August 27, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

Signs of strain

Frédérique Carrier – London

With the Trump administration taking a tough stance on trade issues, tensions between the U.S. and China remain high despite recent hopes of progress. We look at the prospects for China's economic recovery from COVID-19 and the potential impacts of the U.S. elections on the economic superpowers' complex and evolving relationship.

Tension headache

The headlines about U.S.-China trade relations seemed encouraging early this week. Both sides expressed optimism on the Phase 1 trade deal as they held the first direct call between trade officials since the deal was signed early this year.

But despite this progress, U.S.-China relations remain under stress. Two days after the call, the Chinese military fired two missiles into the South China Sea. The move came after China said a U.S. U-2 spy plane entered a no-fly zone without permission during a Chinese live-fire naval drill in the Bohai Sea off its northern coast. The U.S. confirmed a U-2 flight in the region, but said it did not violate international rules.

The sources of friction between both countries are deeply engrained, and the conflict has moved past tough rhetoric. Observers in both the U.S. and China now talk of the potential decoupling of the two countries' economies, going well beyond the rejigging of supply chains. Recent actions point to attempts to sever more commercial ties between the two countries, particularly in the tech industry.

Citing national security concerns related to the use of U.S. citizens' personal data, President Trump recently issued executive orders that would effectively ban two highly popular Chinese apps in mid-September. TikTok, a video sharing app, would be banned unless its U.S. operations are sold to a U.S.-based firm. WeChat is a "super-app" used by more than 1.2 billion people worldwide that integrates payment services and

Key disagreements

Sources of friction

The U.S.'s complaints about China		China's complaints about the U.S.	
Trade surplus	**Capital controls**	**Tariffs**	**Control of global order:**
State-owned enterprises	**COVID-19 origin**	**Pacific clout**	World Bank
Joint venture requirements	**Hong Kong repression**	**Hong Kong interference**	World Trade Organization
Intellectual property theft	**Challenging global order**		United Nations
			International Monetary Fund
			G7

Source - RBC Global Asset Management

Market pulse

Click here for authors' contact information. Priced (in USD) as of 8/27/20 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

e-commerce with messaging to operate like a combination of Amazon, Facebook, WhatsApp, PayPal, and more. Tencent, the owner of WeChat and China's largest tech company, has filed a lawsuit in the U.S. seeking to block the executive order. Beijing already censors most foreign-operated social media apps.

Moreover, the Trump administration has suggested it would make it tougher for Chinese companies to be listed on U.S. stock exchanges. Proposals suggest Chinese companies would be forced to delist from U.S. exchanges unless they give American regulators full access to audit them.

There is little doubt that these bans, in addition to other measures taken over the past two years including tariffs and the Huawei ban, would result in economic losses for China. But the measures could also be costly for U.S. firms, which generate some five percent of their overall global revenues in China—an economy that has grown faster than their domestic market for years. In some sectors, such as Information Technology, the Chinese market has grown five times faster than the U.S. market.

Would Biden change the U.S.-China dynamic?

President Trump's unconventional approach to trade relations has raised tensions with China, but we would not expect a wholesale change in strategy if his administration were replaced in the upcoming elections, as there is bipartisan appeal to being tough on China.

China, for its part, seems to be preparing for years of acrimony, according to RBC Wealth Management Equity Analyst Jasmine Duan in Hong Kong. Perhaps spurred by the recent floods which have devastated a large swathe of the country, authorities recently launched a "no food waste" campaign; this may signal that the country is girding itself for a lasting economic decoupling and attempting to manage its reliance on U.S. agricultural imports.

While the U.S. may maintain pressure on China, we believe further escalation of the conflict is less likely under a Democratic administration. Moreover, the messaging of U.S. policy vis-à-vis China could become more predictable, which could help to reduce tensions. We also see a lower probability that Chinese shares would be delisted under a Biden administration.

Is China's economic rebound moderating?

For now, China is managing a good recovery from the COVID-19 crisis. Its GDP grew 3.2 percent year over year in Q2, a remarkable bounce after a 6.8 percent contraction in Q1. The figure stood out as the rest of the world reported economic contractions in the same period. China was helped by the fact that it clamped down on the virus earlier than other countries via strict quarantines, as well as by its relatively lower exposure to the sectors most affected by the virus, namely tourism and entertainment.

China's recovery is the mirror image of that in the U.S., in that China's industrial sector has shown its resilience as the authorities pumped credit into it, while consumer demand has only partly recovered. RBC Global Asset Management Inc. Chief Economist Eric Lascelles thinks that "each country is playing to its strengths, with the almighty U.S. consumer proving resilient and the legendary Chinse manufacturing base doing likewise."

