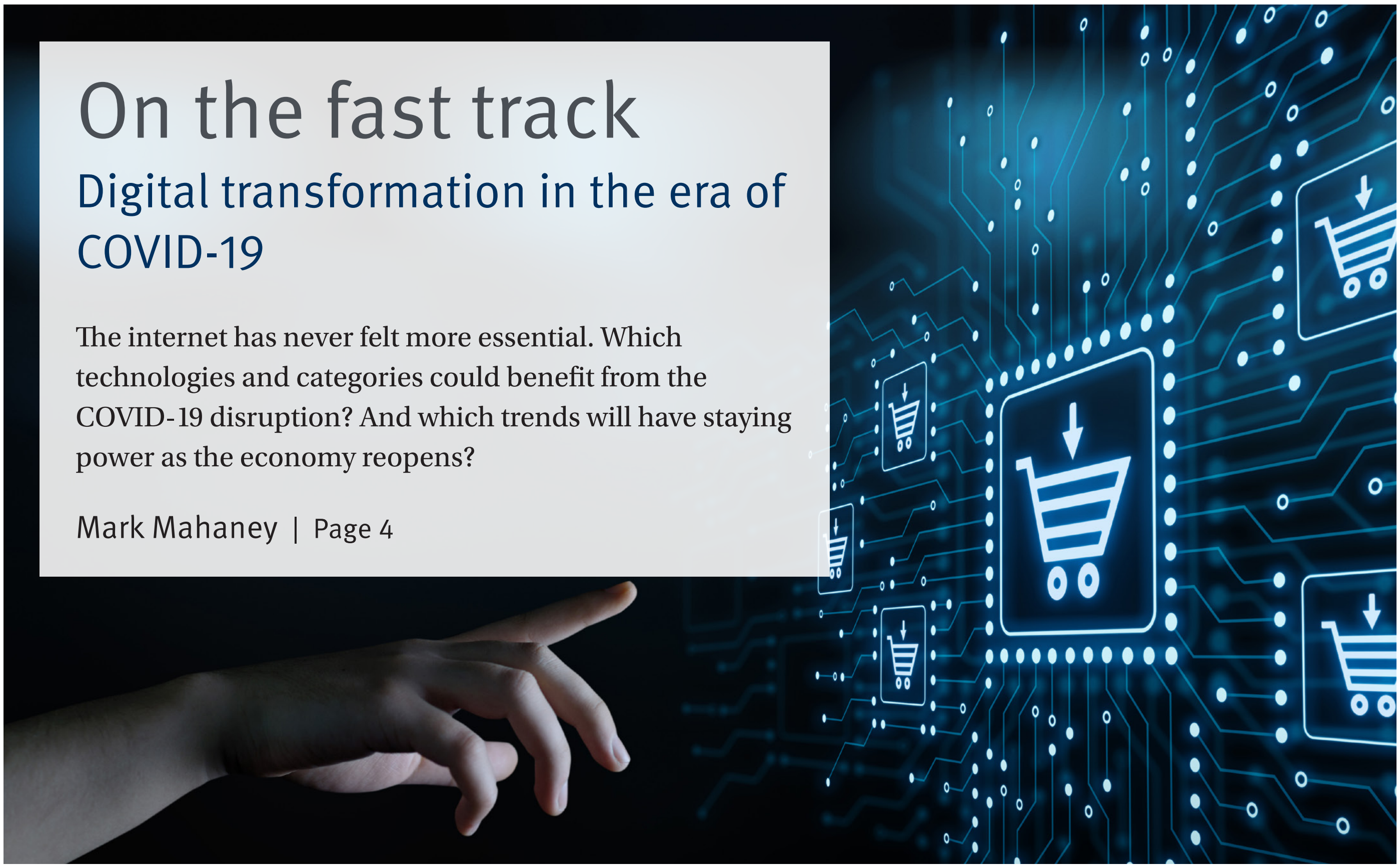
RBC WEALTH MANAGEMENT

# Global Insight

Perspectives from the Global Portfolio Advisory Committee



## On the fast track

### Digital transformation in the era of COVID-19

The internet has never felt more essential. Which technologies and categories could benefit from the COVID-19 disruption? And which trends will have staying power as the economy reopens?

