Wealth Management
Dominion Securities

Wealth Management
Review

COVID-19 UPDATES > www.rbcwealthmanagement.com | October 2020

Levelling off

By Jim Allworth

The economy continued its V-shaped recovery over the summer and, until recently, so did much of the stock market. However, starting in September, several indexes including those of Canada, the U.S. and Japan peaked and have been consolidating or correcting for several weeks. Europe's market began its consolidation back in July, while the U.K. market, encumbered with a new Brexit deadline, has been losing ground since June.

While the economy continues to post mostly strong numbers, we expect the coming months will see the dynamic "re-start" phase give way to an extended stretch of more grudging growth. That translates into the year-over-year GDP comparisons looking quite strong out to the third quarter of 2021 but the much more closely watched quarter-over-quarter growth rates looking much bumpier and less convincing.

Just as was true in the quarters and years following the last recession, which was over by the third quarter of 2009, we expect all economic data in 2021 and probably 2022 will be viewed within the context of a vocal debate about whether the current downturn has ended or not, closely followed by speculation about whether a "double dip" recession is in the offing. As things stand, that's not what we expect. Rather we see the slower, bumpier growth of next year allowing the economies of both the U.S. and Canada to regain their late 2019 high-water marks by mid-2022 and their previous trajectory some time in 2023.

Earnings are likely to follow the same path. For this year, we look for S&P 500 earnings per share to come in at something less than $130, down sharply from last year's $163 per share. For 2021, we see earnings rebounding to $155 with $170 our forecast for 2022. All of our earnings estimates are lower than the current general consensus.

With 2021 projected earnings, by our reckoning, not back to their 2019 peak but the U.S stock market averages trading recently above their 2019 highs, the argument can be made the U.S. market is excessively valued. The Canadian market, still well below its December 2019 highs, not so much.

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2.3 million litres of water

17,000 kg. of waste

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Levelling off

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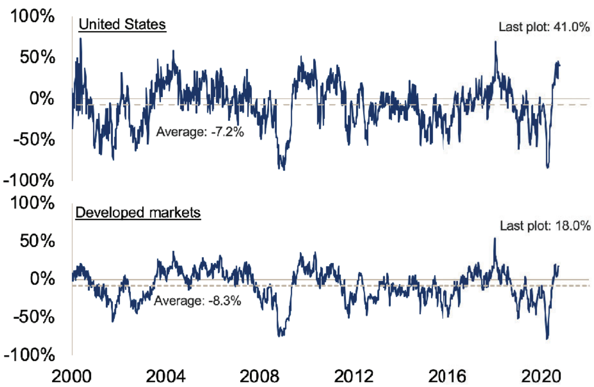
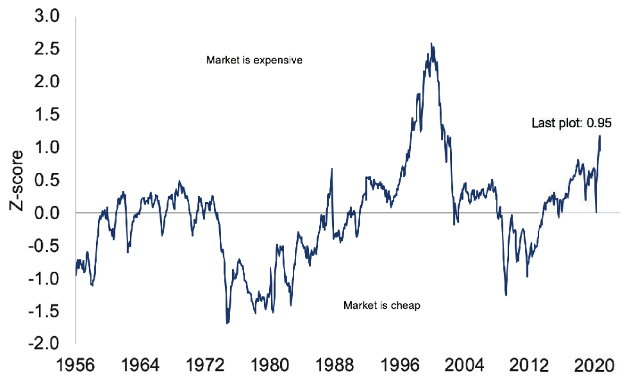
Chart 1: % of companies with upward earnings revisions – Percent balance



Source: Citi, RBC. As of September 21, 2020.

Chart 2: S&P 500 Index – Average of normalized valuation metrics



Notes: Historical data from Jan 1956 for 12-M Trailing P/E, 12-M Forward P/E, Equity risk premium, Shiller P/E, Tobin's Q and Fed model. Historical data from Mar 1956 for market cap ÷ U.S. GDP. Historical data from Jan 1960 for RBC GAM fair value.

Source: Haver Analytics, RBC CM, RBC GAM.

Reconciling valuations

However, there is a reconciling factor at play: corporate bond yields are about 15% lower than they were at the beginning of the year, making the discounted present value of future S&P 500 earnings that much more valuable. Overall stock market valuations are not scarily expensive but they are certainly not cheap. In our view they are likely to remain more richly valued for an extended time for several reasons:

- Central banks, led by the Fed, are committed to ultra-low short-term interest rates out through 2023, probably much longer. The Fed likely would also act to prevent long-term rates from moving high enough to threaten the recovery. This commitment dramatically reduces the risk of widespread corporate insolvencies among public companies and correspondingly supports equity valuations.

- We do not expect a big withdrawal of fiscal support as long as unemployment remains high and social distancing remains the order of the day, with its deeply constraining impact on some significant parts of the economy.

- Second wave increases in the number of new COVID-19 cases notwithstanding, it is fair to say considerable progress has already been made in mitigating the most damaging physical effects of the virus. One doesn't have to be a wild-eyed optimist to expect more progress to arrive over the coming year, permitting further reductions in social and business constraints and adding to both normalcy and the certainty of growth.

We expect the rocket ride the stock markets enjoyed off the depressed March lows is unlikely to be repeated in the coming months and quarters. The broad market averages, already correcting, could be in for a longer stretch of consolidation as conflicting economic forces play out.

