July 16, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

U.S. ELECTIONS & MARKET MATTERS

Just one part of the ensemble

Kelly Bogdanova – San Francisco

While the occupant of the Oval Office dominates the American stage, when it comes to influence on financial markets, the reality is that the president is less a lead player and more a member of a chorus. Don't let the roar of the media's election coverage sway investment strategy. Instead, focus on what matters to markets.

Mainstream media outlets and alternative varieties on each end of the ideological spectrum are quite adept at amplifying the importance of U.S. presidential elections. Ratings and clicks pay the bills, after all. Whoever occupies the Oval Office certainly has great influence and can help or hinder the country's progress and development, but many other factors also determine U.S. asset class returns.

The same goes for Congress. While party control can absolutely make a big difference in setting national priorities and passing substantive legislation, how much does party control *really* impact the stock market as a whole, especially over the long term?

This article kicks off a series titled, "U.S. elections & market matters" by RBC Wealth Management that will examine the aspects of the 2020 elections that are most pertinent to financial markets, investment portfolios, and the economy.

First things first: some perspective on how to think about elections apart from the roar of the media coverage, and instead within the context of investing.

Central bank influence is central

We think there is an even more important entity that sets the tone for markets—the Federal Reserve. Whether on a domestic or global scale, it's difficult to downplay the significance of this institution and its reach, especially the worldwide financial tentacles it has grown over many decades.

At a basic level, the Fed has greater influence on domestic recessions and recoveries than the president or Congress. Fed interest rate cycles—whether rates are falling or rising or are on hold—play a significant role in shaping the direction of the business cycle. When the Fed oversteps by tightening credit too much, too fast, it can quickly bring the U.S. economy to its knees, with knock-on effects for many other countries. In the other direction, every substantial Fed easing cycle has produced an economic recovery or reacceleration.

Since the global financial crisis in 2008–2009, the Fed's influence has grown markedly, and in ways that have yet to be fully fleshed out by Fed watchers, economists, and market analysts.

The Fed's unorthodox tools—such as quantitative easing, which allows it to purchase federal government, state and municipal government, and corporate bonds—have helped shape not just economic cycles but also short- and medium-term financial

Market pulse

Click here for authors' contact information. Priced (in USD) as of 7/16/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6.**
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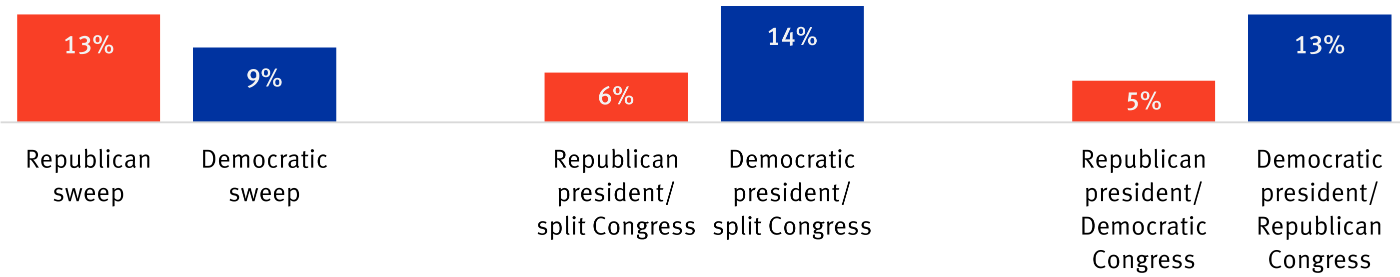
Wealth Management

The elephant or the donkey—or both?

Average historical S&P 500 returns by various party control scenarios since 1933



Source - RBC Capital Markets U.S. Equity Strategy, RBC Wealth Management, Haver Analytics

market returns. Most recently, we doubt the S&P 500 would be up nearly 44 percent from its COVID-19 shutdown low in March had the Fed not stepped in to keep financial markets functioning, especially the corporate bond market. Yes, bipartisan fiscal stimulus from the White House and Congress mattered a lot. But without the Fed's interventions and "money printing" abilities, we think the U.S. market and economic backdrops would look much different right now.

The consequences of the Fed's unprecedented policies—positive and negative—could take many years to sort out. Whether Donald Trump is re-elected or defeated by Joe Biden, and whether a divided Congress or a "blue wave" occurs have comparatively little to do with this.