Mark Mahaney | Page 4

Global equity

Invested, but not fully invested


Global fixed income

Central banks enter the next phase

Key forecasts

**For important and required non-U.S. analyst disclosures, see page 15.**
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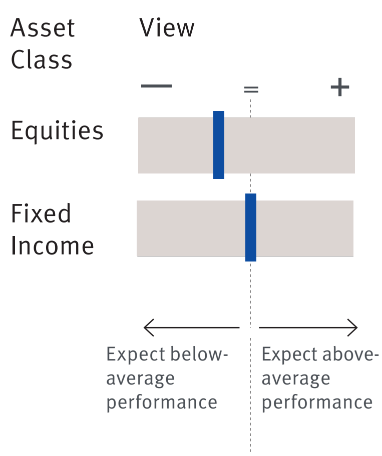
# Table of contents



All values in U.S. dollars and priced as of market close, May 29, 2020, unless otherwise stated.

# RBC's investment stance

Global asset views




See "Views explanation" below for details

Source - RBC Wealth Management

## Equities

- The COVID-19 news flow has improved markedly in the developed world over the past few weeks, with the number of deaths as well as new cases falling and some progress on possible treatments and vaccines announced. Most countries are gradually reopening their economies, and signs of improvement are appearing. Reassuringly, monetary and fiscal authorities remain committed to providing financial support where needed.

- Yet several challenges remain. Certain sectors of the economy will remain under severe strain for months to come, while the swelling ranks of newly unemployed workers may struggle to find work. We continue to expect the recovery will be slow, long, and uneven.

- With stock markets having staged a strong recovery already, valuations full in key regions, and much uncertainty remaining, we believe it is prudent, while remaining invested, to hold a slightly Underweight position in equities.

## Fixed income

- The Fed's efforts to soothe financial markets since March have proven successful. Volatility in the Treasury market remains at the lowest levels of the year, with the Fed's balance sheet having expanded beyond $7 trillion. Though higher-than-normal economic risks will be a feature for some months to come, current market levels still offer an attractive risk/reward profile for investors across a number of fixed income sectors, specifically in corporate credit.

- We maintain our Market Weight in global fixed income. Though global yields are historically low, we think they should remain steady around current levels. With markets already priced for a short recession, we maintain a broad Overweight to corporate credit.

## Views explanation

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

+ Overweight implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

= Market Weight implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

– Underweight implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.

Focus article

# On the fast track

## Digital transformation in the era of COVID-19

**Mark Mahaney**
RBC Capital Markets, LLC
San Francisco, United States

The COVID-19 disruption has hammered home that necessity is the mother of invention. We asked Mark Mahaney, top-ranked internet analyst from RBC Capital Markets, LLC, what impact the COVID-19 crisis is having on the internet sector. Which technologies and categories could benefit? Which could lose out? And which trends will have staying power as the economy reopens?

(This article is a condensed transcript of an audio commentary released on May 13, 2020)

- The pandemic has highlighted the competitive edge that digital platforms can provide and online distribution seems to be a structural winner from the crisis.
- The shift to online distribution has received new impetus due to this crisis and we believe this trend is here to stay.
- Ride-sharing companies were deeply affected by the crisis, but a snapback is already becoming apparent.
- Regulatory risk for the internet sector, which used to be a main concern, is on the back burner for now.

***Global Insight:*** **Mark, as many people find themselves working from home, ordering groceries and other essentials, and binge-watching TV series, all online, it has occurred to them that they—and presumably others—are relying on the internet much more than before the crisis. Are all internet-related businesses benefiting from this surge in activity?**

***Mark Mahaney:*** You're right, this has been a huge shock to systems, economies, and social patterns. Here are some of the things we've learned from the crisis.

First, almost no internet stock, even the most digital, is immune from the kind of social and economic dislocation that has been caused by the COVID-19 crisis. Of the 39 internet companies we cover, only a small handful have experienced material positive revisions to 2020 revenue estimates in the wake of the crisis. And slightly more than half of these companies have suffered 10 percent or greater negative revisions to 2020 revenue estimates.

Said another way, at the beginning of the year the median consensus revenue growth expectation for the internet sector was 21 percent, according to FactSet; it is now eight percent.

Mark Mahaney is a Managing Director covering the internet sector at RBC Capital Markets. Mr. Mahaney has been ranked No. 1 in the Institutional Investor Poll for the internet sector (2008–2012). He has also been ranked No. 1 in the Greenwich Institutional Investor Poll for the internet sector, as well as the No. 1 earnings estimator and the No. 1 stock picker in the internet retail segment by the Financial Times and StarMine.