Larger forces at work

Beyond the pandemic, economic growth in the developed economies is likely to be slower than even the subdued growth of the past decade. The non-partisan Congressional Budget Office, which regularly prepares long-term forecasts for the U.S. economy – and has compiled an enviable track record – in a September report estimates that the annual potential growth rate for the U.S. economy for the coming decade is 1.8% versus the 2.3% achieved from 2010 to 2019.

This further slowdown is the result of very slow growth in the working age population which leaves all of the heavy lifting to productivity increases – a notoriously difficult factor to forecast. Virtually all the developed economies including China are faced with the same set of challenging circumstances.

This argues for a more intensely competitive corporate and business environment. From a portfolio management standpoint, it puts a premium on seeking out those businesses able to grow their sales, earnings and dividends faster than the GDP of the major economies. Those companies' shares may become available at more attractive prices during a period of market correction/consolidation like the one we may be entering.

For more thoughts on our outlook for the economy and financial markets, ask for our most recent issue of *Global Insight Monthly*.

Jim Allworth is co-chair of the RBC Global Portfolio Advisory Committee.

Caring is preparing

Planning your health and wealth in the COVID-19 era

After months of self-isolating at home, and spending more quality time with our closest friends and family, we've all had plenty of time to ponder our priorities in life. In the wake of the COVID-19 pandemic, we may be asking ourselves fundamental questions about what's really important to us. How do we want to live our lives in this strange "new normal" we find ourselves in? How do we want to help our families, now and after we are gone? How do we want to do things differently when the pandemic is over?

And then there are questions about how we manage our health-care needs, both now and in the future. Few of us have been unaffected by the pandemic, whether we've changed our daily routines to help reduce the spread of the virus, or we've experienced first-hand the effects of the virus on ourselves or someone dear to us. During these times, it's difficult not to think about our own mortality or vulnerability – subjects that just a few months ago might have seemed less urgent, perhaps even taboo, and quite possibly something that could be put off until "later." Now, many of us are thinking about our own plans for later in life, and what we can do to get things organized for our families or loved ones. Our thoughts may have turned to our older family members, and what plans they may have in place, and the roles we may have in those plans.

Helping older Canadians plan for their later years

At RBC Wealth Management, we have heard from our clients that these issues are becoming increasingly important – and not just to retirees and those later in life. Recently, we formed a partnership with the National Institute on Ageing (NIA) at Ryerson University to help our clients, and Canadians more generally, prepare for the financial and health issues that will challenge them in their later years.

"COVID-19 is a wake-up call for all Canadians to prepare or update their personal and financial affairs," says Leanne Kaufman, president and CEO of RBC Royal Trust, a division of RBC Wealth Management. "This partnership with the NIA will enhance our ongoing mission to educate older Canadians and their families on the need for sound, long-term financial planning."

While the pandemic has brought financial and health issues facing older Canadians to the forefront, it's something we should address even during "normal" times, and ideally when we're younger and still in relatively good health. Yet, it's something we tend to put off. According to the NIA, 86% of Canadians haven't heard about advanced-care planning, a process which helps us determine how we want to receive medical treatment and personal care. And less than half of Canadians have even had a conversation with someone they trust about this important subject. A key component of advanced-care planning is having a signed power of attorney, or *mandate* in Quebec, in place – and that's something that 71% of Canadian adults don't have.[1]

Through our partnership with NIA, we hope to raise awareness of such issues, and help Canadians take steps to address them – even now, or maybe especially now, during the COVID-19 pandemic.

Advanced-care planning

Through advanced-care planning, you can address important issues related to your later years. Here are some key questions to consider:

- *Where and how do you want to receive the care you may need?* For example, you may wish to receive specialized care in a private facility, or, like many Canadians, stay in your home for as long as possible. "Because we're living longer lives, you could still expect, for any given situation, that you'll spend 10, 15 years, where you'll need some

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level of care," says Michael Nicin, executive director at the NIA. "No one goes from being ... fully independent and healthy into a nursing home. There's usually a progression, and it might start with a few hours of home care."

- *How will you fund it?* You may wish to build a dedicated fund for this purpose, or set aside part of your wealth. Alternatively, an insurance policy solution may be a cost-effective way to fund your future care needs. "Depending on your situation, you may be able to take out disability, critical illness or long-term care insurance that can provide lump-sum payments to fund your care needs as you see fit, while you reserve your investment portfolio and other assets for your retirement or estate," says John Hamilton, President of RBC Wealth Management Financial Services.

- *What if you can't make decisions for yourself?* It's important to discuss with your loved ones what you wish to happen regarding your care and your property in the event you are unable to make these decisions yourself. You should also ensure that you name a power of attorney (known as a *mandatary* in Quebec) who is legally authorized to make financial and/or care decisions on your behalf. As mentioned above, only 29% of Canadians have named a power of attorney, which is something you would typically do at the same time as you write or update your Will. If you haven't named one yet, or it's been a while and things have changed, you should consider who will act as your power of attorney – and ensure it is properly documented.

We're here to help

Helping you manage your finances and investments is an important part of what we do at RBC Wealth Management. But your Investment Advisor can also provide you with access to a wide range of services to help round out your overall wealth management plan, including retirement, health-care and estate planning. If you're reflecting on some of these issues now – as many of us are during these strange and challenging times we find ourselves in – please feel free to reach out to your Investment Advisor.

[1]LawPRO, "Survey: More than half of Canadians do not have a signed will," May 7, 2012 (https://www.newswire.ca/news-releases/survey-more-than-half-of-canadians-do-not-have-a-signed-will-510187441.html)

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