Business cycle spins on

In our view, the natural ebb-and-flow of the business cycle—the movement of economic activity from recovery, to steady growth, to recession, and back—is another key factor beyond the full grasp of the White House and Capitol Hill. Developments in Washington usually don't make or break America's $19 trillion economy, even when tax policy and spending proposals are in play like they are in this election.

Estimating the influence that fiscal policies can have on the stock market is more art than science. The decisions of the president and Congress can certainly boost or weaken economic trends and industries, but Washington's leaders are dependent on business cycle fluctuations, just like investors are. We think the business cycle—which in turn significantly impacts corporate earnings—affects the stock and bond markets more than political outcomes.

Data dynamics

Data is another factor for investors to put into perspective. In each election cycle there is always a bevy of charts and graphs offered up, showing historical returns surrounding elections—returns of equity indexes that are sliced and diced by party control, incumbent versus non-incumbent outcomes, various years of the election cycle, and more, similar to the two charts shown.

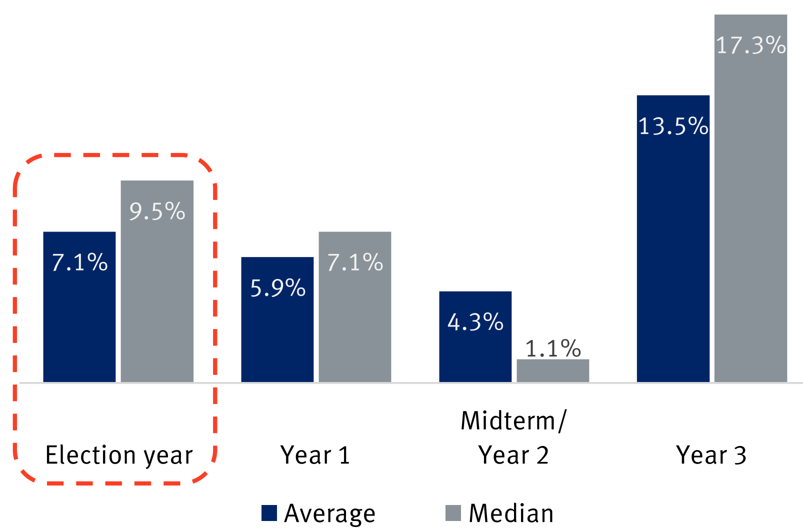
Historical data is useful to consider and can provide some guidance, but we would take them with a pinch of salt. They are based on few data points (there have only been 23 presidential elections since 1928) and, importantly, the data can vary widely around the averages. So the averages aren't an especially reliable guide about what is going to happen next.

Keep your eye on the ball

We advise investors to not allow the roar of the media's election coverage to get in the way of thoughtful portfolio management. When it comes to influence on financial markets, the president and Congress are members of a large chorus. Focus on what matters most to markets.

Historically returns have been second-best in election years

S&P 500 performance during U.S. presidential election cycles since 1928



Source - RBC Capital Markets U.S. Equity Strategy, RBC Wealth Management, Bloomberg

United States

Alan Robinson – Seattle

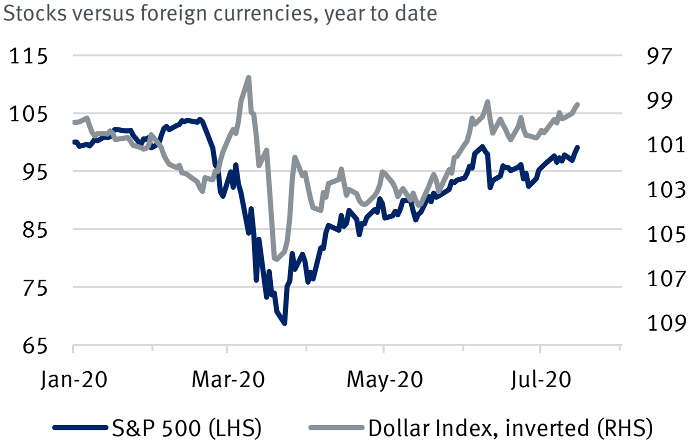
- **Stocks rallied mid-week on positive COVID-19 vaccine news**. Results published in the New England Journal of Medicine showed that Boston-based biotech company Moderna's drug produced antibodies in all 45 patients tested in a Phase 1 trial. Dr. Anthony Fauci, the government's leading infectious disease expert, called the data "really quite promising," and Moderna plans to start Phase 3 trials on 30,000 volunteers by July 27. AstraZeneca also moved up after it received positive news on its vaccine, one of the few under development that would produce both antibodies and a T-cell response.

