March 19, 2020

RBC WEALTH MANAGEMENT

Global Insight

Weekly

Moving at the speed of flight

Thomas Garretson, CFA – Minneapolis

The swift flight to safety and the rush to find U.S. dollars are sparking disruptions in the global financial system. But the Fed and global central banks are moving just as fast to keep the financial system running as economic activity risks slowing to a walk.

What a year this week has been. While central banks have taken numerous steps over the past month as the economic threat of the coronavirus outbreak has grown, this week marked a watershed moment as banks around the world pulled out all the stops. And they're not done.

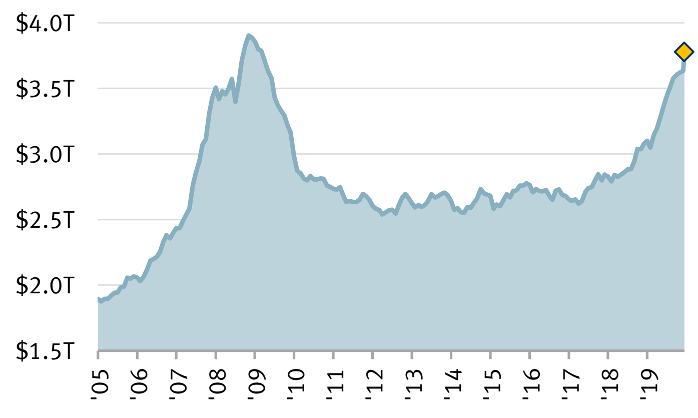
The Federal Reserve began the week with a surprise announcement on Sunday ahead of the scheduled Mar. 17–18 policy meeting, cutting rates back to the effective lower bound of zero percent to 0.25 percent, while announcing a $700 billion asset purchase program comprised of $500 billion in Treasuries and $200 billion in mortgage-backed securities. The European Central Bank added to the size and scope of its bond purchases, which will now exceed €1 trillion this year alone. The Bank of England cut rates and restarted its own asset purchase program as well.

But while economic stimulus is front of mind for most, the Fed's focus thus far has simply been to ensure that liquidity is flowing through financial markets. As Federal Reserve Bank of Richmond President Thomas Barkin remarked, "the place we can add the most value is making markets function."

Lender of last resort

The plumbing of the financial system largely goes ignored—as it should be—during periods of calm, but it is at least as important as any other form of stimulus—fiscal, monetary, or

Money market assets swell as investors rush into cash



Source - RBC Wealth Management, Bloomberg, Investment Company Institute; data through 3/11/20

Market pulse

Click here for authors' contact information. Priced (in USD) as of 3/19/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 8.**
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otherwise—during periods of volatility in terms of promoting economic stability.

To that end, seemingly every day this week has seen the reintroduction of many programs last seen during the depths of the financial crisis. Two major policy tools reintroduced that investors shouldn't ignore are the Commercial Paper Funding Facility and the Money Market Mutual Fund Liquidity Facility. The two are closely intertwined as money market funds are one of the largest purchasers of commercial paper—or short-term debt issued by corporations to fund payrolls and other near-term expense items.

And with the rush to cash, money market fund assets have swelled to $3.8 trillion, nearing the financial crisis peak of $3.9 trillion in 2009, with market risks bringing back the old fears of "breaking the buck" in money market funds. But in our view, the Fed has once again effectively backstopped short-term funding. As the Fed stated, it "will assist money market funds in meeting demands for redemptions by households and other investors, enhancing overall market functioning and credit provision to the broader economy."

Of course, these are extraordinary times. And while the need to break the glass on tools not used since the global financial crisis may in some way be alarming, investors can take some solace in the fact that the Fed not only has the tools but also the prior experience of using them to facilitate market functioning, and rapidly so.