But after the initial V-shaped bounce, Chinese economic data moderated in July. Industrial production remained five percent higher than a year previously, though it dropped a little compared to the preceding month. Retail sales also declined, by one percent year over year, after increasing in June. August data suggests the moderation continues.

The worst flooding in decades is affecting up to a dozen Chinese provinces, threatening agriculture and putting infrastructure projects on hold. This should be a temporary impact, and we expect economic activity to pick up after the floodwaters recede.

Lascelles expects that growth will be underpinned by the authorities' stimulus activity, which has evolved into targeted measures to help selected sectors. He expects China's GDP to grow by just over one percent this year, and as much as eight percent in 2021 as the economy continues to recover lost ground with support from sustained stimulus. Estimates are fluid, however, and much will depend on flooding, COVID-19, and the evolution of the U.S.-China relationship.

China equities strategy

Chinese equities enjoyed a strong rally from the end of March to early July as the country experienced an economic renewal, but they have been range-bound since as tensions unfurled.

We continue to have an Overweight position in Asia Pacific ex Japan, thanks mostly to China. The country is managing a sound, if moderating, recovery and Q2 corporate earnings so far have surprised on the upside. Valuations are still attractive relative to other emerging markets on most metrics. We would nevertheless have a bias toward those Chinese stocks that focus on the domestic market, given the country's emphasis on stimulating domestic demand and the risk that a continued antagonistic relationship with the U.S. could give rise to more volatility, particularly in the Technology sector.

United States

Alan Robinson – Seattle

- U.S. stocks inched higher again during the week as the trajectory of COVID-19 cases continued to grind lower. However, **RBC Capital Markets, LLC Technical Strategist Bob Dickey cautioned that "signs of a market peak are growing** as the number of speculative call option buyers hit levels not seen for over 10 years." He expects the largest correction risk in the most extended stocks, many of which are attracting breathless media coverage.
- **S&P Dow Jones Indices announced a planned shake-up in the 30-stock Dow Jones Industrial Average (DJIA), triggered by Apple's (AAPL) planned 4-for-1 stock split.** The index will add salesforce.com (CRM), Amgen (AMGN), and Honeywell (HON), and remove Exxon Mobil (XOM), Pfizer (PFE), and Raytheon (RTX), with the aim of **adding different types of stocks that better reflect the U.S. economy**. Since the DJIA is price-weighted, the split-related reduction in Apple's share price will reduce the index's exposure to the Information Technology sector, but will not affect Apple's total market value.
- Separately, **Apple's new iOS 14 operating system** to be rolled out in the fall will add restrictions on data that make it harder to serve iPhone users with targeted ads. This will likely **negatively impact ad-based revenues for companies including Facebook (FB) and Alphabet (GOOGL)**, who have complained about the move.
- **Hurricane Laura roared ashore on the Gulf Coast** midweek as a category 4 storm, and the most powerful storm to hit the Texas-Louisiana border since 1856. Although it was too early to assess damage at time of press, we note oil prices remain near five-month highs as traders anticipate disruptions to energy infrastructure in the Gulf Coast region. RBC Capital Markets, LLC Commodity Strategist Michael Tran noted that **oil prices have moved steadily higher as the economy recovers and the dollar falls, and that any supply constraints may increase volatility in the oil market**, which has been rather quiet over the summer. The National Oceanic and Atmospheric Administration expects an "extremely active" hurricane season this year, with 19–25 named storms.

Impact of Hurricane Laura may stir the oil market

West Texas Intermediate front contract

Source - Refinitiv, RBC Wealth Management; data through 8/25/20

Canada

Richard Tan, CFA – Toronto

- **The Canadian banks reported fiscal Q3 2020 earnings** that were, on average, better than feared. **The strength of the banks' capital levels has been a key focus among investors** because in many ways it signals a bank's ability to weather an unforeseen economic shock (e.g., COVID-19). In the early days of the pandemic, we highlighted that capital positions were in a far stronger position compared to the global financial crisis in 2008–2009, which led us to believe the Canadian banks should be able to maintain their respective dividend programs. Post the Q3 results, we were pleased to see that, on average, capital levels experienced **a modest improvement sequentially and year over year.**
- Another important topic has been the notion of credit provisioning. In other words, **have the banks built up sufficient reserves to combat the rise in loan losses?** The short answer is that it remains a fluid situation but, with the economy slowly recovering, **it's possible they posted peak credit provisions in Q2 2020.**
- Overall, the Canadian banks are economically sensitive vehicles given their critical role within commerce. **We expect interest rates to stay low for the foreseeable future** as reinforced by the U.S. Federal Reserve and the Bank of Canada which will, in turn, pressure net interest margins. We've seen some relative strength in precious metals and technology stocks as of late, which has caused the Canadian banks to lag the S&P/TSX Composite year to date by comparison. However, bank valuations are not demanding compared to their long-term averages, and **we believe the dividend yields are also attractive in the current environment** especially in the context of the extremely low yield environment.