The categories that have been hit the hardest have been travel, ride-sharing, event ticketing, real estate, and advertising.

That said, a second key point is there are clearly a few categories of structural winners such as online retail and online food delivery.

Other segments that are really benefiting are those that offer cloud services and a digital presence. Small businesses, local services, or retail companies that find themselves without a digital presence are facing the prospect of no or much lower revenues for a number of months. This has created an impetus to make sure a web presence is part of their core strategy.

The third takeaway is that internet advertising has been negatively impacted—but not equally. Many companies have disclosed a material increase in usage on their platforms, but almost all also experienced a major deceleration in their ad revenue growth rates.

Predictably, the giants are proving to have the most resilient ad platforms. Why? Because they offer marketers the greatest reach and frequency in terms of audience—billions of daily users.

Because the ad marketplace is based on auction dynamics, prices can immediately correct and rebalance to meet and generate marketer demand. Also, no one would question a decision to buy ads on these huge industry-leading platforms, in our view. All these were reasonable assumptions going into the COVID-19 crisis, and they were all proved correct.

Fourth, online retail names have been positively impacted, for the most part equally. But at the same time, in a crude way, this pandemic has become an advertisement for the benefits and necessities of online retail.

Certain categories such as groceries, health care, home office supplies, distance learning, and home fitness have all experienced a spike in demand. There has been strength even among categories that would be considered highly discretionary such as fashion & apparel.

Our own Grocery Survey report supported this dramatically accelerated adoption. Yet we believe this adoption has been broad-based across all online retail verticals.

Fifth, the companies that have been negatively impacted have focused on cost management and liquidity in a way I've not seen in a while. More capital has been raised to shore up the balance sheet in the last month than we've seen in two or three years.

# On the fast track

**The world has changed in ways we never thought possible over the last three months. You have been researching companies for a long time and have seen other paradigm shifts with consumer spending, advertising, and travel following the 9/11 attacks and the Great Recession. How quickly can consumer spending rebound or consumers' willingness to travel return?**

We have definitely seen a shift in how consumers want to spend. I would expect that they will get back to normal spending patterns at the very end of this year or sometime in 2021.

I'm most struck by the way travel is likely to be the most delayed recovery category as well as by how much and how rapidly retail has shifted to online. The latter has been a two-decade phenomenon, but it's clearly accelerating due to this crisis.

And it's not just necessities, groceries, and personal care, but across the board: for example, home office supplies, home fitness equipment, and consumer discretionary categories such as fashion & apparel.

When people go back to work, they may cut back on their online shopping somewhat, but I think the overall trend is going to be there as we've had this accelerated adoption of the online retail channel.

To me, that's going to be one of the biggest structural changes that comes out of this crisis.

**So let's focus on online grocery shopping. Certainly, it has taken off during the COVID-19 pandemic. Many more people are utilizing pickup at curbside as well as delivery. Do you think this will remain a part of life once the crisis passes?**

I think so. We hosted a call with the president of Instacart, a private company in the online grocery space. The company has seen in weeks an acceleration in online grocery adoption that it thought would take years to occur. That company had to hire 300,000 individuals, more than doubling its employee base. Amazon has talked about building out its capacity by 60 percent in order to meet grocery demand.

Whether this surge in demand for online groceries is permanent or not, I don't think that the acceleration in online grocery adoption will reverse. A lot of people needed to become comfortable with the idea of safely and effectively purchasing groceries from home.

My view is that most people have had a positive experience and will continue to do it once the crisis passes.

## Ride-sharing companies have obviously changed our lives in many ways over the past few years. Will this concept be able to weather consumers worried about contagion?

There has been a dramatic reduction in ride-sharing usage during the pandemic, as sharp as in travel and live events, which have suffered a decline in demand of between 80 percent and 90 percent year over year.

If we can't leave our homes it undercuts the basic value proposition of ride-sharing, which is inexpensive and effective mobility. My view is that demand comes back relatively quickly.

A few data points give us an indication. Uber, on its earnings call in early May, said that in states that have opened up such as Georgia and Texas, it has already seen a 40 percent to 50 percent increase in ride volume. That is off the bottom; rides are still down some 60 percent year over year—a dramatic reduction but you've seen a snapback.

For many, health risks associated with ride-sharing are preferable to those of public transportation. There will be extra costs for the ride-sharing companies to ensure that those cars are reasonably hygienic, but I think demand snaps back relatively quickly for ride-sharing.