The Fed still has room to maneuver

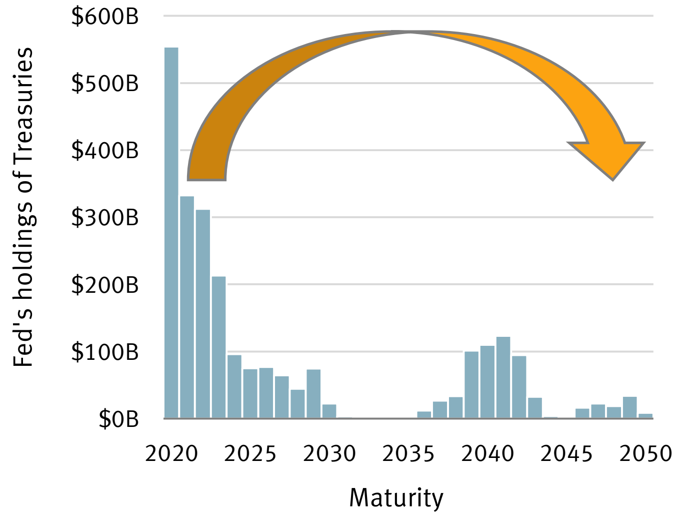
To this point, the Fed's focus has primarily been on market functioning, but as Federal Reserve Bank of Boston President Eric Rosengren said that he expects markets to stabilize in the next week or two, we think that the focus will then shift towards stimulus in the days and weeks ahead.

While a common concern has been that the Fed and central banks globally have less room to act to support economies given historically low, or even negative policy rates, and already large balance sheets, we think that concern is largely unfounded.

In terms of the Fed, the announced asset purchase program as currently structured is essentially aimed at providing liquidity to Treasury markets amid signs of rising transactions costs and forced selling due to fund outflows from many fixed income sector exchange-traded funds and mutual funds—partly fueling the puzzling rise in Treasury yields in recent weeks at the same time that stock markets continue to sell off.

The key difference from past quantitative easing programs is that the Fed is buying across all maturities at the moment, instead of targeting the long end in an effort to drive down yields. Should markets stabilize, we think the buying program

Expand and extend: Look for the Fed's balance sheet to grow and lengthen



Note: Federal Reserve's holdings of Treasuries, mortgage-backed securities excluded
Source - RBC Wealth Management, Bloomberg

could be shifted toward that strategy, and that the Fed could even execute another "operation twist," as it last did in 2011, of selling short-dated Treasuries and buying further out on the yield curve.

As the chart shows, in the years since the Fed stopped expanding its balance sheet, the average Treasury maturity has become quite short, with roughly half of its Treasury holdings now maturing in less than three years. The next step may be to sell some short-duration Treasuries, and redeploy those funds into longer-dated securities—thereby adding stimulus via lower yields and forcing investors into other asset classes.

On top of that, there remains the possibility that the Fed could begin buying municipal bonds. The Fed already has the authority to do so, but only with a maximum of a six-month maturity. Given the stress in the U.S. muni market, and the likely increase in funding needs of local governments in the midst of the current crisis, this may be the next phase of Fed stimulus and support.

Central banks may have kicked off the fireworks display this week, but the grand finale is still to come.

Emergency care

Frédérique Carrier – London

Central banks led the first charge against COVID-19 with aggressive monetary actions. We are now seeing another prong of defense—fiscal stimulus—to combat the insidious attack of the coronavirus. We look at the importance of these "antiviral injections" of cash that will be critical to buttress economies against the ongoing economic threats posed by the pathogen.

Monetary, regulatory, and fiscal measures

Drastic restrictions are being imposed on citizens everywhere in the hope of tackling the pandemic, and containing the human cost of the crisis. A wide range of countries and cities are going into lockdown, including sweeping travel and shopping constraints. These measures will have extremely severe consequences for the global economy in the short term.

Until recently, monetary authorities largely took the reins of the response to the coronavirus pandemic and its impact on the economy with decisive action. Most developed central banks cut rates aggressively or, as in the case of the European Central Bank (ECB), unveiled a massive package to support the banks, or both.

But in itself monetary policy cannot effectively deal with a health crisis of this scale, the shocks to both supply and demand, as factories close or restrict their hours and consumption dwindles, and the negative feedback loop from the financial market turmoil.

