April 23, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

The new abnormal

Kelly Bogdanova – San Francisco

COVID-19 has left economies and companies operating in a state of business as unusual. So, when it comes to the outlook for corporate profits, it's time to throw out the playbook. We look at how investors should gauge the outlook for earnings and stock market valuations.

This corporate earnings season and the next are oddities. This is not because of the double-digit retrenchments that we expect in earnings growth—that's normal during recessions. A key reason we think the Q1 and Q2 reporting seasons will be outliers is because many management teams are having a very difficult time gauging the future amid COVID-19 uncertainties.

Given the abundance of unknowns about the contours of economic recessions and subsequent recoveries in North America, Europe, and globally, there is a meaningful lack of visibility about corporate profits, especially in economically-sensitive industries and those hit hardest by COVID-19 shutdowns.

As a result, we think investors should take 2020 and 2021 earnings forecasts with a grain of salt, and should use a range of estimates when attempting to gauge the future outlook for profits and equity market valuations.

A lack of guidance

Normally during earnings season, analysts and investors have a well-established playbook to work from—profit estimates for the current and next quarters that tend to come reasonably close to reality. Not in this COVID-19 environment. This go-around, many Wall Street industry analysts who cover individual companies will be left in the dark.

Our national research correspondent believes a meaningful share of S&P 500 management teams will withdraw earnings guidance during the Q1 reporting season due to substantial COVID-19-related uncertainties. Companies domiciled in other countries and regions will likely do the same, and we're already seeing this play out in the early stage of the European reporting season.

There is not much incentive for management teams of economically-sensitive companies to go out on a limb to forecast earnings when operations in so many national and local jurisdictions are in flux and subject to government decisions on when and at what pace businesses can begin getting back to normal.

Before COVID-19 caught fire, roughly half of S&P 500 companies had not yet provided full-year guidance (this is not atypical for early in the year), while roughly the other half had provided guidance.

After the Q1 earnings season largely concludes in the latter part of May, our national research correspondent believes the majority of companies that had previously provided full-year earnings guidance will have withdrawn it. It also thinks the original pack of companies that refrained from providing guidance will continue to sit on the sidelines. It anticipates only

Market pulse

3 U.S. Energy sector looks beyond oil futures capitulation

3 What oil below zero means

4 ECB loosens collateral rules to accept "fallen angels"

4 China's Q1 GDP gives a sense of COVID-19's impact

Click here for authors' contact information. Priced (in USD) as of 4/23/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6.**
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16 percent of companies will provide full-year guidance, as the middle chart shows.

Room for movement

The lack of and withdrawal of earnings guidance would leave profit forecasts for this year and next even more in flux than they normally are.

The S&P 500 consensus forecast for 2020 of $136 per share has declined substantially from $173 since mid-March, according to bottom-up estimates of Wall Street analysts aggregated by Refinitiv I/B/E/S, just as it should have amid COVID-19 risks. RBC Capital Markets is currently forecasting $135 per share.

Even though both of these 2020 forecasts are in the "reasonable zone," in our view, there is still downside risk considering the Q1 reporting trends thus far. With 22 percent of S&P 500 companies having reported, 30 percent of them have missed the consensus forecast, a higher rate than usual. The 2020 consensus estimate could continue to drift down in the weeks ahead, and visibility about the remaining quarters of this year is lacking.

The 2021 consensus estimate of $171 per share still seems far too elevated to us, despite the fact that it has been cut from $197 per share at the beginning of the year due to COVID-19. RBC Capital Markets is at $153 per share for next year.

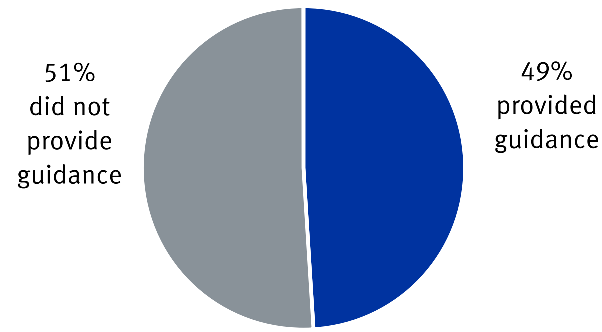
Rely on a range

At this stage, we think investors should take the bottom-up consensus earnings forecasts of Wall Street analysts and the top-down estimates of equity strategists with a grain of salt. We would use a range of estimates to gauge the future path of earnings and market valuations.

