March 26, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

Everything and the kitchen sink

Kelly Bogdanova – San Francisco

With a mammoth, multipronged stimulus package, Washington is doing whatever it takes and then some to confront the mounting crisis. We look at who gets what from the key pieces of this historic legislation, and consider the impact for the economy.

"We are all Keynesians now," quipped Milton Friedman, Nobel Prize winner and a patriarch of modern-era capitalism, as he pondered the turbulent political and economic environment during the Nixon years. Jumping ahead to today, with two separate periods of bazooka-sized bailouts and stimulus packages in a little more than a decade, that famous phrase is even more apropos.

The ink isn't even dry on Washington's $2 trillion coronavirus aid package and some senators are already laying the groundwork for more.

We don't doubt there will be additional rounds of federal aid, at least for the hardest hit areas of the country, and perhaps more for public health. With New York currently the epicenter of the U.S. coronavirus crisis, and the state's estimated $15 billion coronavirus-related revenue shortfall well in excess of the $3.1 billion or $3.8 billion allocated for it in the $2 trillion package, we think additional federal relief will be in store.

This no-holds-barred approach to U.S. fiscal spending (borrowing) and aggressive spending in other countries, combined with the swift and resolute actions of major central banks, should help blunt the domestic and global economic downturn and could potentially support a faster and stronger recovery once the virus has largely runs its course.

Following is our assessment of the key provisions in the $2 trillion U.S. aid package—the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)—from the perspective of the U.S. economy.

Individual relief

Among the most important provisions are the direct cash payments to American workers and increased unemployment benefits, totaling about $300 billion. If this health crisis lasts a number of weeks rather than many months, these funds can help plug some holes in household balance sheets.

The vast majority of American workers would receive a one-time cash payment of various levels. The maximum amounts are $1,200 for individuals, $2,400 for married couples, and an additional $500 per child.

The amounts are means tested, so they decline at higher income levels and then phase out. For example, an individual that has annual adjusted gross income of less than $75,000 would receive $1,200. The amount decreases incrementally as the income level rises to $99,000, and then phases out entirely.

The sliding scale of payments according to various scenarios (single, married, with children, without children) has been

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estimated by the Tax Foundation, a Washington D.C.-based tax policy organization, and is shown in the chart.

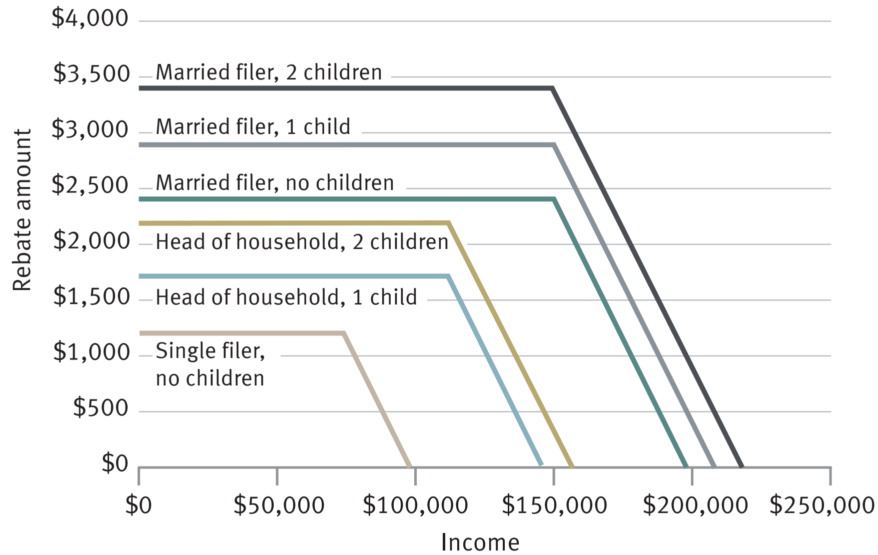
The Tax Foundation estimates that almost all income tax filers up to the 94th percentile will receive a check, with close to maximum payments for tax filers up to the 80th percentile.

