risks would increase exponentially.

If the COVID-19 crisis taught us anything, it revealed that countries are deeply linked through trade ties and supply chains. And we know from other crises in prior decades that countries are also linked by a complex web of financial ties. This is how the global economic system has evolved—like it or not—and damaging those links can have unintended negative consequences.

UNITED STATES

Michael Roedl – Minneapolis

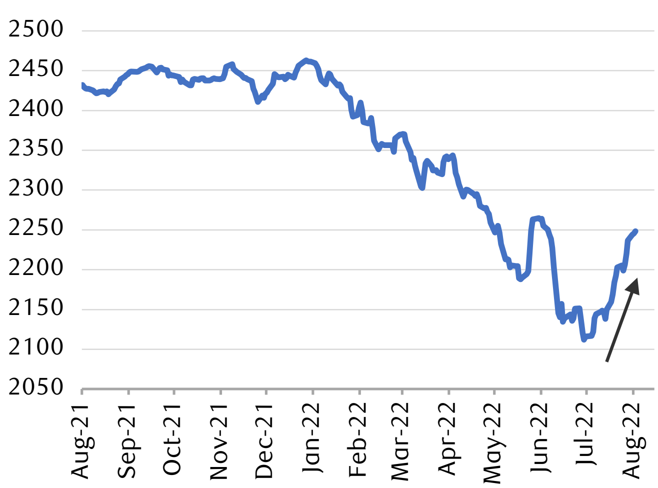
- **The number of available positions fell to a nine-month low, according to the U.S. job openings survey for June**, suggesting tight labor market conditions are beginning to ease on the back of growing economic pressures. We are seeing labor market strength losing momentum as companies such as Amazon are beginning to cut back on hiring after announcing they were overstaffed. According to the U.S. Labor Department, job vacancies fell by 605,000 in June from May, the largest monthly decline since April 2020.

- **U.S. fixed income markets saw continued strong volatility** as Treasury yields drifted higher across the curve after Fed policymakers stated the fight against inflation is far from over, prompting lower expectations for rate cuts in 2023. On Tuesday, the yield on the 10-year Treasury rose as much as 18 basis points (bps) while the yield on the 3-year surged more than 20 bps. Large daily swings in Treasury yields have become more mainstream due to uncertainty over the path of Fed policy and persistent inflation. Heavy Treasury volatility will likely remain throughout the course of the year, though we believe long-term yields may have peaked in this Fed cycle as inflation shows signs of slowing.

- **High-yield credit markets extended their rally this week** on equity market strength, driving yields on the Bloomberg U.S. High-Yield Corporate Index down to an eight-week low of 7.63% as of yesterday's close. Despite very little new-issue supply, investors have been deploying cash back into the sector after high-yield funds received the largest inflows since June 2020 during the week ending July 27. While high-yield corporates are still down nearly 9% year to date, the sector has rallied over 6% since the start of July, according to Bloomberg.

High-yield corporates extend strong July rally

Bloomberg U.S. High-Yield Corporate Index



Source - RBC Wealth Management, Bloomberg; daily data through 8/3/22

CANADA

Luis Castillo & Simon Jones – Toronto

- **The combination of surging inflation, tighter financial conditions, and lingering geopolitical tensions has taken a toll on the market's expectation for future economic growth**. Weakening sentiment has led bond markets to position for a peak of around 3.5% in the Bank of Canada (BoC) policy rate by the end of 2022, from the current 2.5%. In fact, bond markets are pricing in central bank rate cuts by the first quarter of 2023. **However, as markets continue to question the BoC's ability to hike rates into a recession, central bankers globally have shown no intentions of deviating from their aggressive tightening paths**, signaling that the inflation fight is still ongoing and leaving the door wide open for additional hikes at upcoming meetings. This reinvigorated hawkish rhetoric put the brakes on the recent bond rally, as Government of Canada benchmark rates climbed by more than 20 bps across short-to-mid durations so far this week.

- **The Canadian economy showed signs of cooling in May, with GDP coming in unchanged from April** according to Statistics Canada. Areas of economic strength and weakness were largely split between the goods and services sectors of the economy. Growth in the services sector was concentrated in transportation and food services, areas that have continued to benefit from the removal of public health restrictions, the resumption of air travel, and the increasing number of Canadians returning to work in person. However, these gains were offset by significant pullbacks in manufacturing and construction activity that resulted from supply-side constraints. Although preliminary data from Statistics Canada indicates these segments of the economy rebounded in June, **RBC Economics expects the rise in interest rates and ongoing capacity constraints will likely cause growth to slow considerably going forward** and forecasts a modest recession starting in mid-2023.

