GLOBAL Insight WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee November 10, 2022

An unsettled environment

Joseph Wu, CFA – Toronto

Global risk sentiment remains volatile in the face of many macro crosswinds. While some parts of the macro landscape could deliver positive surprises, we think an unusually wide range of potential economic outcomes warrants a modestly defensive stance in portfolio positioning.

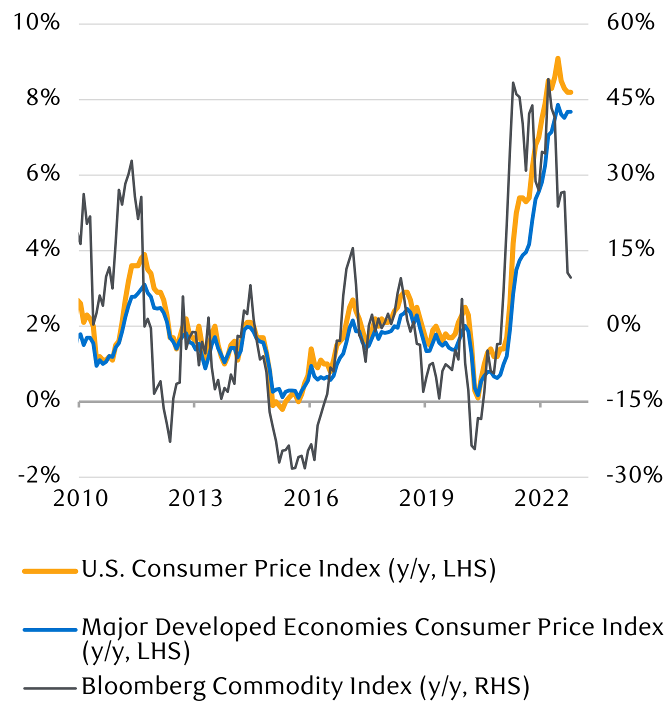
Not all bad news

Amidst mounting economic pessimism, it is worthwhile to take a step back and consider potential areas that could produce constructive surprises. To begin with, we think the prospects of inflation cooling over the coming months appear reasonably good, a view underpinned by the recent pullback in commodity prices, which have historically exhibited a close relationship with price pressures (see chart). Other indicators that typically lead inflation—global supply chain pressures, prices paid components of Purchasing Managers' Indexes (PMIs), and shipping costs—also point towards moderating goods inflation in the near term.

Meanwhile, despite persistently elevated inflation and higher borrowing costs, household expenditures have held up quite well. Sustained strength in the labour market is underscored by solid wage gains and ample job openings. This, coupled with a still-sizeable amount of savings that households can tap into, suggests to us that consumer spending—a crucial pillar of the U.S. economy that makes up nearly 70 percent of GDP—could remain well supported in the quarters ahead.

Lastly, now that the U.S. midterm elections are in the rearview mirror, this likely resolves one of the overhangs

Softening resource prices should filter through to lower inflation



Source - RBC Wealth Management, Bloomberg; monthly data through 10/31/22

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

that may have hindered risk appetite in recent months. As of this writing, the election outcome remains unclear. Depending on recounts and runoffs, the balance of power in Congress may take days or weeks to determine. But based on initial results, the "gridlock" outcome, featuring a Democrat president alongside at least a split Congress, remains likely. As we outlined in September, equities have historically fared well in the year following the midterms since 1932, with the S&P 500 generating an average return of 16.3 percent. While the historical returns data around midterm elections paint a relatively sanguine picture, we believe investors should focus more on fundamental factors, including economic conditions, corporate earnings, and monetary policy, which together typically have much greater explanatory power for equity market trends over the medium and long term.