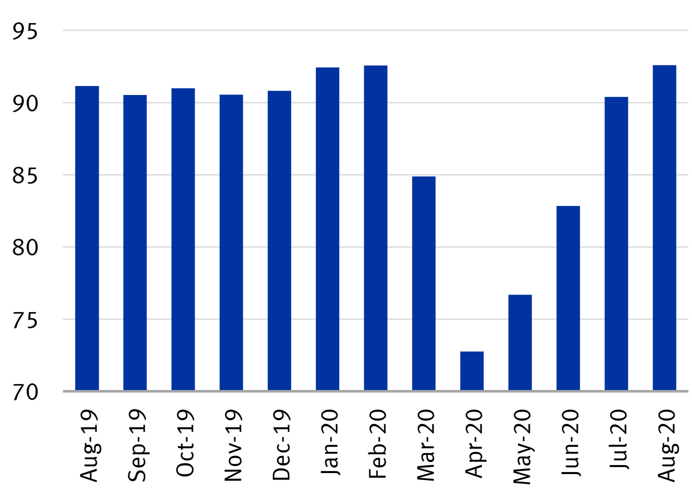
Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- The top-performing stock across both the pan-European STOXX Europe 600 Index and the UK's FTSE 100 Index was **engineering software company AVEVA Group, up 21% over the past week, following its announcement that it is acquiring U.S.-based OSIsoft** for an enterprise value of $5 billion. Management expects the deal to be accretive to AVEVA's growth trajectory as well as diversify its industry and geographic end-market exposure.
- **Shares of global consumer internet group Prosus rose 15%** in the days following a Bloomberg report on August 21 that the **Trump administration had signalled U.S. companies could continue to do business with Tencent's WeChat app in China**. Prosus owns a 31% stake in Tencent. Separately, Prosus is one of the stocks that is likely to enter the eurozone's blue-chip EURO STOXX 50 Index in the annual benchmark review in September.
- **Encouraging data related to the development of vaccines and therapies for COVID-19 helped boost the travel and leisure subsector**, which rose 4.5% during the week, led by airlines. Other cyclical subsectors, such as autos, chemicals, and industrial goods and services, also outperformed.
- In addition to positive news on the vaccine front, European cyclicals benefitted from **German Chancellor Angela Merkel agreeing to extend Germany's wage-support program until the end of 2021**. This follows the moves of other major euro area countries, such as France, Spain, and Italy, which have already extended their wage-support schemes, as the region looks to stave off the prospect of mass unemployment as an impediment to its post-pandemic recovery.
- **Encouragingly, the ifo business survey for Germany (monthly survey of 9,000 German companies) continued to rebound**, with the headline Business Climate Index rising to 92.6 points in August from 90.4 in July. Companies in the survey assessed their current business situation "markedly more positively" than last month, though this component remains low in a historical context, while their expectations were also slightly more optimistic.

German business sentiment shakes off spring woes

German ifo Business Climate Index



Source - ifo Institute, FactSet monthly data, RBC Wealth Management

Asia Pacific

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

- The Asia-Pacific equity market traded mostly higher during the week, led by Thailand and Vietnam. **The MSCI Asia ex Japan Index managed to push ahead and trade at its highest level since early 2018.** The positive sentiment was partly driven by signs of progress (or the lack of deterioration) in U.S.-China trade talks. The rally took a breather midweek following a mixed bag of macroeconomic data.
- **Senior trade officials from the U.S. and China spoke by telephone** this week and affirmed the progress made in the Phase 1 trade deal. The Chinese side called the talk **"a constructive dialogue."** The discussion came despite the world's two largest economies sparring over a slew of other issues, including technology and national security. Notwithstanding the tit-for-tat actions, we believe the two countries have an interest in maintaining stable economic relations, and have a history of continuing those ties even in the face of other contentious issues.
- Japanese Prime Minister Shinzo Abe became the country's longest-serving prime minister in terms of consecutive days in office. Public opinion of the Abe administration's handling of the COVID-19 outbreak and the associated economic downturn has faltered. **Meanwhile, concerns over Abe's health have re-emerged following his recent visits to the hospital.** Abe's second hospital visit within days sparked concern that he may step down before the end of his term. In that event, we think Japan equities may temporarily correct, and that subsequent market trends would depend on his successor's policies.
- **Ant Financial**, the payment- and finance-focused sister company of Alibaba (BABA US), **filed papers to go public in a dual listing in Shanghai and Hong Kong**. The filings did not indicate how much it hopes to raise through the share sales.