## There has been a lot of concern about increased regulation for big tech. Is that still an issue?

It's certainly on the back burner for now, but it will probably come back as an issue, perhaps in a year or two, and over that period, the U.S. presidential election could also have a major impact on what happens to the regulatory risk.

## Is there one trend that you believe our clients must keep their eyes on for the next year, or even for the long term?

We've had an acceleration in the adoption of all things digital. This unfortunate crisis has highlighted and elevated the importance of digital platforms, whether for consumers who need to provide for themselves at home, educate, and entertain, or for small businesses that need to reach customers, market and deliver to them, and provide for them while physical facilities are shut down.

***Mark, thank you so much for your time and insights. For our readers, if you have an interest in learning more about Mark's recommendations, please reach out to your RBC advisor.***

# Invested, but not fully invested

Within a global balanced portfolio we would carry equity exposure that is modestly below benchmark. This stance reflects our thinking on two factors:

1) Long-term share values are attractive but not mouth-wateringly compelling today.
2) The nearer-term picture still entails some outsized risks associated with the eventual path of the pandemic as well as the vulnerability of the recovery to unanticipated shocks.

Price-to-earnings (P/E) ratios are not very helpful when the economic downturn and downward earnings estimate revisions are still in full flood, when one recognizes that stock markets are looking a year or more ahead to when a recovery is expected to be underway and earnings appreciably higher. A valuation method that minimizes this distortion is one that calculates the net present value of all the future earnings of the stock market (or an individual business) and sets that as fair value.

RBC Global Asset Management has done that calculation and concludes that the permanent loss of value for the S&P 500 due to the COVID-19 episode will turn out to be in the neighbourhood of five percent. Among other things, that assumes earnings endure a significant drop this year, improve but don't get back to their 2019 peak in 2021, and don't get back to where they would have been without the pandemic until 2024.

At one point the S&P 500 Index was down 35 percent from its peak. As of this writing, that gap has narrowed to just 10 percent. That leaves the market, looked at from a net-present-value-of-all-future-earnings perspective, trading not far off its fair value.

### Equity views

| Region | Current |
|---|---|
| Global | – |
| United States | – |
| Canada | – |
| Continental Europe | – |
| United Kingdom | – |
| Asia (ex-Japan) | + |
| Japan | = |

\+ Overweight = Market Weight – Underweight
Source - RBC Wealth Management

When we shift our focus to the next 6–12 months, we are aware of some outsized risks that might deepen or widen the economic/earnings valley we are trying to get beyond.

Some have to do with the pandemic itself. While it's heartening that the number of daily new cases seems to be in decline in every developed economy, there are concerns that a too-rapid reopening could produce a renewed surge in infection rates.

It is good news that at last count, globally there are at least eight new possible vaccines headed for or already in clinical trials, three of which are backed by major pharmaceutical giants. But it has to be said that so far we know very little about the efficacy or safety of any of these potential vaccines. They are just the furthest along of any of the dozens under development. Nor do we know whether those who have been infected by the virus

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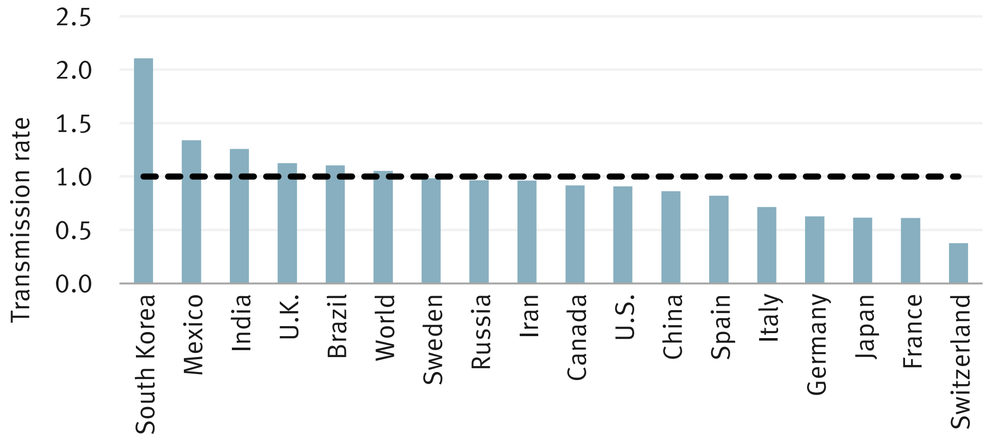
Transmission rate above one suggests continued growth (based on new cases)




Note: Transmission rate calculated as 7-day percentage change of underlying 5-day moving average of new daily cases.
Source - European Centre for Disease Prevention and Control (ECDC), Macrobond, RBC Global Asset Management; data as of 5/28/20

and recovered are now immune. And if they are, for how long?