EUROPE

Rufaro Chiriseri, CFA & Frédérique Carrier – London

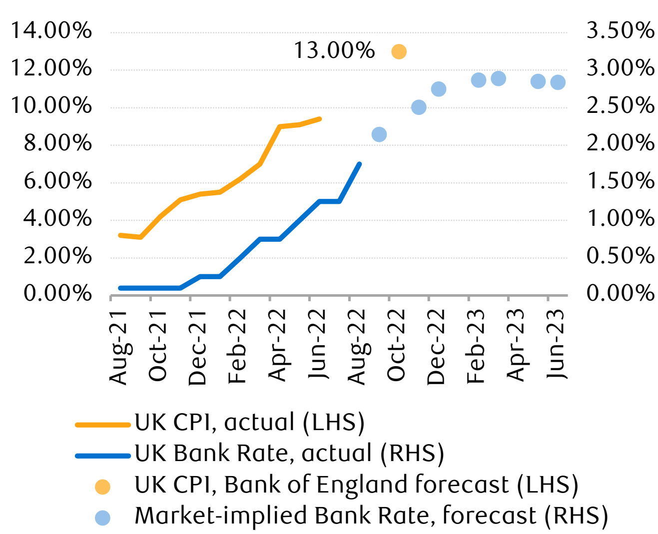
- **The Bank of England (BoE) delivered its biggest interest rate hike since 1995**; the 50 basis point (bps) increase had been widely expected, and was approved by the bank's Monetary Policy Committee (MPC) by a vote of eight to one. The MPC meeting summary noted that near-term inflationary pressures in the UK and the rest of Europe have intensified significantly since the release of the May Monetary Policy Report (MPR), and this led to this outsized move.

- **According to the August MPR, the BoE expects the UK energy regulator (Ofgem) to increase its energy price cap by 75% in October**, compared to an expectation of 40% in the May MPR, **resulting in inflation rising to 13.1%**. In addition, the BoE forecasts an even bigger economic contraction beginning in Q4 this year and continuing into mid-2024. On the recession outlook, delivery of further fiscal support could cause the central bank to revise its gloomy growth forecast upward and give room for further monetary policy tightening. Markets interpreted the meeting minutes as dovish, with the year-end and peak Bank Rate now seen at 2.75% and 2.88%, respectively.

- **The MPC has also joined the cohort of central bank policymakers that have abandoned forward guidance**, stating that "all options" are on the table, thus shifting to a data-dependent, meeting-by-meeting decision making process.
- **The BoE also confirmed that a vote will be held at the September meeting to reduce the central bank's balance sheet by about £80 billion in the first year**, with gilt sales expected to commence shortly thereafter at a pace of around £10 billion per quarter.
- **Eurozone GDP grew 0.7% in Q2, considerably more than consensus expected**. Though details are still scant, growth may have been aided by a healthy tourism season, reopening momentum, and fiscal support via the EU recovery funds and to combat energy prices.
- **The second half of the year is likely to be much more challenging**. Lower demand from the U.S., a waning tourism season, and elevated domestic gas prices will all likely put a damper on the eurozone's growth.
- **Given the strong momentum in the first half of 2022, RBC Capital Markets expects eurozone GDP growth of 2.6% for the full year, roughly in line with consensus**. GDP growth for 2023 could be close to flat, though further reductions in Russian gas inflows could cause a more severe downturn.

Higher energy prices leading to higher inflation

UK Consumer Price Index (CPI) and Bank Rate



Source - RBC Wealth Management, Bloomberg; data as of 9:55 am ET 8/4/22

ASIA PACIFIC

Emily Li – Hong Kong

- **China is ramping up trade sanctions on Taiwan in the wake of the high-profile visit of U.S. House of Representatives Speaker Nancy Pelosi to the island**. China suspended natural sand exports to Taiwan, while also blocking imports of Taiwanese citrus fruits, chilled white scallops, and frozen mackerel. With Taiwan's agricultural exports accounting for only 0.6% of its total exports and China's sand exports to the island amounting to just over US$1 million in 2021, **the trade bans imposed so far are likely to have only a minor impact on Taiwan's economy**, in our view. However, China is Taiwan's largest trading partner, with bilateral trade rising 26% y/y to US$328.3 billion in 2021. Taiwan held a sizeable trade surplus with China, with exports from the island exceeding imports by US$172 billion, according to Chinese customs data. While Beijing could leverage that advantage by sanctioning exporters, China also relies on Taiwan for semiconductor supplies.
- **On July 29, Alibaba Group Holding Ltd. (BABA US) was added to the U.S. Securities and Exchange Commission's (SEC) list of Chinese companies that might be delisted**. Alibaba is one of the more than 270 Chinese companies listed in New York identified as being at risk of delisting. According to Reuters, U.S. regulators have been demanding complete access to audit working papers of these companies, which are stored in China. The SEC's move adds more concerns for investors, including earnings risk and the impact of founder Jack Ma reportedly planning to cede control of Alibaba's fintech affiliate Ant Group Co., according to the Wall Street Journal. There are also persistent COVID-19 policy risks in China.
- **Samsung Electronics Co.** (005930 KS) reported quarterly results last Thursday, with **net profit up 16% y/y, which was less than the consensus forecast**. The company is the world's largest memory provider, with major chip customers including Apple Inc. (AAPL US), Amazon.com Inc. (AMZN US), and Microsoft Corp. (MSFT US). The weak results are indicative of soft electronics demand and rising uncertainty around a potential global recession.