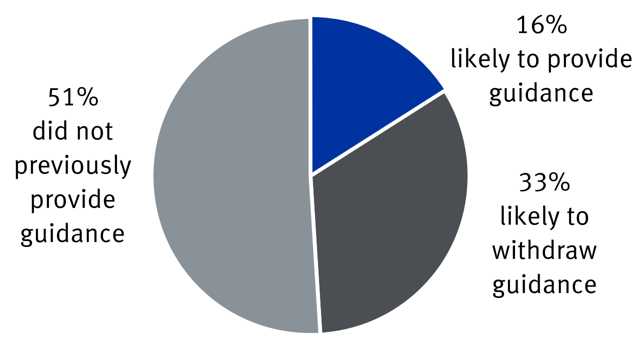
We think $125–$135 per share seems like a reasonable range for 2020 until more is known about the depth and duration of the U.S. and global economic recessions. We think $150 per share is a good ballpark estimate for 2021, but we wouldn't hold onto it too tightly given the abundance of unknowns about the contours of the economic rebound.

About one-third of U.S. large-cap companies are likely to withdraw earnings guidance

Percentage of S&P 500 companies that previously provided 2020 earnings guidance



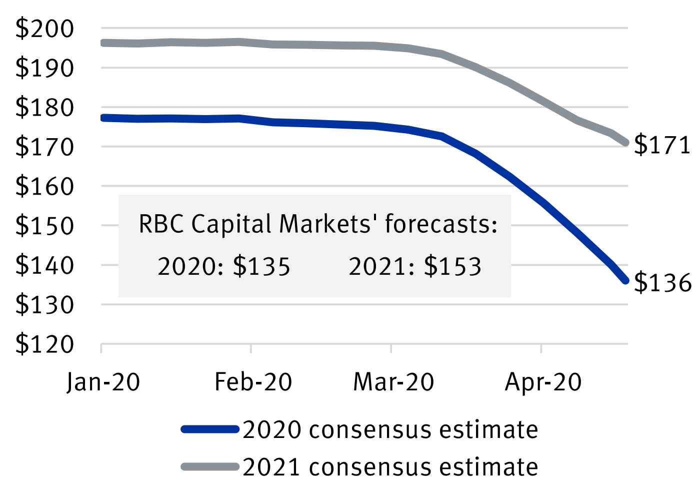
Percentage of S&P 500 companies likely to provide 2020 earnings guidance post-Q1 results



Source - National research correspondent, Standard & Poor's, FactSet; data as of 4/20/20

COVID-19 has pushed profit estimates down substantially, but is it enough?

S&P 500 consensus earnings-per-share forecasts



Source - RBC Wealth Management, Refinitiv I/B/E/S, RBC Capital Markets U.S. Equity Strategy; weekly data from 1/6/20 through 4/23/20