- However, **other COVID-19 headlines were less rosy**. A study from King's College London showed recovered patients' antibodies declined rapidly within months of infection, raising doubts about the efficacy of potential vaccines. Additionally, 46 U.S. states posted higher infection rates during the week. A rise in cases caused California to reverse course and close all indoor bars and restaurants again. **California, Texas, and Florida, three of the states hardest hit by the virus, represent roughly 30% of U.S. GDP**. With many reopening efforts on hold or reversed, downside risks to Q3 GDP have increased, in our view.

- **Second-quarter earnings season kicked off during the week, and banks led the charge** with results that were generally better than expected. Bellwether JPMorgan posted core earnings per share of $1.25, beating the consensus estimate of $1.10. The bank's earnings benefitted from strong capital markets results, offset by higher loan loss provisions.

Foreign currencies have followed the stock market higher in a risk-on move

Stocks versus foreign currencies, year to date



Source - RBC Wealth Management, Thomson Reuters. Normalized with 1/1/20 values = 100; data through 7/15/20

Not all banks joined the party, as **Wells Fargo reported a worse-than-expected loss** due to customer remediation costs.

- **June retail sales increased 7.5% m/m**, beating expectations for 5.4% growth. Most of this beat was driven by strong automobile and gasoline sales, while online retail and grocery store sales declined. The U.S. also posted **a record budget deficit of $864 billion in June**; this one-month figure is almost equal to the deficit for all of 2019 and brings the 12-month deficit to a record high of $3 trillion.

- The U.S. dollar resumed its fall from grace during the week. The currency had benefited from flight-to-quality flows as the pandemic hit international markets, but **improving COVID-19 conditions overseas relative to the U.S. have put the dollar under pressure**. The recovery in stocks since March has also hurt the dollar, as risk-on sentiment tends to support foreign currencies.

Canada

Meika McKelvey & Sayada Nabi – Toronto
Mikhial Pasic, CFA – Vancouver

- As expected by market participants, the Bank of Canada (BoC) did not make any policy changes at its July 15 meeting, holding the overnight rate target at what it continues to view as the effective lower bound of 0.25% and recommitting to the current pace of purchasing Government of Canada, provincial, and corporate bonds. However, the Bank did provide some **clarity on the expected path for the policy rate**, giving condition-based guidance in its statement for the first time. The statement noted that the BoC would **keep rates on hold until "economic slack is absorbed so that the 2% inflation target is sustainably achieved."** The July Monetary Policy Report, also released on July 15, showed the BoC's base-case expectation is that inflation will not return to the target level until after 2022, when CPI is expected to be 1.7%. In other words, the BoC's messaging implies the overnight rate could be held at the effective lower bound until at least 2023.

- **The coronavirus pandemic is unwinding decades of progress for women in the labour force**, according to RBC Economics. The economic downturn has pushed female participation in the Canadian labour force from a historic high of 61% to a 30-year low of 55%. At least 1.5 million women lost their jobs within the first two months of the recession, and since the start of the downturn in March **the female unemployment rate has consistently been higher than the male rate**, peaking at 14% in May. According to RBC Economics, this is because a majority of job losses during the pandemic have occurred in female-dominated industries such as food services, retail trade, education services, health care, and social assistance. **While women absorbed 51% of the job losses in March and April, they only accounted for 45% of job gains** in May and June when the economy started to reopen because most of the jobs created were in construction and manufacturing.

- **Preferred shares rallied more than 5% this week** following a ruling from the bank regulator that will permit the issuance of a new product representing **an alternative to exchange-traded, $25-par-value preferred shares**. Based on initial pricing guidance, it appears this new structure will be a lower-cost funding vehicle than $25 preferred shares. Accordingly, we expect to see less preferred share issuance going forward as well as increased redemptions, which we view as **a technical tailwind for preferreds**.