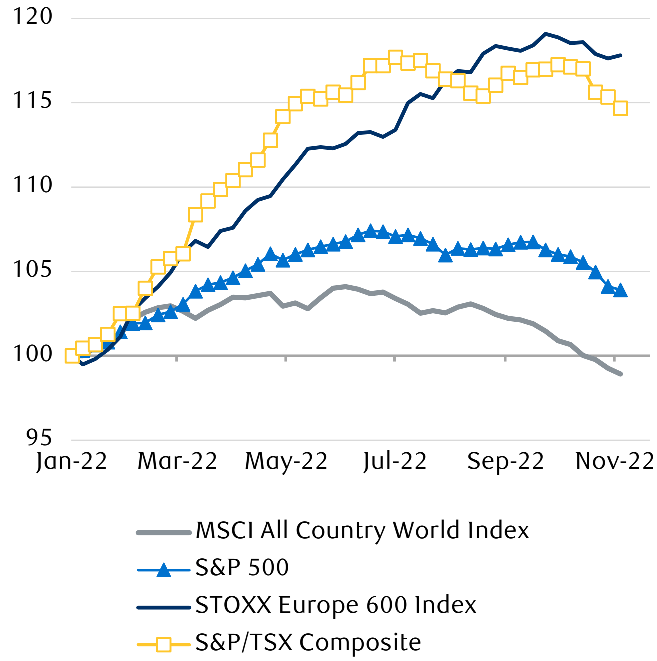
But outlook still murky

We believe the outlook for the world economy and, by extension, corporate profits, remains challenging with risks broadly skewed to the downside. Part of the reasoning for this downbeat assessment derives from thinking about whether the main macro forces that have hampered the economy and financial markets, namely inflation and hawkish central banks, have faded or stabilized to a degree that would inspire sufficient confidence that the worst is behind us.

Although we may be getting closer to that inflection point, the main concern is that we have not yet seen concrete signs of an inflation peak. Goods inflation may be in the process of coming back down from very elevated levels seen over the last two years, but we believe more persistent price increases in services and shelter (housing) could prove to be more difficult to control, which may necessitate further monetary tightening beyond what's currently anticipated by markets.

Profit estimates will need to "catch down" to worsening business conditions

Consensus forward 12-month EPS estimate (Jan. 1, 2022 = 100)

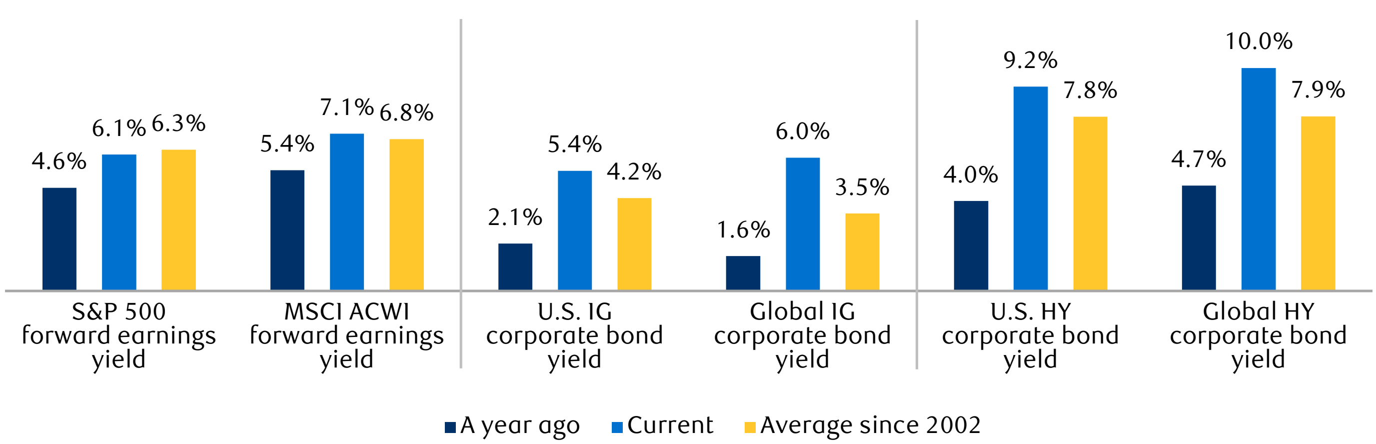


Source - RBC Wealth Management, Bloomberg; weekly data through 11/4/22

While the Fed and other central banks must balance the risk of inflation becoming entrenched with the prospect of a severe economic slowdown, their mandates are currently focused on taming inflation. The Fed ostensibly opened the door to slowing the pace of rate hikes "as soon as the next meeting" in December, but policymakers also reiterated that the path of interest rates will remain higher over the coming quarters.