Targeted fiscal policies are critical to prevent a cash flow crunch from turning into a solvency crunch, and to sustain the economy amid restrictions and confinement. As RBC Capital Markets points out, while central banks can provide liquidity, only government action can ensure that it is channeled to businesses, in effect backstopping the corporate sector.

Fiscal policies can come in many guises including: state guaranteed loans to corporations; company bailouts; cash handouts to households; sick pay (or more generous statutory sick pay); government subsidies for underutilized workers; tax deferrals/rebates; and mortgage and rent deferrals/rebates.

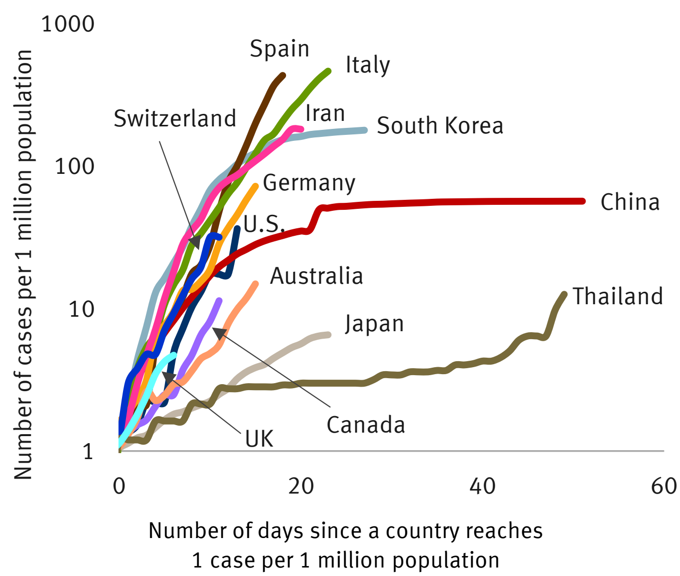
Many governments in developed economies are stepping to the plate, though perhaps not as systematically as financial markets might like. More action is certain to come, in our view, given the rapidly evolving crisis. We look at how various regions are tackling the problems.

Continental Europe opens the taps

With the epicenter of the crisis moving from China to Europe, and Italy in particular, this region has taken many steps to contain the virus and respond to the crisis. Most of the continent is locked down with restrictions on civil liberties unseen since World War II in effect on local movement (only grocery and pharmacy shopping is permitted), travel, and large group gatherings. Many countries have a curfew after 6pm, and police control is becoming the norm.

New cases running amok in many countries

Trajectory of spread of COVID-19 in different countries



Note: As of 3/17/20, number of cases per 1 million population in log scale. U.S. first exceeded 1 case per 1 million population on 3/4/20.
Source - World Health Organization, Macrobond, RBC Global Asset Management

With the resulting fall in demand, a recession looks all but inevitable. Its magnitude will depend on the duration of the lockdown, but fiscal measures, in addition to the ECB's package to support banks, should help to lessen its intensity. Negative growth rates of -1.0 percent to -2.0 percent for 2020 should not be dismissed, in our view.

The antiquated EU fiscal rules, which require national deficits to be restricted to three percent of GDP, are being set aside for now. Italy started off with an injection of a little more than €3.5 billion, though it will now make €25 billion available via an emergency fund, with some €12 billion of this likely earmarked for immediate health care spending, bridge loans to small and medium-sized enterprises (SMEs), postponing tax payments, and some broad protection for workers.

France is offering guarantees to corporate debt to the tune of €300 billion, in addition to allowing companies to defer tax payments, while temporarily suspending households' energy bills and rent. Importantly, German leaders have put aside an obsession with balanced budgets, which is a requirement enshrined in its constitution. The government announced it would offer unlimited federal guarantees to facilitate corporate lending.

UK follows in the footsteps

The UK's official containment strategy was initially much less stringent than what we've seen from the continent. But fiscal measures were nonetheless drastic with the UK government guaranteeing up to £330 billion of corporate loans, in an effort to convince companies not to lay off workers in light of lower activity levels. How quickly these funds can be channeled to companies and whether they are willing to take on more debt remains to be seen. Downing Street also announced £20 billion in tax and spending measures, in addition to the £12 billion support package unveiled in the Mar. 11 budget statement to tackle the pandemic.