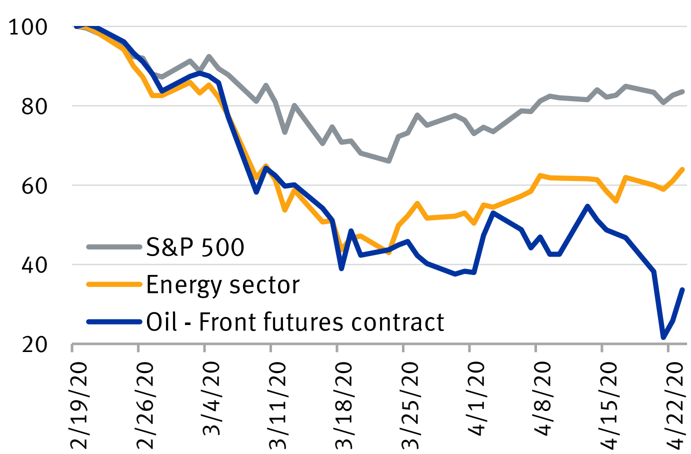
United States

Alan Robinson – Seattle

- **The sharp selloff in oil futures during the week refocused investors' attention on the Energy sector**. Three main factors coincided to cause the decline in North American oil prices. First, a glut of oil arrived as Saudi Arabia and Russia pumped more than was needed in order to lower prices and force competitors out of business. Second, widespread lockdown actions precipitated a sharp decline in demand for gasoline and jet fuel in North America, as road and air traffic volumes plummeted. But while too much supply and too little demand is usually enough to push prices down, the final nail in the coffin came in the form of a severe shortage of places to store oil.
- With crude inventories piling up, RBC Capital Markets, LLC Energy Analyst Kurt Hallead estimates the remaining storage capacity at the Cushing, Oklahoma, hub will be full in a few weeks at the current rate of inflow. Consequently, Hallead **lowered his 2020 average crude oil price forecasts for West Texas Intermediate (WTI) and Brent crude to $35 and $39 per barrel, respectively, rising to $44 and $46 in 2021**.
- However, we believe equity investors saw this coming and are now looking beyond the near-term disruptions in the oil markets. While it underperformed the S&P 500 through the market low on Mar. 23, the **Energy sector appears to have disconnected from the physical oil market** since then (see chart).
- Our immediate concern regarding the Energy sector is the **sustainability of dividend payments**. While only one of the 27 energy companies in the S&P 500 has cut its dividend so far, we note that 18 of the remaining 26 have negative "Dividend Health" ratings according to Bloomberg. A negative rating suggests a significant near-term risk of a cut. We believe **a wait-and-see approach to Energy stocks may be appropriate**.
- During the week, **the U.S. Senate passed a $484 billion COVID-19 relief bill** to expand the Paycheck Protection Program by $310 billion and to increase funding for hospitals and testing. The U.S. House of Representatives has yet to pass the bill at the time of writing, but a "phase four" stimulus package that would focus on infrastructure spending is already being discussed in Washington.

Energy sector looks beyond oil futures capitulation

Relative performance since stock market peak



Source - RBC Wealth Management, Thomson Reuters; data through 4/23/20
Normalized, with 2/19/20 values = 100

Canada

Richard Tan, CFA & Carolyn Schroeder – Toronto

- Oil-related headlines have captured investor attention amid unprecedented demand destruction and an on-again, off-again price war. This week also showed that negative oil prices are more than a possibility. **The futures market, particularly the May 2020 West Texas Intermediate contracts, dipped into negative territory for the first time ever on Apr. 20**. In other words, if you owned the contract to buy oil and wanted to exit your position, you had to pay someone to take the barrels of oil off your hands. **It's a strange concept, partly driven by the fact that the May 2020 contracts expired on Apr. 21**. Therefore, if you retained your long position, you would be obligated to take physical delivery of the barrels next month despite storage capacity that is already limited and poised to worsen with consumption in a deeply compromised state.
- It's important to note that there is not one singular "oil price." In fact, there are various grades of oil and different contract maturities. If one were to look at contracts with longer-dated maturities, you would see that prices remain depressed but are at least in positive territory. We believe investing into underlying producers remains challenging in the current environment as **oil prices could remain below the level needed to fund capital investments and dividends via cash flow**.
- RBC Economics believes **February data is a prelude to March figures that will likely show a substantial decline in retail activity** due to the mid-month closure of many non-essential retailers. While some sectors will be spared (or even benefit), RBC Economics believes the majority of retailers will see a dramatic pullback in sales with stores closed and consumers strongly encouraged to stay home. Prior to the pandemic, e-commerce sales from domestic retailers were up 18% y/y in February, and Statistics Canada noted many retailers were opening or expanding online platforms in response to COVID-19 containment measures. Although

grocery spending increased 80% in the week ending Mar. 17, shopping patterns have subsequently normalized. Software and data services spending held up better than other discretionary categories, as Canadians equipped themselves to work from home. In addition, spending on books and music (including streaming and online services) has not suffered notably. The combination of Employment Insurance and the new Canada Emergency Response Benefit program will provide a larger-than-usual income offset for the millions of workers losing their jobs, but the still-significant income loss means **consumer spending may experience more of a gradual recovery when physical distancing measures begin to ease**.

Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- At a summit on Apr. 23, **EU leaders plan to discuss necessary steps to avoid the tail risk of the COVID-19 crisis morphing into a full blown EU and euro crisis**. There is broad based agreement the recently announced €540 billion package agreed to by Eurogroup finance ministers needs to be enlarged, but details have to be worked out.
- Meanwhile, **the European Central Bank (ECB) is widening further its collateral rules**, now accepting so called 'fallen angels,' i.e., marketable securities that held an investment-grade rating on or prior to Apr. 7 but were downgraded subsequently to levels of BB or above.
- By doing so, the ECB is **following in the footsteps of the Federal Reserve**, which announced a similar measure recently. We think it should benefit significant areas of the corporate sector whose ratings came under significant pressure in the wake of the current economic slowdown. The ECB's steps **should help contain a possible widening of spreads**. More should be divulged at the Apr. 30 ECB meeting.
- In the early stages of Q1 results season, **the aggregate earnings per share for constituents of the STOXX Europe 600 Index is down 11% y/y**. Cyclical sectors, particularly Financials, have seen a significant earnings decline. Results in defensive sectors have been less extreme, at times even pleasing.
- **Swiss health care giant Roche reported sales growth of 7% y/y**, slightly ahead of consensus, driven by higher sales from new product launches. Given the uptake of its recently introduced medicines, the company confirmed its guidance for low- to mid-single-digit sales growth in 2020.
- **Danone**, the French food manufacturer, **generated organic sales growth of 3.7% y/y**, ahead of consensus, as the company benefitted from consumers' pantry loading. Nevertheless, the company **withdrew its full-year guidance** due to its expectation that global supply and demand will remain highly volatile and unpredictable for the remainder of 2020.
- **Unilever also withdrew its full-year outlook** due to the lack of visibility. Its flat Q1 y/y organic sales, despite a sales upswing in hygiene and in-home food products, was due to a collapse in out-of-home consumption affecting its ice cream and food service businesses.

Asia Pacific

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

- China's Q1 GDP has given the market a sense of COVID-19's economic impact. **The Chinese economy declined 6.8% y/y in the quarter** (vs. Bloomberg median estimate of -6.0%), following a 6.0% expansion in Q4 2019. This was the first contraction since the country began publishing quarterly data in 1992. **The data suggests that activity improved in March but remained weak** even as containment measures were relaxed. The weak Q1 data was somewhat expected and digested by investors. However, another concern now is that the rebound in activity in March could be partially due to orders received before the global outbreak of the virus. **The plunge in global demand and order cancellations may drag on a recovery in China's economy in Q2**, and the extent of any rebound remains highly uncertain. The Chinese market's performance in the medium term will be affected by other countries' progress in containing the virus and mitigating its impact.
- **The nonperforming loan ratio of Chinese banks rose** by 0.06 percentage points to 2.04% in March. According to the regulator, the banks have deferred payments on RMB 880 billion in loans and rolled over another RMB 576.8 billion in loans for small businesses in Q1. **The regulator said asset quality could worsen in Q2, but overall risks are under control**. In addition, China has drafted plans to restructure some small and medium-sized banks, mostly with market-oriented measures.
- **The Singapore government expects a sharper economic contraction this year** as COVID-19 affects the global economy and supply chains. The Ministry of Trade and Industry now anticipates 2020 GDP growth will contract between 1% and 4%. On Apr. 21, Singapore extended its "circuit-breaker" COVID-19 restrictions for another four weeks until Jun. 1. **The country hopes to "progressively reopen" its economy in about a month's time** and also plans to significantly expand testing for infection throughout its population.