Unless inflation declines faster than expected over the months ahead, additional rate hikes by the Fed will keep

Relative value has shifted in favour of fixed income



Note: Earnings yield is the inverse of the forward price-to-earnings ratio. Bond yield refers to yield to worst for the Bloomberg U.S. Corporate Index, the Bloomberg Global Agg Credit Index, the Bloomberg U.S. Corporate High Yield Index, and the Bloomberg Global Corporate High Yield Index

Source - RBC Wealth Management, Bloomberg; weekly data through 11/4/22 tightening pressure on financial conditions, which should continue to dampen economic activity. Against this backdrop, consensus corporate earnings forecasts still seem too optimistic, in our view, and will likely need to be recalibrated lower to reflect the significant downgrades to 2024 GDP growth projections across major economies and the sharp deceleration in global PMIs.

Risks and opportunities

When considering the full picture of this economic uncertainty, we believe investors should maintain a modestly defensive stance in portfolio positioning. Given coordinated global monetary tightening and ongoing geopolitical turbulence, many of the global leading indicators we monitor continue to trend unfavourably.

For equities, uncertainties about the economy, interest rates, and inflation indicate the range of potential outcomes in the near term is unusually wide. And even though we believe stocks are more reasonably priced today following the selloff year to date, the focus here could shift to weakening fundamentals, where limited downward revisions to consensus earnings estimates this year despite a decelerating economy point to downside risks.

Meanwhile, we believe the risk-reward profile in fixed income has improved considerably. Virtually every segment of the bond market has suffered negative returns in 2022 as a result of the historically rapid rise in rates this year. But the silver lining, in our view, is that substantially higher yields have greatly improved return expectations going forward. In addition to boosting return potential, we believe higher starting yields also provide bonds with a relatively greater cushion to absorb further increases in rates.

While we are cognizant of intensifying economic headwinds, the higher all-in yields in fixed income, which appears to have undergone a more pronounced risk-adjusted repricing than equities, suggest to us that it is still a timely opportunity to rotate portfolio risk budgets towards bonds.

UNITED STATES

Atul Bhatia, CFA – Minneapolis

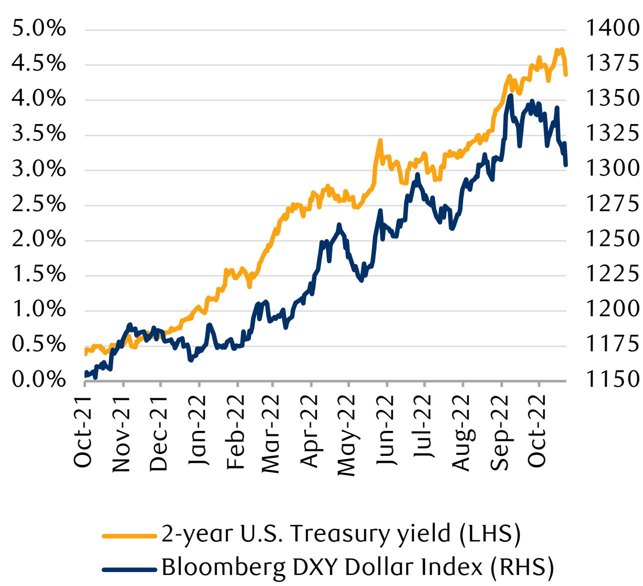
- **October jobs data presented a mixed picture of the U.S. labor market**. Employers reported robust job creation, with 261,000 employees added to payrolls during the month and an upward revision of 50,000 to September's number. A separate survey of households, however, offered a relatively bleak take on employment: a net loss of 328,000 jobs resulted in the unemployment rate rising to 3.7%. While it's fairly common for the two measures to differ, the magnitude of last month's difference is atypical. We believe the Fed is likely to give more weight to the data showing payroll growth, as it is more consistent with other labor market measures such as the Employment Cost Index and the Atlanta Fed's Wage Growth Tracker.