MARKET
Scorecard

Data as of August 3, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,155.17	0.6%	-12.8%	-6.1%	26.1%
Dow Industrials (DJIA)	32,812.50	-0.1%	-9.7%	-6.6%	23.1%
Nasdaq	12,668.16	2.2%	-19.0%	-14.2%	16.2%
Russell 2000	1,908.93	1.3%	-15.0%	-14.2%	26.7%
S&P/TSX Comp	19,545.94	-0.7%	-7.9%	-4.0%	20.9%
FTSE All-Share	4,112.78	0.1%	-2.3%	0.9%	22.8%
STOXX Europe 600	438.29	0.0%	-10.1%	-5.8%	20.5%
EURO STOXX 50	3,732.54	0.7%	-13.2%	-9.4%	14.9%
Hang Seng	19,767.09	-1.9%	-15.5%	-24.5%	-19.2%
Shanghai Comp	3,163.67	-2.8%	-13.1%	-8.2%	-6.1%
Nikkei 225	27,741.90	-0.2%	-3.6%	0.4%	25.0%
India Sensex	58,350.53	1.4%	0.2%	8.4%	58.0%
Singapore Straits Times	3,252.06	1.3%	4.1%	3.3%	30.9%
Brazil Ibovespa	103,774.68	0.6%	-1.0%	-16.0%	0.9%
Mexican Bolsa IPC	47,008.78	-2.4%	-11.8%	-9.0%	25.2%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	2.703%	5.4	119.3	153.1	214.9
Canada 10-Yr	2.717%	10.7	129.1	160.0	225.0
UK 10-Yr	1.912%	4.8	94.1	139.2	181.3
Germany 10-Yr	0.874%	5.7	105.1	135.6	139.7
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	3.56%	-0.6%	-8.7%	-9.9%	-10.2%
U.S. Investment-Grade Corp	4.44%	-0.5%	-12.1%	-13.3%	-11.7%
U.S. High-Yield Corp	7.66%	0.4%	-8.8%	-7.6%	1.9%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,765.34	0.0%	-3.5%	-2.5%	-10.7%
Silver (spot $/oz)	20.07	-1.4%	-13.9%	-21.4%	-17.4%
Copper ($/metric ton)	7,808.75	-1.5%	-19.8%	-18.0%	20.2%
Oil (WTI spot/bbl)	90.66	-8.1%	17.8%	28.5%	121.1%
Oil (Brent spot/bbl)	96.98	-11.8%	24.7%	33.9%	119.7%
Natural Gas ($/mmBtu)	8.29	0.8%	122.3%	105.9%	294.7%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	106.3690	0.4%	11.2%	15.5%	13.7%
CAD/USD	0.7789	-0.3%	-1.6%	-2.3%	4.3%
USD/CAD	1.2839	0.3%	1.6%	2.4%	-4.1%
EUR/USD	1.0170	-0.5%	-10.6%	-14.3%	-13.5%
GBP/USD	1.2147	-0.2%	-10.2%	-12.7%	-7.1%
AUD/USD	0.6951	-0.5%	-4.3%	-6.0%	-2.4%
USD/JPY	133.8600	0.4%	16.3%	22.8%	26.3%
EUR/JPY	136.1400	0.0%	4.0%	5.2%	9.2%
EUR/GBP	0.8372	-0.3%	-0.5%	-1.8%	-6.9%
EUR/CHF	0.9766	0.4%	-5.9%	-8.9%	-9.5%
USD/SGD	1.3805	0.0%	2.3%	2.2%	0.3%
USD/CNY	6.7580	0.2%	6.3%	4.4%	-3.2%
USD/MXN	20.4757	0.5%	-0.3%	3.0%	-9.5%
USD/BRL	5.2870	2.2%	-5.2%	1.7%	-0.7%

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 0.77 means 1 Canadian dollar will buy 0.77 U.S. dollar. CAD/USD -1.6% return means the Canadian dollar fell 1.6% vs. the U.S. dollar year to date. USD/JPY 133.86 means 1 U.S. dollar will buy 133.86 yen. USD/JPY 16.3% return means the U.S. dollar rose 16.3% vs. the yen year to date.

Source - Bloomberg; data as of 8/3/22 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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