The pandemic could go on pitching curveballs for some time to come. It has already thrown a doozy—how do you restart an economy that has been arbitrarily shut down? Telling businesses they can reopen and employees they can go back to work doesn't mean they will. It remains an open question whether the massive injections of stimulus by governments and central banks around the world will have the desired effects and for how long. How do you reel the stimulus back in once it's no longer needed or effective? Could it produce problematic distortions in the economy down the road?

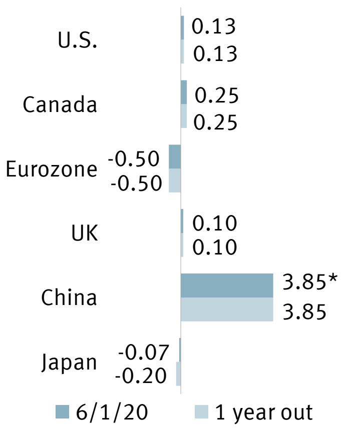
We believe some of these questions will be answered over the next few quarters. For our part, we expect a measurable improvement in GDP growth throughout the developed economies starting in Q3. Momentum will likely build further in Q4 and throughout 2021, with most economies regaining their 2019 peaks by 2022. We also expect the path the recovery takes will prove to be uneven and uncomfortable to experience. Confidence that the economy is once again on a sustainable footing will probably take far longer to build than the economy takes to achieve that state.

The stock market rally since March suggests investors have put fears of an open-ended economic downturn to one side for now. We believe they have been persuaded by the avalanche of fiscal and monetary support which arrived and, in particular, by the related collapse in corporate bond yields which took away the threat of a destructive credit crunch and allowed P/E multiples to rise.

A revival in GDP and earnings growth more or less along the path we have outlined should permit investor focus to shift back to the prospect for the long-term appreciation of the value of businesses. We think the proper way to reflect these prospects in a global equity portfolio today, while acknowledging the lingering risks that adverse pandemic/reopening developments still pose, is to be invested, but not fully invested. We recommend a modestly-below-benchmark exposure to equities.

# Central banks enter the next phase

### Central bank rate (%)




*1-yr base lending rate for working capital, PBoC

Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

We expect that central banks, having pulled out all of the stops since March, will now shift their focus to what comes next, and what more can be done, with major meetings scheduled this month.

The Federal Reserve has not published its quarterly Summary of Economic Projections since the December 2019 meeting, opting to forgo the March edition given monumental uncertainty. Therefore, we think the June 9–10 meeting will offer the first formal glimpse in nearly six months at how the Fed sees the economy developing.

While little of the uncertainty has faded, Federal Reserve Chair Jerome Powell has warned of a shallow economic recovery that could extend through 2021, which is likely to be reflected in the Fed's projections. Its forecast period will extend through 2022, a time in which we expect unemployment to remain high, the economic recovery to be uncertain, inflation below target, and ultimately for the Fed's forecast for interest rates to remain at 0%.

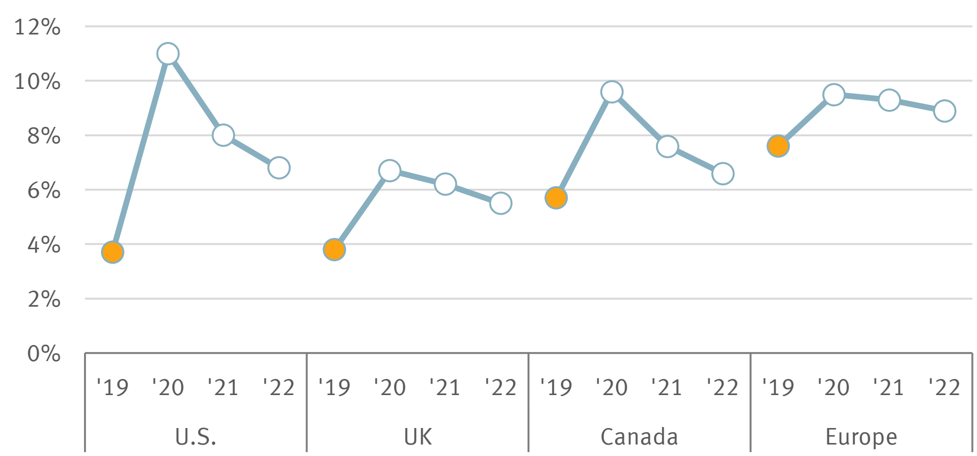
And with a slower recovery expected, markets have begun to price some chance the Fed might eventually turn to negative interest rates, but Powell again pushed back against the notion, stating that "the committee's view on negative rates really