The big guns?

In a press conference on Mar. 17, the Trump administration proposed a new, eye-popping stimulus package that could total more than $1 trillion, or just under five percent of U.S. GDP, to protect individuals and businesses. This comes on top of an $8 billion package announced two weeks ago, and another one signed into law on March 18. Details of the third package are being ironed out and should be released imminently. The stimulus needs to be approved by Congress, but it seems to have broad bipartisan support.

Measures may include: $250 billion in direct payments of $1,000 to most Americans, with an additional $250 billion to be paid out within the next six weeks after the first payment if the crisis continues; $300 billion in lending to SMEs, the lifeblood of the economy; $50 billion in relief for the hardest-hit industries such as airlines and hotels; and an extension of tax payment deadlines and tax credit for sick leave.

With respect to the direct payments, by comparison, under the 2009 America Recovery and Reinvestment Act, $250 checks were sent to people on social security, while the average taxpayer received a tax cut of $400 per individual and $800 per family. The current payment under consideration would therefore be more generous, but should the epidemic last a few months or more, as currently anticipated by epidemiologists, more cash handouts may be needed to combat the financial damage.

The new normal

Overall, fiscal deficits as a percentage of GDP are set to rise abruptly. The U.S. is a case in point. At the height of the Great Recession, the U.S. fiscal deficit reached close to 10 percent of GDP. The ratio this time around could well exceed this eventually, as any likely recession would be anything but routine.

Monetary, fiscal, and regulatory policies are necessary but not sufficient to completely stanch the crisis. For a sustainable rebound in financial markets, some concrete success in the fight against the coronavirus on the medical front (e.g., number of new cases plateauing, more efficient testing, vaccine development, etc.) is also probably needed.

United States

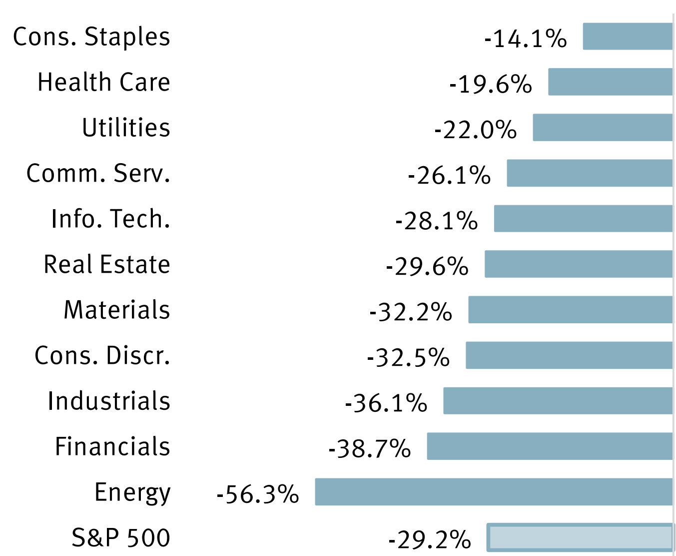
Ben Graham, CFA – Minneapolis

- **U.S. equity markets continue to engage in price discovery** as investors attempt to properly account for a fluid economic situation characterized by an exponentially growing number of COVID-19 cases and the related, but highly unclear, financial impact of the precautionary steps being taken by U.S. consumers. With the S&P 500 about 30% lower than its mid-February highs and down approximately 10% this week, RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina has made another attempt at properly adjusting S&P 500 earnings estimates in light of this new normal. **The 2020 estimate falls to $139 from $165, reflecting Calvasina's new assumption that a recession will in fact occur in 2020, most likely during Q2 and Q3**. She arrived at $139 by reducing last year's EPS of $166 by 16%, an amount in line with the median recessionary decline in S&P 500 EPS during each of the last three recessionary periods.