Importantly, the bill also boosts payments for the unemployed, which can't come soon enough given that nearly 3.3 million Americans filed for unemployment benefits last week, almost five times the previous weekly record set in 1982, a period when a vicious double-dip recession occurred amid the Federal Reserve's assault on sky-high inflation.

During this coronavirus crisis, we expect unemployment benefit claims to continue to surge in the coming weeks given many parts of the country are nearly shut down and more "stay at home" measures could be implemented.

Proposed relief rebate in the CARES Act

Proposed individual economic relief rebate by filing status



Source - Tax Foundation, "Coronavirus Aid, Relief, and Economic Security Act"

In the CARES Act, expanded unemployment payments of $600 per week for four months per unemployed worker would be provided. That amount is on top of existing state-administered unemployment benefits that vary in amounts. The goal of this extra $600 per week provision is to cover 100 percent of the average wage. "Gig" workers will also receive the payments.

For many working families that have experienced a dramatic drop in income due to work stoppages because of the coronavirus crisis, these are stop-gap measures, and may not fully cover living expenses, especially in cities and states with high costs of living. But the money should help keep millions of families afloat for the time being. We view these two provisions as essential for households and the economy, and more funds may be needed if battling the virus lasts months rather than weeks.

Buttressing business

Other major provisions in the $2 trillion CARES Act target businesses, including distressed industries.

For example, there is $349 billion in loans guarantees for small businesses, i.e., those with fewer than 500 employees. There are employee retention incentives, so that companies that keep employees on the payroll could benefit from some loan forgiveness.

The bill directs a separate $454 billion tranche to the Treasury Department to support credit facilities recently established by the Federal Reserve for loans to businesses, with an emphasis on companies that employ between 500–10,000 people, or medium-sized businesses. There is much more here than initially meets the eye, as the funding can be leveraged up significantly, to up to $4 trillion, according to the Treasury Department.

In addition, the bill provides support for the beleaguered airline industry (including cargo airlines) of $29 billion in grants and $29 billion in zero-interest loans, which represents the total amount the industry requested. The grants are designated for employee wages, salaries, and benefits. An additional $3 billion in payroll grants are earmarked for airline catering, baggage handling, security, and other contractors. Finally, there is another $10 billion provided for airports around the country.

Damage control

The CARES Act is imperfect, as is almost always the case with legislation that arises out of compromise, and especially with bills that are rushed through the process. The details will likely be nitpicked in the days and weeks ahead, and the flaws will be exposed.

But we are of the mindset that during a crisis, Washington and other policymakers should not let the perfect be the enemy of the good. We think the CARES Act and the two smaller federal aid bills that preceded it will help blunt the economic downturn, and will ultimately be supportive of the recovery. Indeed, we are all Keynesians now.

United States

Alan Robinson – Seattle

- **Stocks posted new lows for the year on Monday before rebounding handily** on the bipartisan fiscal stimulus package. However, we believe it is still too early to sound an all-clear for the market until news flow on COVID-19 cases improves. While daily changes in the number of new cases may have slowed in some locations, we believe this is likely due to a temporary slowdown in testing.