### Fixed income views

| Region | Gov't Bonds | Corp. Credit | Duration |
|---|---|---|---|
| Global | = | + | 5–7 yr |
| United States | + | + | 7–10 yr |
| Canada | = | + | 3–5 yr |
| Continental Europe | = | + | 5–7 yr |
| United Kingdom | – | = | 3–5 yr |

+ Overweight = Market Weight – Underweight
Source - RBC Wealth Management

### Unemployment projected to remain above 2019 levels




Source - RBC Wealth Management, Bloomberg Consensus Survey for May

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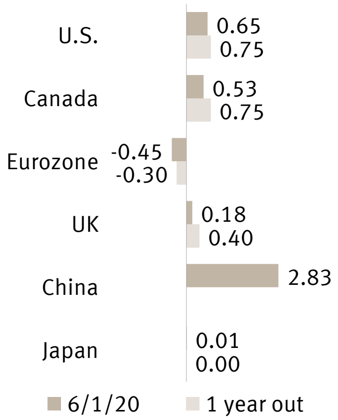
## 10-year rate (%)




Note: Eurozone utilizes German Bunds.

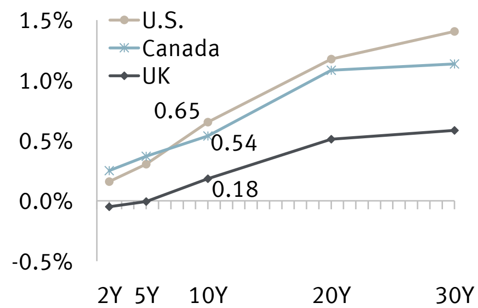
Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

has not changed. This is not something we're looking at."

The same can't be said for the Bank of England where, for possibly the first time, an official stated something more accepting of the idea of negative interest rates, though it was stressed that it is not the main policy choice being considered. The next step will be to expand the quantitative easing program. We expect a similar approach from the European Central Bank this month to pair with its updated macroeconomic projections that are likely to show fading V-shaped economic recovery expectations.

Though central banks have already waded into new waters in various respects, we largely see them sticking to the scripts they have already written, with the trajectory of the global recovery dictating any need for new pages.

## Sovereign yield curves



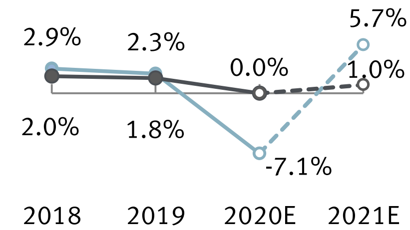

Source - Bloomberg; data through 5/31/20

# Key forecasts

Real GDP growth    Inflation rate

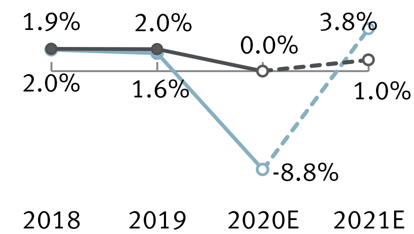
### United States – Retail sales plunge

COVID-19 took a heavy toll in May. Unemployment claims topped 40 million in about 10 weeks. Retail sales plunged 16.4% as the pandemic shuttered business, spurred layoffs, and kept Americans at home. Durable goods orders reflect a sharp pullback in consumer demand and business investment. The CARES Act injected some positive momentum into the economy, sending sentiment unexpectedly higher.