- **Unlike the jobs data, the inflation data for October was unambiguously better than economists expected**, according to a pre-release survey by Bloomberg. The Consumer Price Index (CPI) rose 0.4% from its September level, below the 0.6% consensus forecast. The picture was even better on so-called core inflation, which does not include volatile food and energy prices; it rose by 0.3%, below both the forecast level and the prior month's increase. Although the Fed is unlikely to be satisfied with the still-high level of price increases—overall CPI was up 7.7% from last year—we believe the central bank will take comfort in the slowing pace of monthly core price moves.

- **Initial market reaction to the inflation numbers was positive for both equities and bonds**. Yields—which move in the opposite direction to prices—declined by nearly 0.25% on both 2-year and 5-year Treasuries, as interest rate futures reflected a market expectation for less-aggressive Fed action. In particular, **markets now see little chance of a rate hike larger than 0.5% at the December Fed meeting, and also view the current tightening campaign as likely to result in a peak interest rate below 5%**. The prospect of lower interest rates weighed on the dollar, however, which fell more than 1% on a trade-weighted index basis following the CPI report.

The greenback gives back some gains as yields dip

Potential for less-aggressive Fed weighs on trade-weighted dollar index



Source - RBC Wealth Management, Bloomberg; data through 11/10/22

CANADA

Mila Krunic & Matt Altro – Toronto

- **Canada's labour market added 108,000 jobs in October (+0.6% m/m), recouping much of the losses during the summer months**. The unemployment rate remained at 5.2%, modestly above the 4.9% record low recorded in June and July. Job creation was widespread, with six of the eight industries measured reporting gains, led by construction and manufacturing, offset largely by wholesale and retail trade. An increase in employment naturally comes off as positive news but given the current interest rate environment, investors will likely be focused on how this may affect the Bank of Canada's (BoC) policy rate decision at its next meeting in early December. Amidst ongoing debate regarding whether the BoC has done enough to tame inflation to potentially moderate the size of rate hikes in the months ahead, the strength of the latest labour market report could keep pressure on the central bank to maintain a hawkish bias in monetary policy.

- **Canada's provinces have enjoyed a robust recovery in revenues**, as the lifting of pandemic restrictions, strong commodity markets, and rising inflation have led to higher-than-expected tax revenue and income generated from government business enterprises. According to RBC Economics, Alberta recorded the largest surplus among the provinces at nearly CA$4 billion in 2021–2022, in addition to posting the largest jump in revenue (58.4%). However, the impact of inflation has yet to affect provincial balance sheets. As the BoC continues to fight inflation, provincial governments will likely confront the prospect of lower revenues and higher expenditures. RBC Economics notes that Newfoundland and Labrador, Ontario, and Quebec are the three provincial governments that are particularly sensitive to rising interest rates due to their relatively higher debt-to-GDP levels.

EUROPE

Thomas McGarrity, CFA – London

- We are entering the final stages of the Q3 reporting season. The trends have been very similar to earlier quarters in 2022, with **more beats to consensus**

expectations at the top-line sales level than bottom-line earnings results, while "misses" have been punished by the market.

- Consensus earnings revisions in aggregate remain negative, with **only the Energy sector and the banks group having seen positive earnings revisions** over the past month. Sales revisions are still positive, reflecting the top-line boost from inflation, corporate pricing power, and a weak euro for internationally oriented companies.