Europe

Thomas McGarrity, CFA & Faisal Manji – London

- **Reports of progress towards the development of COVID-19 vaccines helped lift pan-European equities to their highest point in more than a month** on July 15. AstraZeneca, which is collaborating with the University of Oxford on the development of a vaccine known as AZD1222, gained more than 5% on July 15 following media reports that participants in a Phase 1 trial involving around 1,000 volunteers developed the desired immune response. The data will reportedly be published in the medical journal The Lancet in the coming days.

- From a sector perspective, **vaccine optimism led to cyclicals outperforming** over the past week. Travel & Leisure was the best performer, gaining more than 6% on July 15, led up by airlines, cruise operators, and hotels.

- **European leaders will meet on July 17 to begin two days of talks** on a new long-term EU budget as well as **Next Generation EU**, the proposed €750 billion recovery plan in response to COVID-19. The plan has strong support from France and Germany, but reaching a deal is by no means a forgone conclusion at this weekend's summit. The Netherlands, Denmark, Sweden, and Austria, known as the "frugal four", have been vocal in their scepticism about key aspects of the plan including its size, the way funds are allocated, and the split between loans and grants. Resolving issues around governance and the amount of spending on climate-related projects could help win over the frugal four and pave the way to a final agreement. Whether or not a deal is reached this weekend, we expect an agreement will be achieved in the end.

- **An agreement would be a positive catalyst for the euro**, in our view. Moreover, the step towards **greater fiscal union within the EU** was one of the key factors behind our recent upgrade of European equities to Market Weight.

Asia Pacific

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

- **The Asia-Pacific equity market saw mixed trading** this week despite positive developments regarding vaccines for COVID-19.

- **China's economy grew 3.2% y/y in Q2 2020, recovering from a record 6.8% contraction in the previous quarter** as lockdown measures ended and policymakers stepped up stimulus to combat the shock from the COVID-19 crisis. The growth exceeded the 2.5% forecast of analysts in a Reuters poll. On the other hand, retail sales—a key indication of consumer sentiment—undershot expectations, shrinking 1.8% y/y in June. While the Chinese economy returned to growth in Q2, weaker-than-expected retail sales suggest that the recovery remains uneven and consumer confidence is fragile. **The three major mainland China indexes fell more than 4% on July 16**, the day the news was released. In particular, the CSI 300 Index posted its biggest daily decline since the market reopened in February following the Lunar New Year break. With the recent **criticism from the influential People's Daily, the Communist Party's main newspaper, on liquor producer Kweichow Moutai** (600519 CH), **investors are reminded of the recent efforts by policymakers to cool the Chinese equity market** after retail investors took on the largest amount of leverage in five years to invest in shares.

- Following a surge in new local COVID-19 cases with unknown origins, **Hong Kong once again stepped up social distancing measures** and plans to roll out large-scale testing for high-risk groups. In Japan, **the Tokyo Metropolitan Government raised its alert for infections to the highest level** due to a recent surge in cases in the capital.

- **Singapore's ruling party kept its grip on power but suffered its weakest performance since independence in 1965**. The People's Action Party won 83 of the 93 parliamentary seats. We expect any impact on domestic stock market sentiment to be short-lived. Historically, there is no long-lasting relationship between stock market performance and election results in Singapore. We believe investors will turn their attention towards the Q2 earnings season and the phased reopening of the economy in the coming months.