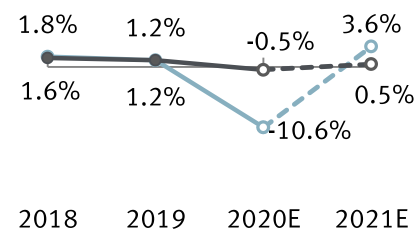

### Canada – Unemployment rate surges

The unemployment rate almost doubled from the previous reading as it climbed to 13.0%, a year after hitting an all-time low of 5.4%. Q1 GDP contracted at an 8.1% annualized rate. Q2 will be worse but expected to mark the bottom. The BoC began use of QE—a tool it did not resort to following the financial crisis—starting purchases of CA$5 billion weekly in Government of Canada securities.



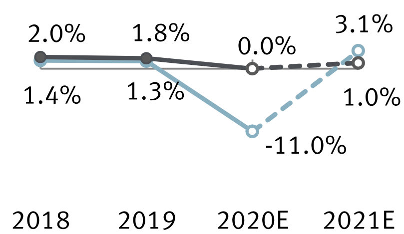

### Eurozone – Banks under stress

Investor confidence picked up slightly in May from April's all-time low. Manufacturing also improved but remains deep in contraction. GDP sagged by a record 3.8% in Q1 while employment declined by 0.3%, the first drop since 2013. The ECB noted that the "deep recession" has exposed new risks to the financial system, which could cause heavy stress on banks and hamper their ability to support economic recovery.



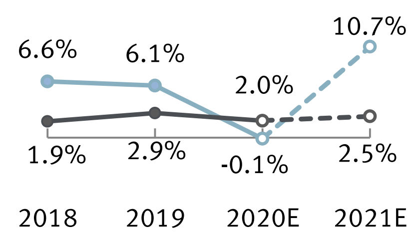

### United Kingdom – Consumer weakness

UK retail sale volumes fell 18% in April signaling the economy could contract as much as 17% in Q2. According to RBC GAM, the British economy is expected to contract 7% in 2020, with a partial rebound expected during the second half of the year due to Treasury and Bank of England intervention. Manufacturing and services PMIs improved in May but remain in contraction territory. Brexit negotiations complicated by economic disarray.



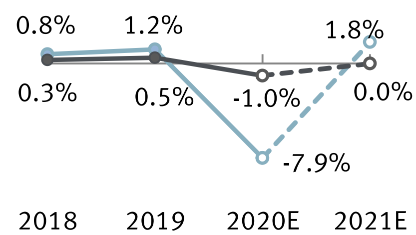

### China – Moderate improvement

China's manufacturing sector continues to ramp up, but global demand is not yet keeping pace with Chinese output. Official manufacturing PMI eased to 49.4 from 50.8 in April. Non-manufacturing PMI is notably stronger. Consumer spending and new home sales are both growing. New car sales rebounding. Consumer confidence lower, business confidence stable.




### Japan – Double down

The Bank of Japan (BoJ) has pledged ¥117.1 trillion on top of its earlier ¥117 trillion bond purchase program to combat the impact of the economic downturn. Another ¥32 trillion (5.8% of GDP) will come from a second budget funded by the same amount of government bond issuance. The economic stimulus package as presented so far, is expected to add 0.7 percentage point to GDP growth.




Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management(RBC GAM), Bloomberg consensus estimates