- Within the nearly 30% decline in the S&P 500, **the hardest-hit sectors have been those most levered to cyclical and commoditized end markets**. Notably, Energy is down more than 50% on the loss of rationality from geopolitical actors as oil supply is boosted ahead of a demand reduction. Energy is followed by Financials, Industrials, Consumer Discretionary, and Materials, all of which have underperformed the S&P 500 and are considered the most cyclical sectors in the U.S.

Less economically sensitive sectors performing best in this correction

S&P 500 sector returns since 2/19/20



Source - RBC Wealth Management, FactSet; data through 3/18/20

On the other side of the coin, **more traditionally defensive sectors have held up better than average** with Consumer Staples, Health Care, and Utilities performing best, in that order.

- We think **a key signal that a recession is likely to materialize due to this health crisis would be a continuing increase in unemployment insurance claims over the coming weeks**. Jobless claims for the week ending March 14 hit 281,000, above the consensus estimate of 218,000. We believe the next few weeks are likely to see elevated results with the initial claims figure expected to rise meaningfully, and very little clarity on what a realistic expectation should be. RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli believes that the number of initial jobless claims may approach 350,000 in coming weeks based on the strong correlation between unemployment insurance searches on Google and actual claims. But Porcelli also cautions against adopting as a base case assumption the 20% unemployment scenario Treasury Secretary Mnuchin presented to Congress. **In his most extreme scenario, Porcelli doesn't see unemployment rising above 15%**, a figure based on the leisure, hospitality, and retail industries seeing job cuts of about 50% while health care employment remains flat, which he believes is a highly unlikely outcome.

Canada

Arete Zafiriou & Ryan Harder – Toronto

- The fiscal and monetary policy response this week to the growing COVID-19 crisis was unprecedented in its breadth, speed, and magnitude. On the monetary side, asset purchases by central banks have increased rapidly, with the Bank of England restarting its quantitative easing program while the Federal Reserve and European Central Bank expanded both the quantity and eligibility of their asset purchases. Governments around the world also ramped up their efforts: **the Canadian government announced an CA$83 billion aid package, including CA$27 billion in direct support and CA$55 billion in tax deferrals**; in the U.S., an emergency package was signed into law authorizing paid sick leave and other benefits, with the potential for direct cheques to American citizens representing the next step in an additional, much larger aid package.

- **Corporate borrowing costs have been increasing rapidly as the risk premium investors demand to lend to corporate issuers has surged**. This swift adjustment in borrowing costs has impaired the ability of more heavily leveraged corporate borrowers to quickly access funding, and has added to the volatility in fixed income markets. A knock-on effect has been reduced liquidity in bond markets, where market makers are struggling with price discovery amid rapid price changes. This lack of liquidity is evident in fixed income exchange-traded funds, where many bond funds are trading at substantial discounts to their net asset values.

- **The S&P/TSX Composite Index is down 32% since its peak on Feb. 20**, with all 11 sectors posting losses. The **Energy sector has been hit hardest**, down 50% year to date, due to the sharp drop in oil prices amid the Saudi Arabia-Russia price war overlaid by softer demand given the COVID-19 outbreak. The novel coronavirus has also been particularly hard on the Consumer Discretionary sector, which is down 42% year to date. On the other side of the spectrum, **the Consumer Staples and Utilities sectors have been the benchmark's best performers**, as would normally be expected in down markets.

Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- Since its peak on Feb. 19, **the STOXX Europe 600 is down almost 34%** (through March 19 close). The health care and food & beverage sub-sectors have outperformed on a relative basis, down around 21% and 23%, respectively. **Only nine companies in the index are in positive territory**, six of which are involved in food and/or drug retail. The best performing stock has been **Ocado Group plc**, up 23%. The company reported that its home grocery delivery business has seen increased demand since the beginning of this month, as well as higher-value baskets with an increase in mix of shelf-stable foods.
- **Reports from fashion retailers and luxury companies have demonstrated the severe impact COVID-19 is having on trading. Inditex**, one of the world's largest fashion retailers, reported a 24% y/y drop in sales between Mar. 1 and Mar. 16, as around 50% of its stores (3,785) are temporarily closed across 39 markets. Luxury goods brand **Burberry** reported that trading has deteriorated significantly with year-over-year retail store sales tracking between -40% and -50% over the past six weeks.
- While the market selloff was relatively indiscriminate initially, the past week has demonstrated **equity investors appear to be shifting to more defensive positioning**. While the STOXX Europe 600 is down 2.4% over the past five trading days (through Mar. 19 close), the telecommunications, food & beverage and health care sub-sectors were up 9.%, 4.8%, and 4.7%, respectively. The retail (led by food retailers), utilities, chemicals, and personal & household good sub-sectors also held up, with small gains of between 1.0% and 3.7%.
- With respect to portfolio positioning, **we recommend investors in UK and/or European equities adopt a defensive stance**, being overweight the Health Care (particularly pharmaceuticals), Consumer Staples, and Utilities sectors, while being underweight Financials (particularly banks), Energy, and Materials. We see opportunities in select Consumer Discretionary names with sufficiently strong balance sheets to weather the current demand shock.

Asia Pacific

Jasmine Duan – Hong Kong & Nicholas Gwee, CFA – Singapore

- **Asian equities have been tumbling during the week** following the overseas market turmoil. The **Philippine Stock Exchange Index plunged 13.3%** today after a two-day market shutdown, making it the worst performer in the region for the week. On the other hand, Japan's **Tokyo Stock Price Index** (TPX Index) has recorded a **1.75% gain** so far this week as investors expect further exchange-traded fund purchases by the Bank of Japan (BOJ).
- Earlier today, **China reported no new local cases of coronavirus** for the first time since the outbreak began, marking an important turning point. According to the National Development and Reform Commission (NDRC), **more than 90% of China's large enterprises outside Hubei province have resumed work**. However, on Mar. 13, the government reported that only about 60% small and medium-sized companies outside of Hubei have done the same.
- **South Korea also appears to be getting the virus outbreak under control**. On Feb. 29, the outbreak's peak in the country, 909 new cases were reported. On most days since then, the number of newly reported cases has been decreasing. On Monday, only 74 new cases were reported, and on Wednesday there were 93. It is believed the country's **rapid large-scale virus testing and well-organized contact tracing program** have worked well.
- **Japan's February consumer price index excluding fresh food was up 0.6% y/y**, decelerating from 0.8% in January. The inflation was far below the BOJ's 2% target despite years of massive easing and a recent sales tax hike. Falling energy prices and a near 10% drop in prices of overseas vacation packages were the main factors pressing down the index. The government said the impact of coronavirus hasn't really shown up in the data. As such, we believe there is still downside risk on the index.