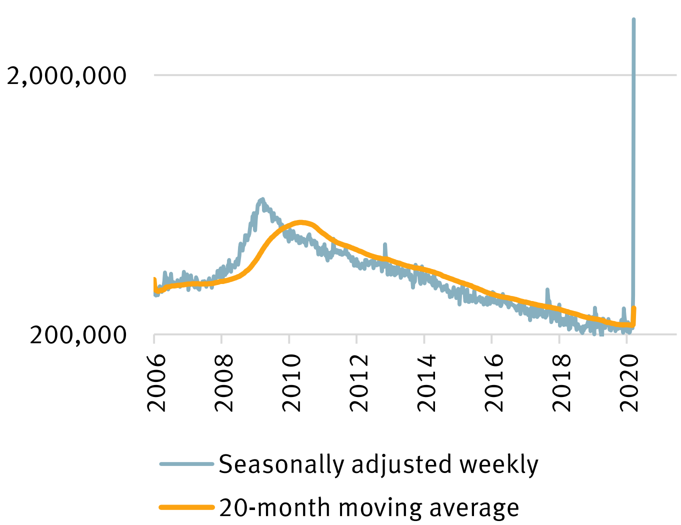
- Data on the rapidly changing employment picture in the U.S. were released during the week. **Initial claims for unemployment insurance** for the period March 14–21 **soared even more than expected**, due to layoffs associated with social isolation policies. Weekly new claims jumped **to 3.3 million** from 282,000 the prior week and 211,000 the week before that. This was an order of magnitude above the previous high of 695,000 claims filed in October 1982. This week's layoffs have been concentrated in the services sector and they highlight the speed with which this sector of the economy has effectively ground to a halt.

- Heidi Shierholz, an analyst at the Economic Policy Institute, believes **unemployment will get worse before it gets better** and that by summer "14 million workers will have lost their jobs due to the coronavirus shock."

- We pay close attention to the initial claims data series as, **historically, a pickup in unemployment claims has reliably preceded the arrival of U.S. recessions**, although usually the reversal is gradual enough to provide more of a lead time in its warning signal. To that point, RBC Global Asset Management Inc. Chief Economist Eric Lascelles now sees a base case of a moderate U.S. recession this year, with GDP falling 2.8% y/y.

This time it's different - COVID-19 leads to mass layoffs

Initial claims for U.S. unemployment insurance (log scale)



Source - RBC Wealth Management, U.S. Bureau of Labor Statistics

- **The Cheesecake Factory**, a national restaurant chain, **has told its landlords it won't be able to pay rent on its properties next month** due to COVID-19 shutdowns, according to Eater, a restaurant industry publication. **Other retail chains** including Mattress Firm and Subway **have issued similar warnings**. While the pain facing such businesses is real, we believe publicizing these issues may lead to forbearance on the part of property owners given the unknown duration of this crisis.

Canada

Sayada Nabi & Meika McKelvey – Toronto

- **The baton has officially been passed from monetary to fiscal policy** to stem the economic losses due to COVID-19, and RBC Economics expects the **Canadian government to go "all-in" on additional stimulus in the near term**. RBC Economics stated that although Canada's CA$27 billion fiscal program announced last week, combined with this week's CA$25 billion new merged benefit for workers, isn't too far off the action taken by global peers, when direct loans and credit guarantees are included, **Canada still comes up considerably short**. With RBC Economics penciling in a 2.5% drop in Canadian GDP for 2020, and weekly employment insurance claims in Canada jumping to unprecedented levels, **the need for significant government aid is clear**, in our view. RBC Economics believes the support provided thus far still leaves room for more to be done, and it expects the Canadian government to **materially increase the budget deficit** to tackle the economic shock from the virus, up to CA$200 billion if necessary.

- **Canadian corporate borrowing costs received some relief** over the past few trading days after the **Federal Reserve announced new plans to purchase unlimited amounts of U.S. corporate bonds**. This has helped improve credit market conditions across North America with both investment-grade and high-yield bond spreads tightening meaningfully on the week. With broader risk assets reacting positively to aggressive central bank and fiscal action, the **Canadian preferred share market has seen some recovery** after hitting a fresh all-time low in price terms on Monday, Mar. 23. The index is still about 25% lower on the month, and we continue to view this market as down, but not for the count as yields greater than 7% can be earned on a diverse mix of structures, and companies must continue to service this dividend stream unless common equity dividends are reduced to zero.

- **Canadian equities have also displayed some appreciation** towards the liquidity injections and stimulus from the fiscal and monetary policies to date. While the S&P/TSX Composite Index is still off its February peak and started the week in the red, the index played into "turnaround Tuesday" and surged close to 12% that day. The positive move continued yesterday with the index gaining another 4.5%, resulting in the index's **first two consecutively positive trading sessions in five weeks**.

Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **The UK now has a full lockdown policy in effect** after 335 confirmed coronavirus deaths. As a frame of reference, China imposed a lockdown on the Hubei province epicenter after 30 confirmed fatalities. Activity indicators already reflect a sharp deterioration in the economic climate. **The decline in Q2 GDP will clearly be deep, likely reaching -10%**, in our view, as a large swath of industries, such as retail, restaurants, hotels, and transport, have ground to a halt or are operating at very low capacity.

- **How far GDP will fall is difficult to assess and will be determined by how long containment measures last**. Rapid deployment of antibodies testing would be a positive development, but the effectiveness of the tests and how many tests will be available remains unclear.

- **The large fiscal packages** announced over the past couple of weeks in the UK will undoubtedly help, in our view. In particular, measures to pay 80% of employee wages (capped at £2,500 per worker) and widely expected measures to support the five million self-employed **should not only soften the economic contraction but also support the rebound** when containment measures are relaxed.

- Continental Europe, most of which went into lockdown weeks ago, continues to announce measures to support economies. **The EU officially suspended normal budgetary rules prohibiting national deficits of more than 3% of GDP**, the first such suspension in the EU's existence. Most European countries have already announced large fiscal spending and guarantees schemes, to the tune of some 15% of GDP on average. Meanwhile, the European Central Bank removed some of the constraints and rules for its €750 billion asset purchase programme to grant itself more flexibility and to deploy the programme more efficiently. As a result, Italy's 10-year government bond yield fell more than 0.15 percentage points to 1.38%, a level similar to where it was in January 2020.

- An EU-level response in the guise of **eurobond issuance is still missing**, though it is under discussion. This step may only be taken should the situation deteriorate markedly.

Asia Pacific

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

- **Asian equity markets traded mostly higher for the week led by the Philippines and Japan**. The Philippine Stock Exchange rebounded strongly after it plunged to a 10-year low last week. Apart from overall elevated risk appetite due to the expectation of a $2 trillion stimulus package in the U.S., the rally in Philippine stocks was also driven by the Philippine central bank's decision to cut the reserve-requirement ratio by 200 basis points. In Japan, the market was well supported by the Bank of Japan's (BoJ) purchases of exchange-traded funds (ETFs). **The BoJ bought over ¥200 billion worth of ETFs for the second straight trading day** through Mar. 23.
- India has ordered its 1.3 billion people to stay at home for three weeks. A third of the world's population is now under orders to stay indoors in an effort to contain the COVID-19 outbreak. The pandemic has forced Japan to postpone the Olympics until next year, making it the first time the Games have been moved outside of World War I and II. According to a Nikkei report, **the Japanese government is considering a fiscal stimulus package worth roughly 10% of annual economic output** to combat the impact of the coronavirus outbreak.
- **In China**, where the virus emerged late last year, **the government has loosened the tough travel restrictions in Hubei** after a months-long lockdown as the country reported no new cases from local transmission. Residents of Wuhan, the initial epicenter of the outbreak, will be allowed to leave the city beginning Apr. 8. According to Capital Economics, over the past four weeks road congestion in major cities has increased from 30% to 65% of the 2019 level, while the number of people travelling on subway systems in large cities has increased from 10% to nearly 40% of the 2019 norm. While trends are clearly positive in China, we think a **deepening economic downturn overseas will keep demand depressed for a much longer period of time**.
- **SoftBank Group's share price surged 40.6% this week** as the technology conglomerate announced up to $41 billion in asset sales and a record share buyback to shore up its depressed share price.