# Market scorecard

| Index (local currency) | Level | 1 month | YTD | 12 month |
|---|---|---|---|---|
| S&P 500 | 3,044.31 | 4.5% | -5.8% | 10.6% |
| Dow Industrials (DJIA) | 25,383.11 | 4.3% | -11.1% | 2.3% |
| NASDAQ | 9,489.87 | 6.8% | 5.8% | 27.3% |
| Russell 2000 | 1,394.04 | 6.4% | -16.4% | -4.9% |
| S&P/TSX Comp | 15,192.83 | 2.8% | -11.0% | -5.3% |
| FTSE All-Share | 3,363.67 | 3.1% | -19.8% | -14.3% |
| STOXX Europe 600 | 350.36 | 3.0% | -15.7% | -5.1% |
| EURO STOXX 50 | 3,050.20 | 4.2% | -18.6% | -7.0% |
| Hang Seng | 22,961.47 | -6.8% | -18.5% | -14.6% |
| Shanghai Comp | 2,852.35 | -0.3% | -6.5% | -1.6% |
| Nikkei 225 | 21,877.89 | 8.3% | -7.5% | 6.2% |
| India Sensex | 32,424.10 | -3.8% | -21.4% | -18.4% |
| Singapore Straits Times | 2,510.75 | -4.3% | -22.1% | -19.5% |
| Brazil Ibovespa | 87,402.60 | 8.6% | -24.4% | -9.9% |
| Mexican Bolsa IPC | 36,122.73 | -1.0% | -17.0% | -15.5% |
| **Bond yields** | **5/29/20** | **4/30/20** | **5/31/19** | **12 mo. chg** |
| US 2-Yr Tsy | 0.160% | 0.196% | 1.922% | -1.76% |
| US 10-Yr Tsy | 0.653% | 0.639% | 2.125% | -1.47% |
| Canada 2-Yr | 0.290% | 0.312% | 1.429% | -1.14% |
| Canada 10-Yr | 0.534% | 0.547% | 1.488% | -0.95% |
| UK 2-Yr | -0.043% | 0.017% | 0.600% | -0.64% |
| UK 10-Yr | 0.184% | 0.231% | 0.886% | -0.70% |
| Germany 2-Yr | -0.659% | -0.601% | -0.659% | 0.00% |
| Germany 10-Yr | -0.447% | -0.185% | -0.202% | -0.25% |
| **Commodities (USD)** | **Price** | **1 month** | **YTD** | **12 month** |
| Gold (spot $/oz) | 1,730.27 | 2.6% | 14.0% | 32.5% |
| Silver (spot $/oz) | 17.87 | 19.3% | 0.1% | 22.4% |
| Copper ($/metric ton) | 6,486.50 | 3.7% | -13.0% | -7.8% |
| Uranium ($/lb) | 20.90 | -0.5% | -12.6% | -7.7% |
| Oil (WTI spot/bbl) | 35.49 | 88.4% | -41.9% | -33.7% |
| Oil (Brent spot/bbl) | 35.33 | 39.8% | -46.5% | -45.2% |
| Natural Gas ($/mmBtu) | 1.85 | -5.1% | -15.5% | -24.7% |
| Agriculture Index | 273.20 | -0.2% | -12.9% | -10.2% |
| **Currencies** | **Rate** | **1 month** | **YTD** | **12 month** |
| US Dollar Index | 98.3440 | -0.7% | 2.0% | 0.6% |
| CAD/USD | 0.7259 | 1.2% | -5.7% | -1.9% |
| USD/CAD | 1.3780 | -1.2% | 6.1% | 2.0% |
| EUR/USD | 1.1101 | 1.3% | -1.0% | -0.6% |
| GBP/USD | 1.2343 | -2.0% | -6.9% | -2.3% |
| AUD/USD | 0.6667 | 2.4% | -5.0% | -3.9% |
| USD/JPY | 107.8300 | 0.6% | -0.7% | -0.4% |
| EUR/JPY | 119.7700 | 2.0% | -1.6% | -1.0% |
| EUR/GBP | 0.8995 | 3.4% | 6.3% | 1.7% |
| EUR/CHF | 1.0675 | 0.9% | -1.7% | -4.5% |
| USD/SGD | 1.4135 | 0.3% | 5.0% | 2.8% |
| USD/CNY | 7.1364 | 1.0% | 2.5% | 3.4% |
| USD/MXN | 22.1761 | -8.3% | 17.2% | 13.0% |
| USD/BRL | 5.3370 | -2.7% | 32.6% | 36.0% |

U.S. equity markets posted strong gains as many states began their initial phases of reopening.

Global bond yields were mixed with the U.S. 2-year firmer and UK 2-year drifting into negative yield territory.

Commodity prices were mostly higher with WTI and Brent posting solid gains and closing above $30 per barrel.

U.S. Dollar Index weakened against most of its global peers with the exception of the British pound where USD gained 2.0%.

Equity returns do not include dividends, except for the Brazilian Ibovespa. Equity performance and bond yields in local currencies. U.S. 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 0.72 means 1 Canadian dollar will buy 0.72 U.S. dollar. CAD/USD -1.9% return means the Canadian dollar has fallen 1.9% vs. the U.S. dollar during the past 12 months. USD/JPY 107.83 means 1 U.S. dollar will buy 107.83 yen. USD/JPY -0.4% return means the U.S. dollar has fallen 0.4% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 5/31/20.

# Research resources

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As of March 31, 2020

| | | | Investment Banking Services Provided During Past 12 Months | |
|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
| Buy [Outperform] | 755 | 51.64 | 220 | 29.14 |
| Hold [Sector Perform] | 619 | 42.34 | 126 | 20.36 |
| Sell [Underperform] | 88 | 6.02 | 11 | 12.50 |

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