MARKET SCORECARD

Data as of April 23, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,797.80	8.2%	-13.4%	-4.6%	4.8%
Dow Industrials (DJIA)	23,515.26	7.3%	-17.6%	-11.8%	-3.8%
NASDAQ	8,494.75	10.3%	-5.3%	4.6%	19.2%
Russell 2000	1,214.07	5.3%	-27.2%	-23.4%	-22.3%
S&P/TSX Comp	14,251.09	6.5%	-16.5%	-14.5%	-8.4%
FTSE All-Share	3,205.67	3.2%	-23.6%	-22.1%	-21.4%
STOXX Europe 600	333.24	4.1%	-19.9%	-14.8%	-13.0%
EURO STOXX 50	2,852.46	2.4%	-23.8%	-18.6%	-18.8%
Hang Seng	23,977.32	1.6%	-14.9%	-20.0%	-20.7%
Shanghai Comp	2,838.50	3.2%	-6.9%	-11.3%	-7.5%
Nikkei 225	19,429.44	2.7%	-17.9%	-12.7%	-12.0%
India Sensex	31,863.08	8.1%	-22.8%	-17.4%	-7.5%
Singapore Straits Times	2,542.37	2.5%	-21.1%	-24.2%	-29.0%
Brazil Ibovespa	79,673.30	9.1%	-31.1%	-16.9%	-6.9%
Mexican Bolsa IPC	34,240.60	-0.9%	-21.4%	-24.2%	-29.3%

Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot $/oz)	1,732.14	9.8%	14.2%	36.1%	30.7%
Silver (spot $/oz)	15.24	9.1%	-14.6%	2.7%	-8.3%
Copper ($/metric ton)	5,109.25	3.5%	-16.9%	-20.1%	-25.9%
Oil (WTI spot/bbl)	15.75	-23.1%	-74.2%	-76.3%	-77.0%
Oil (Brent spot/bbl)	21.91	-3.6%	-66.8%	-70.6%	-70.7%
Natural Gas ($/mmBtu)	1.82	10.7%	-17.0%	-26.0%	-33.7%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.597%	-7.3	-132.1	-196.8	-237.8
Canada 10-Yr	0.598%	-9.9	-110.4	-115.2	-175.5
U.K. 10-Yr	0.292%	-6.4	-53.0	-93.5	-124.7
Germany 10-Yr	-0.424%	4.7	-23.9	-46.5	-106.0

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.42%	1.6%	4.8%	11.1%	16.8%
U.S. Invest Grade Corp	2.76%	4.9%	1.1%	10.1%	16.7%
U.S. High Yield Corp	8.26%	4.0%	-9.2%	-4.3%	1.7%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	100.5310	1.5%	4.3%	3.0%	10.5%
CAD/USD	0.7106	0.0%	-7.7%	-4.6%	-8.7%
USD/CAD	1.4073	0.1%	8.3%	4.8%	9.5%
EUR/USD	1.0767	-2.4%	-4.0%	-4.1%	-11.8%
GBP/USD	1.2340	-0.6%	-6.9%	-4.6%	-11.5%
AUD/USD	0.6367	3.8%	-9.3%	-10.3%	-16.3%
USD/JPY	107.6400	0.1%	-0.9%	-3.8%	-1.0%
EUR/JPY	115.9000	-2.3%	-4.8%	-7.7%	-12.7%
EUR/GBP	0.8726	-1.8%	3.1%	0.5%	-0.4%
EUR/CHF	1.0518	-0.8%	-3.1%	-8.2%	-11.9%
USD/SGD	1.4245	0.2%	5.8%	5.0%	7.5%
USD/CNY	7.0667	-0.2%	1.5%	5.1%	11.9%
USD/MXN	24.8173	4.8%	31.1%	31.3%	31.0%
USD/BRL	5.5275	6.2%	37.1%	46.3%	60.1%

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 4/23/20.

Examples of how to interpret currency data: CAD/USD 0.71 means 1 Canadian dollar will buy 0.71 U.S. dollar. CAD/USD -7.7% return means the Canadian dollar fell 7.7% vs. the U.S. dollar year to date. USD/JPY 107.64 means 1 U.S. dollar will buy 107.64 yen. USD/JPY -0.9% return means the U.S. dollar fell 0.9% vs. the yen year to date.

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Hold [Sector Perform]	619	42.34	126	20.36
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