MARKET SCORECARD

Data as of August 27, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,484.55	6.5%	7.9%	21.4%	20.3%
Dow Industrials (DJIA)	28,492.27	7.8%	-0.2%	10.5%	9.4%
NASDAQ	11,625.34	8.2%	29.6%	48.5%	45.0%
Russell 2000	1,564.56	5.7%	-6.2%	7.5%	-9.5%
S&P/TSX Comp	16,731.49	3.5%	-1.9%	3.4%	1.7%
FTSE All-Share	3,357.92	2.3%	-20.0%	-13.9%	-19.5%
STOXX Europe 600	370.72	4.0%	-10.9%	-0.8%	-3.9%
EURO STOXX 50	3,331.04	4.9%	-11.1%	-1.2%	-3.6%
Hang Seng	25,281.15	2.8%	-10.3%	-1.5%	-10.6%
Shanghai Comp	3,350.11	1.2%	9.8%	15.4%	20.5%
Nikkei 225	23,208.86	6.9%	-1.9%	13.5%	1.8%
India Sensex	39,113.47	4.0%	-5.2%	3.9%	1.1%
Singapore Straits Times	2,519.81	-0.4%	-21.8%	-17.9%	-21.9%
Brazil Ibovespa	100,623.60	-2.2%	-13.0%	3.4%	29.1%
Mexican Bolsa IPC	37,647.19	1.7%	-13.5%	-7.4%	-25.3%

Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot $/oz)	1,928.42	-2.4%	27.1%	25.0%	59.2%
Silver (spot $/oz)	26.99	10.7%	51.2%	48.3%	81.2%
Copper ($/metric ton)	6,615.00	3.0%	7.6%	16.8%	8.6%
Oil (WTI spot/bbl)	43.04	6.9%	-29.5%	-21.6%	-37.5%
Oil (Brent spot/bbl)	45.13	4.2%	-31.6%	-24.2%	-40.8%
Natural Gas ($/mmBtu)	2.58	43.4%	17.8%	17.1%	-10.3%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.751%	22.2	-116.7	-72.1	-209.5
Canada 10-Yr	0.664%	19.7	-103.8	-46.1	-163.3
U.K. 10-Yr	0.336%	23.2	-48.6	-16.6	-94.2
Germany 10-Yr	-0.407%	11.7	-22.2	28.6	-78.3

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.17%	-0.8%	6.9%	6.5%	17.3%
U.S. Invest Grade Corp	1.97%	-1.3%	7.0%	7.4%	21.7%
U.S. High Yield Corp	5.40%	0.7%	1.4%	4.7%	11.3%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	93.0020	-0.4%	-3.5%	-5.1%	-1.9%
CAD/USD	0.7618	2.2%	-1.0%	1.2%	-1.2%
USD/CAD	1.3123	-2.2%	1.0%	-1.2%	1.2%
EUR/USD	1.1822	0.4%	5.4%	6.6%	1.2%
GBP/USD	1.3206	0.9%	-0.4%	7.5%	2.4%
AUD/USD	0.7258	1.6%	3.4%	7.5%	-1.3%
USD/JPY	106.5800	0.7%	-1.9%	0.8%	-4.1%
EUR/JPY	126.0000	1.0%	3.5%	7.4%	-2.9%
EUR/GBP	0.8953	-0.5%	5.8%	-0.8%	-1.2%
EUR/CHF	1.0747	-0.1%	-1.0%	-1.3%	-6.1%
USD/SGD	1.3662	-0.6%	1.5%	-1.7%	0.3%
USD/CNY	6.8941	-1.2%	-1.0%	-3.7%	1.2%
USD/MXN	22.1518	-0.6%	17.0%	10.8%	18.0%
USD/BRL	5.5641	6.6%	38.1%	47.3%	36.3%

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 8/27/20.

Examples of how to interpret currency data: CAD/USD 0.77 means 1 Canadian dollar will buy 0.77 U.S. dollar. CAD/USD -1.0% return means the Canadian dollar fell 1.0% vs. the U.S. dollar year to date. USD/JPY 106.58 means 1 U.S. dollar will buy 106.58 yen. USD/JPY -1.9% return means the U.S. dollar fell 1.9% vs. the yen year to date.

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As of June 30, 2020

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Rating	Count	Percent	Count	Percent
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Hold [Sector Perform]	635	42.25	130	20.47
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