MARKET SCORECARD

Data as of March 26, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,630.07	-11.0%	-18.6%	-6.7%	-1.1%
Dow Industrials (DJIA)	22,552.17	-11.2%	-21.0%	-12.1%	-6.8%
NASDAQ	7,797.54	-9.0%	-13.1%	1.4%	8.0%
Russell 2000	1,180.32	-20.1%	-29.3%	-22.8%	-23.5%
S&P/TSX Comp	13,371.17	-17.8%	-21.6%	-17.2%	-12.6%
FTSE All-Share	3,179.75	-13.4%	-24.2%	-19.1%	-16.6%
STOXX Europe 600	321.38	-14.4%	-22.7%	-14.8%	-11.5%
EURO STOXX 50	2,847.78	-14.5%	-24.0%	-14.2%	-13.1%
Hang Seng	23,352.34	-10.6%	-17.2%	-18.3%	-23.6%
Shanghai Comp	2,764.91	-4.0%	-9.4%	-7.7%	-11.8%
Nikkei 225	18,664.60	-11.7%	-21.1%	-12.9%	-10.1%
India Sensex	29,946.77	-21.8%	-27.4%	-21.7%	-9.4%
Singapore Straits Times	2,487.56	-17.4%	-22.8%	-22.3%	-27.1%
Brazil Ibovespa	77,686.10	-25.4%	-32.8%	-18.5%	-8.7%
Mexican Bolsa IPC	35,666.80	-13.7%	-18.1%	-16.7%	-23.9%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,633.34	3.0%	7.6%	24.1%	20.7%
Silver (spot $/oz)	14.42	-13.5%	-19.2%	-6.6%	-13.7%
Copper ($/metric ton)	4,846.15	-13.7%	-21.2%	-23.5%	-26.1%
Oil (WTI spot/bbl)	22.60	-49.5%	-63.0%	-62.3%	-65.5%
Oil (Brent spot/bbl)	26.73	-47.1%	-59.5%	-60.7%	-61.9%
Natural Gas ($/mmBtu)	1.63	-3.0%	-25.4%	-40.4%	-37.6%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.835%	-31.4	-108.2	-158.8	-201.7
Canada 10-Yr	0.851%	-28.1	-85.1	-72.3	-138.2
U.K. 10-Yr	0.399%	-4.3	-42.3	-60.8	-104.1
Germany 10-Yr	-0.361%	24.6	-17.6	-34.6	-88.5
Fixed Income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.81%	-2.0%	1.7%	7.5%	12.9%
U.S. Invest Grade Corp	4.09%	-10.7%	-7.4%	1.0%	6.7%
U.S. High Yield Corp	11.00%	-16.5%	-17.7%	-12.0%	-6.9%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	99.3150	1.2%	3.0%	2.7%	11.6%
CAD/USD	0.7113	-4.7%	-7.6%	-4.8%	-8.7%
USD/CAD	1.4057	4.8%	8.2%	5.1%	9.5%
EUR/USD	1.1047	0.2%	-1.5%	-1.9%	-11.2%
GBP/USD	1.2210	-4.8%	-7.9%	-7.6%	-14.2%
AUD/USD	0.6067	-6.9%	-13.6%	-15.0%	-21.7%
USD/JPY	109.4100	1.4%	0.7%	-1.1%	3.8%
EUR/JPY	120.8200	1.5%	-0.8%	-3.1%	-7.9%
EUR/GBP	0.9052	5.2%	7.0%	6.1%	3.5%
EUR/CHF	1.0628	-0.2%	-2.1%	-5.1%	-9.7%
USD/SGD	1.4308	2.7%	6.3%	5.8%	9.3%
USD/CNY	7.0747	1.2%	1.6%	5.3%	12.8%
USD/MXN	23.0484	17.3%	21.8%	20.6%	25.7%
USD/BRL	5.0225	12.3%	24.6%	32.9%	51.5%

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 3/26/20.

Examples of how to interpret currency data: CAD/USD 0.71 means 1 Canadian dollar will buy 0.71 U.S. dollar. CAD/USD -7.6% return means the Canadian dollar fell 7.6% vs. the U.S. dollar year to date. USD/JPY 109.41 means 1 U.S. dollar will buy 109.41 yen. USD/JPY 0.7% return means the U.S. dollar rose 0.7% vs. the yen year to date.

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