- **Positive sales revisions coupled with negative earnings revisions point to margin pressures continuing to build**, in our view. While pricing power has been strong so far, as the macro backdrop becomes more difficult, we believe it's going to become increasingly tricky for some companies to raise prices without negatively impacting volumes. Looking into 2023, we expect this margin sustainability dynamic at the stock level to lead to increasing share price performance dispersion within sectors.

- One of the bright spots this European results season has been the banks. Higher interest rates are helping improve banks' net interest margins by more than the consensus anticipated, which is helping support consensus earnings upgrades. **Despite the profitability tailwinds from rising interest rates, European banks' valuations remain materially discounted**. However, we believe scope for a positive re-rating will require more visibility on an improving economic outlook, with the heightened prospect of elevated loan loss charges in 2023 keeping the risk premium attached to banks' valuations high, in our view.

- Although Energy sector earnings were down slightly from record levels in Q2 2022, in aggregate they were still more than double the prior-year levels. Notably, **Energy companies delivered a strong signal of commitment to shareholders**, with several increasing their shareholder returns through both higher dividends and share buybacks.

- A clear theme from company financial results reports has been **weaker consumer trends in Europe across various small- (e.g., beverages) and large-ticket (e.g., entry-level car models) categories**. Demand for luxury goods remains healthy, which we think reflects their consumer base being relatively immune to inflation pressures.

STOXX Europe 600 Index Q3 earnings surprises versus consensus

Sector	Beat	In-line	Miss	Aggregate surprise
STOXX Europe 600	**144 (53%)**	**31 (11%)**	**99 (36%)**	**5.1%**
Materials	18	2	10	4.2%
Industrials	25	6	20	7.4%
Consumer Staples	7	4	5	1.0%
Energy	7	1	5	9.8%
Information Tech.	9	2	7	4.6%
Consumer Discr.	7	0	10	-14.1%
Comm. Srvcs.	9	3	6	-44.5%
Financials	32	6	17	10.4%
Health Care	19	1	9	6.9%
Utilities	4	5	5	16.7%
Real Estate	7	1	5	-9.9%

Source - Bloomberg; data as of 11/9/22

ASIA PACIFIC

Jasmine Duan – Hong Kong

- **We have seen multiple signs that China is starting to prepare for reopening since last week**. A People's Daily article de-emphasized the long-term impact of COVID-19 infections and stated that most symptoms are temporary and mild; meanwhile, several regions have stopped requiring a 48-hour negative polymerase chain reaction (PCR) test proof for passengers travelling via railways and airlines, and several cities have been criticized by national authorities for overly strict lockdown and containment measures. And during a visit to China, German Chancellor Olaf Scholz announced last Friday that an agreement had been reached to let German expatriates in China use the COVID-19 vaccine from Germany's BioNTech.

- During a press conference on Nov. 5, the Chinese Center for Disease Control and Prevention reiterated the country's adherence to the general COVID-19 control policy of "Dynamic Zero." This is largely in line with our expectations—before there is an official policy change, state media and authorities typically justify the current policy until all preparations are complete. Therefore, **we think investors should read between the lines and focus on signs of change**. We anticipate a gradual reopening will occur.

- **Japan's household spending rose 2.3% y/y in September, slightly less than the Bloomberg consensus forecast of 2.6%**. Spending on recreation, transportation, and communication expanded as hotel and package tour bookings increased. Spending on food also climbed, as consumers rushed to buy alcohol products before prices increased and as people dined out more. The reopening is providing support to consumption recovery, but high inflation remains a concern and may weigh on household spending power. Real wages fell 1.3% y/y in September, the sixth consecutive month of declines; **sluggish wage growth could put pressure on consumer sentiment in the coming months**, in our view.