MARKET SCORECARD

Data as of March 19, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,409.39	-18.4%	-25.4%	-14.9%	-11.2%
Dow Industrials (DJIA)	20,087.19	-20.9%	-29.6%	-22.4%	-18.4%
NASDAQ	7,150.58	-16.5%	-20.3%	-7.4%	-2.6%
Russell 2000	1,058.72	-28.3%	-36.5%	-31.9%	-32.6%
S&P/TSX Comp	12,170.52	-25.2%	-28.7%	-24.8%	-21.9%
FTSE All-Share	2,788.37	-24.1%	-33.6%	-30.5%	-28.5%
STOXX Europe 600	287.80	-23.4%	-30.8%	-25.1%	-23.0%
EURO STOXX 50	2,454.08	-26.3%	-34.5%	-28.0%	-27.7%
Hang Seng	21,709.13	-16.9%	-23.0%	-26.3%	-31.1%
Shanghai Comp	2,702.13	-6.2%	-11.4%	-12.6%	-17.6%
Nikkei 225	16,552.83	-21.7%	-30.0%	-23.2%	-22.9%
India Sensex	28,288.23	-26.1%	-31.4%	-26.3%	-14.1%
Singapore Straits Times	2,311.00	-23.3%	-28.3%	-28.3%	-33.9%
Brazil Ibovespa	68,331.80	-34.4%	-40.9%	-31.4%	-18.6%
Mexican Bolsa IPC	35,143.63	-15.0%	-19.3%	-17.1%	-26.0%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,472.73	-7.1%	-2.9%	12.7%	11.8%
Silver (spot $/oz)	12.11	-27.3%	-32.2%	-21.2%	-25.8%
Copper ($/metric ton)	4,729.50	-15.8%	-23.1%	-26.9%	-30.6%
Oil (WTI spot/bbl)	25.22	-43.7%	-58.7%	-57.3%	-59.4%
Oil (Brent spot/bbl)	28.25	-44.1%	-57.2%	-58.2%	-57.2%
Natural Gas ($/mmBtu)	1.66	-1.7%	-24.3%	-42.4%	-37.5%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	1.165%	1.6	-75.3	-144.7	-169.1
Canada 10-Yr	1.001%	-13.1	-70.1	-72.7	-116.8
U.K. 10-Yr	0.724%	28.2	-9.8	-46.2	-72.1
Germany 10-Yr	-0.193%	41.4	-0.8	-29.0	-76.2
Fixed Income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	2.23%	-4.0%	-0.3%	6.5%	10.5%
U.S. Invest Grade Corp	4.06%	-11.4%	-8.1%	1.7%	5.5%
U.S. High Yield Corp	10.12%	-14.2%	-15.4%	-9.4%	-4.6%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	102.6250	4.6%	6.5%	6.5%	14.3%
CAD/USD	0.6888	-7.8%	-10.5%	-8.2%	-9.9%
USD/CAD	1.4519	8.3%	11.8%	9.0%	11.0%
EUR/USD	1.0688	-3.1%	-4.7%	-5.8%	-13.4%
GBP/USD	1.1517	-10.2%	-13.1%	-13.2%	-17.9%
AUD/USD	0.5740	-11.9%	-18.2%	-19.0%	-25.6%
USD/JPY	110.6600	2.6%	1.9%	-0.7%	4.3%
EUR/JPY	118.2800	-0.6%	-2.9%	-6.5%	-9.6%
EUR/GBP	0.9279	7.9%	9.7%	8.5%	5.5%
EUR/CHF	1.0537	-1.0%	-2.9%	-7.1%	-10.2%
USD/SGD	1.4527	4.3%	7.9%	7.5%	10.3%
USD/CNY	7.1086	1.7%	2.1%	5.9%	12.3%
USD/MXN	24.0143	22.2%	26.9%	26.3%	28.4%
USD/BRL	5.0796	13.6%	26.2%	34.4%	54.5%

Source - Bloomberg. Note: 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. Data as of 9:35 pm GMT 3/19/20.

Examples of how to interpret currency data: CAD/USD 0.68 means 1 Canadian dollar will buy 0.68 U.S. dollar. CAD/USD -10.5% return means the Canadian dollar fell 10.5% vs. the U.S. dollar year to date. USD/JPY 110.66 means 1 U.S. dollar will buy 110.66 yen. USD/JPY 1.9% return means the U.S. dollar rose 1.9% vs. the yen year to date.

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As of December 31, 2019

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	765	51.97	225	29.41
Hold [Sector Perform]	625	42.46	127	20.32
Sell [Underperform]	82	5.57	5	6.10

Ratings:

Top Pick (TP): Represents analyst's best idea in the sector; expected to provide significant absolute total return over 12 months with a favorable risk-reward ratio. **Outperform (O):** Expected to materially outperform sector average over 12 months. **Sector Perform (SP):** Returns expected to be in line with sector average over 12 months. **Underperform (U):** Returns expected to be materially below sector average over 12 months. **Restricted (R):** RBC policy precludes certain types of communications, including an investment recommendation, when RBC is acting as an advisor in certain merger or other strategic transactions and in certain other circumstances. **Not Rated (NR):** The rating, price targets and estimates have been removed due to applicable legal, regulatory or policy constraints which may include when RBC Capital Markets is acting in an advisory capacity involving the company.

Risk Rating:
The **Speculative** risk rating reflects a security's lower level of financial or operating predictability, illiquid share trading volumes, high balance sheet leverage, or limited operating history that result in a higher expectation of financial and/or stock price volatility.

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