MARKET SCORECARD

Data as of July 16, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,215.57	3.7%	-0.5%	7.0%	14.9%
Dow Industrials (DJIA)	26,734.71	3.6%	-6.3%	-2.2%	6.7%
NASDAQ	10,473.83	4.1%	16.7%	27.4%	34.2%
Russell 2000	1,467.56	1.8%	-12.0%	-6.0%	-12.6%
S&P/TSX Comp	16,024.50	3.3%	-6.1%	-2.9%	-2.9%
FTSE All-Share	3,454.00	1.3%	-17.7%	-16.4%	-17.5%
STOXX Europe 600	372.13	3.3%	-10.5%	-4.4%	-3.1%
EURO STOXX 50	3,365.35	4.1%	-10.1%	-4.4%	-2.4%
Hang Seng	24,970.69	2.2%	-11.4%	-12.7%	-12.5%
Shanghai Comp	3,210.10	7.6%	5.2%	9.3%	14.1%
Nikkei 225	22,770.36	2.2%	-3.7%	5.7%	0.8%
India Sensex	36,471.68	4.5%	-11.6%	-6.8%	0.4%
Singapore Straits Times	2,623.67	1.3%	-18.6%	-21.9%	-18.8%
Brazil Ibovespa	100,553.30	5.8%	-13.1%	-3.1%	31.2%
Mexican Bolsa IPC	36,465.67	-3.3%	-16.2%	-15.2%	-24.7%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,796.65	0.9%	18.4%	27.8%	44.8%
Silver (spot $/oz)	19.14	5.1%	7.2%	23.0%	21.2%
Copper ($/metric ton)	6,378.75	6.2%	3.7%	6.3%	3.5%
Oil (WTI spot/bbl)	40.75	3.8%	-33.3%	-29.3%	-40.1%
Oil (Brent spot/bbl)	43.28	5.2%	-34.4%	-32.7%	-39.8%
Natural Gas ($/mmBtu)	1.73	-1.4%	-21.2%	-25.2%	-37.4%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.615%	-4.1	-130.2	-148.8	-224.3
Canada 10-Yr	0.505%	-2.3	-119.7	-108.2	-163.3
U.K. 10-Yr	0.139%	-3.3	-68.3	-68.2	-114.1
Germany 10-Yr	-0.465%	-1.1	-28.0	-22.1	-82.8
Fixed Income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.18%	0.7%	6.9%	9.9%	17.7%
U.S. Invest Grade Corp	2.01%	1.8%	6.9%	12.0%	22.4%
U.S. High Yield Corp	6.22%	1.9%	-2.0%	1.7%	9.0%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	96.3080	-1.1%	-0.1%	-1.1%	1.9%
CAD/USD	0.7368	0.0%	-4.3%	-3.6%	-3.2%
USD/CAD	1.3572	0.0%	4.5%	3.7%	3.3%
EUR/USD	1.1384	1.3%	1.5%	1.5%	-2.8%
GBP/USD	1.2553	1.2%	-5.3%	1.2%	-5.2%
AUD/USD	0.6972	1.0%	-0.7%	-0.6%	-6.0%
USD/JPY	107.2800	-0.6%	-1.2%	-0.9%	-4.5%
EUR/JPY	122.1300	0.7%	0.3%	0.6%	-7.1%
EUR/GBP	0.9069	0.1%	7.2%	0.4%	2.5%
EUR/CHF	1.0760	1.1%	-0.9%	-2.8%	-7.8%
USD/SGD	1.3925	-0.1%	3.5%	2.5%	2.2%
USD/CNY	6.9902	-1.0%	0.4%	1.7%	4.5%
USD/MXN	22.4263	-2.5%	18.5%	17.4%	19.2%
USD/BRL	5.3263	-2.6%	32.2%	41.0%	38.0%

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 7/16/20.

Examples of how to interpret currency data: CAD/USD 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD -4.3% return means the Canadian dollar fell 4.3% vs. the U.S. dollar year to date. USD/JPY 107.28 means 1 U.S. dollar will buy 107.28 yen. USD/JPY -1.2% return means the U.S. dollar fell 1.2% vs. the yen year to date.

Authors

Kelly Bogdanova – San Francisco, United States
kelly.bogdanova@rbc.com; RBC Capital Markets, LLC

Alan Robinson – Seattle, United States
alan.robinson@rbc.com; RBC Capital Markets, LLC

Meika McKelvey – Toronto, Canada
meika.mckelvey@rbccm.com; RBC Dominion Securities Inc.

Sayada Nabi – Toronto, Canada
sayada.nabi@rbc.com; RBC Dominion Securities Inc.

Mikhial Pasic, CFA – Vancouver, Canada
mikhial.pasic@rbc.com; RBC Dominion Securities Inc.

Thomas McGarrity, CFA – London, United Kingdom
thomas.mcgarrity@rbc.com; RBC Europe Limited

Faisal Manji – London, United Kingdom
faisal.manji@rbc.com; RBC Europe Limited

Jasmine Duan – Hong Kong, China
jasmine.duan@rbc.com; RBC Investment Services (Asia) Limited

Nicholas Gwee, CFA – Singapore
nicholas.gwee@rbc.com; Royal Bank of Canada, Singapore Branch

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As of June 30, 2020

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Hold [Sector Perform]	635	42.25	130	20.47
Sell [Underperform]	92	6.12	12	13.04

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