MARKET
Scorecard

Data as of November 9, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,748.57	-3.2%	-21.4%	-20.0%	5.6%
Dow Industrials (DJIA)	32,513.94	-0.7%	-10.5%	-10.5%	11.5%
Nasdaq	10,353.17	-5.8%	-33.8%	-34.8%	-11.6%
Russell 2000	1,760.40	-4.7%	-21.6%	-27.5%	3.2%
S&P/TSX Comp	19,344.25	-0.4%	-8.9%	-10.4%	17.4%
FTSE All-Share	3,994.13	3.0%	-5.1%	-3.9%	14.6%
STOXX Europe 600	420.34	2.0%	-13.8%	-12.9%	10.3%
EURO STOXX 50	3,728.03	3.1%	-13.3%	-14.2%	9.4%
Hang Seng	16,358.52	11.4%	-30.1%	-34.1%	-37.1%
Shanghai Comp	3,048.17	5.3%	-16.3%	-13.1%	-9.7%
Nikkei 225	27,716.43	0.5%	-3.7%	-5.4%	11.6%
India Sensex	61,033.55	0.5%	4.8%	1.0%	43.3%
Singapore Straits Times	3,165.50	2.3%	1.3%	-2.4%	21.3%
Brazil Ibovespa	113,580.09	-2.1%	8.4%	7.6%	9.7%
Mexican Bolsa IPC	50,545.76	1.2%	-5.1%	-3.0%	27.5%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	4.094%	4.7	258.4	265.9	317.1
Canada 10-Yr	3.392%	14.1	196.6	179.9	264.3
UK 10-Yr	3.457%	-5.9	248.6	263.3	308.5
Germany 10-Yr	2.172%	3.0	234.9	247.0	268.1
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	5.08%	-0.2%	-15.9%	-16.5%	-16.3%
U.S. Investment-Grade Corp	5.95%	0.0%	-19.5%	-20.4%	-18.5%
U.S. High-Yield Corp	9.18%	-0.7%	-13.1%	-13.0%	-6.1%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,706.06	4.4%	-6.7%	-6.9%	-8.4%
Silver (spot $/oz)	21.02	9.7%	-9.8%	-13.5%	-12.8%
Copper ($/metric ton)	8,127.50	8.0%	-16.6%	-16.8%	17.7%
Oil (WTI spot/bbl)	85.83	-0.8%	11.5%	2.0%	113.0%
Oil (Brent spot/bbl)	92.35	-2.6%	18.7%	8.9%	117.8%
Natural Gas ($/mmBtu)	5.92	-6.9%	58.6%	18.8%	107.0%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	110.4150	-1.0%	15.4%	17.5%	19.1%
CAD/USD	0.7393	0.7%	-6.6%	-8.1%	-3.8%
USD/CAD	1.3526	-0.7%	7.0%	8.7%	4.0%
EUR/USD	1.0013	1.3%	-11.9%	-13.6%	-15.2%
GBP/USD	1.1356	-1.0%	-16.1%	-16.2%	-13.7%
AUD/USD	0.6429	0.5%	-11.5%	-12.9%	-11.7%
USD/JPY	146.3600	-1.6%	27.2%	29.7%	38.9%
EUR/JPY	146.5500	-0.3%	12.0%	12.0%	17.7%
EUR/GBP	0.8818	2.3%	4.8%	3.1%	-1.7%
EUR/CHF	0.9856	-0.4%	-5.0%	-6.7%	-8.7%
USD/SGD	1.4028	-1.0%	4.0%	4.1%	4.1%
USD/CNY	7.2410	-0.9%	13.9%	13.3%	9.2%
USD/MXN	19.5745	-1.2%	-4.7%	-3.7%	-3.8%
USD/BRL	5.1965	0.3%	-6.8%	-5.3%	-3.4%

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 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD -6.6% return means the Canadian dollar fell 6.6% vs. the U.S. dollar year to date. USD/JPY 146.36 means 1 U.S. dollar will buy 146.36 yen. USD/JPY 27.2% return means the U.S. dollar rose 27.2% vs. the yen year to date.

Source - Bloomberg; data as of 11/9/22

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As of September 30, 2022

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Hold [Sector Perform]	580	39.30	161	27.76
Sell [Underperform]	52	3.52	5	9.62

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