December 17, 2020

RBC WEALTH MANAGEMENT

Global Insight

Weekly

Settling in for the long haul

Atul Bhatia, CFA – Minneapolis

A dark year is giving way to a brighter outlook as the calendar turns, and the Fed has made clear its accommodation will be a way of life for the economy and markets. We look at what's behind the Fed's thinking, the fiscal stimulus that's coming into view, and what this all means for investors.

The Federal Reserve made no significant policy moves in its December meeting. Instead, the Fed's policy statement emphasized the semi-permanent nature of existing accommodation, saying that "substantial further progress" on employment and inflation creation was required before monetary support could be withdrawn. In particular, the central bank plans to continue buying at least $120 billion of Treasury and Agency bonds per month and expects to hold rates near zero through at least 2023.

Not just one recovery, but several

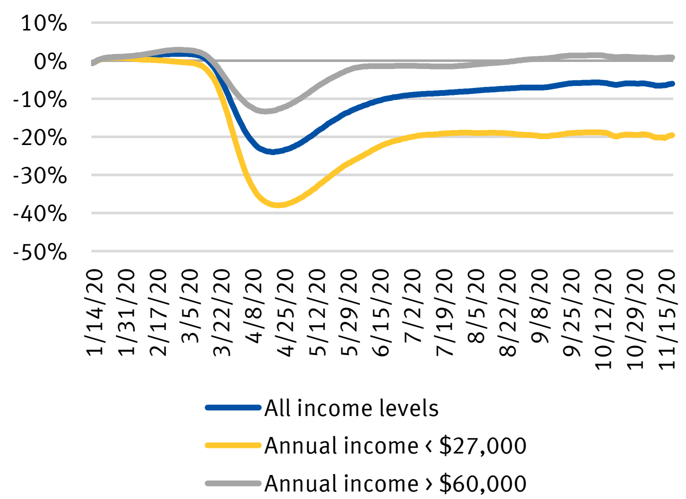
Investors looking at near-record levels in equity and bond indexes may wonder why the Fed is emphasizing the need for substantial additional progress, or why there is even discussion of bringing bond yields lower now that the vaccine has arrived.

The answer lies in the uneven nature of the recovery and the near-crisis levels that are still impacting large swaths of the economy.

Looking at the nationwide unemployment rate, the data shows a rapid—and faster-than-initially expected—drop from 14.7 percent in April to the current 6.7 percent. But that aggregation masks a very different job picture for low- and higher-wage workers. Paycheck and time card data, for instance, show that since January, there has been a small net employment increase for workers making at least $60,000/year; at the other end of the scale, workers making less than $27,000/year—who represent nearly 40 percent of the U.S. labor force—continue to suffer a near 20 percent drop in employment.

Large divergence in jobs recovery

Change from January 2020 employment by income category



Source - Opportunity Insights, Intuit, Paychex, Earnin, Kronos; data through 11/19/20

Market pulse

The next edition of the Global Insight Weekly will be published on January 7, 2021.

Click here for authors' contact information. Priced (in USD) as of 12/17/20 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

For companies, there is a similar split in conditions when it comes to financing availability.

The Financial Conditions Index, a composite of public market indicators, demonstrates the rapid improvement in financial terms for large companies with access to markets. Bond markets are setting records for issuance amounts and coupon levels across the credit spectrum.

For businesses that rely primarily on bank financing, however, the picture is reversed, with the last reported data showing that as recently as October, 40 percent of banks were tightening borrowing standards.

These fault lines in the recovery go a long way to explaining the apparent contradiction between the Fed's insistence on the need for further substantial improvement in the economy and its failure to announce any policy initiatives. The tools it has are ill-suited to addressing individual business loan decisions by banks or to providing direct economic relief to unemployed workers. What the Fed can do—improve market financing conditions—it has done, but that is not a panacea.

We believe that despite inaction at this policy meeting, the Fed will eventually modify its Treasury purchase program to emphasize longer-maturity bonds, most likely in an attempt to help offset upward rates pressure as the recovery accelerates in the second half of 2021. If, on the other hand, there were a step back in the recovery, we would expect the Fed to increase the dollar amount of its purchases.

Fiscal policy to the rescue?

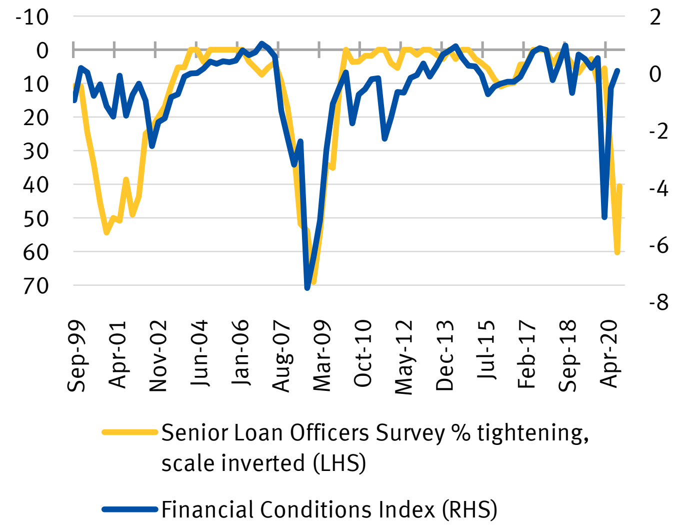
While the Fed deferred action this week, congressional negotiators may have finally reached a compromise on a fiscal spending package for COVID-19 relief. As of this writing, there is no official deal, but the contours are coming into view: a one-time stimulus check for all Americans; a continuation of some or all of the existing federal unemployment benefits; funding for vaccine distribution; and additional targeted funding. The total package is likely to be less than the $908 billion of the original bipartisan proposal, as it appears negotiators have agreed to defer discussion of both federal limits on COVID-19 litigation and $165 billion of aid to states and municipalities, according to a Bloomberg report.

The surviving provisions focus on areas where monetary policy necessarily falls short. In particular, the stimulus checks and ongoing unemployment assistance may help maintain consumer spending until mass vaccination is available and normal economic activity resumes.

Although recent public comments are optimistic, Congress has engaged in sporadic negotiations on stimulus for months without success and the current deal optimism may prove misplaced.

Divergent financial conditions

Market-based finance measures show easy conditions; bank lending increasingly difficult



Source - Federal Reserve Board, Bloomberg, RBC Wealth Management; financial conditions data through 12/16/20; SLO Survey data through 10/31/20

Forest for the trees

Fiscal stimulus would certainly be of near-term benefit to the economy, but even without new legislation, we believe it's critical for investors to focus on the powerful tailwinds supporting markets:

- **An accommodative Fed:** The reality is that the Fed is not raising rates for years. The central bank raised its growth and inflation estimates at this meeting but chose instead to emphasize how much more is required before it pulls back on easy money policy.
- **Pent-up demand:** Personal savings have nearly doubled in 2020 and are up by almost $1.2 trillion year to date. A return to normalcy has the potential to unlock some or all of these pandemic-related savings.
- **A weaker dollar:** The nearly 10 percent drop in the U.S. Dollar Index since May helps companies on many levels, particularly large multinationals and commodity producers. The decrease in currency value can make debt repayment easier and contributes to revenue growth.

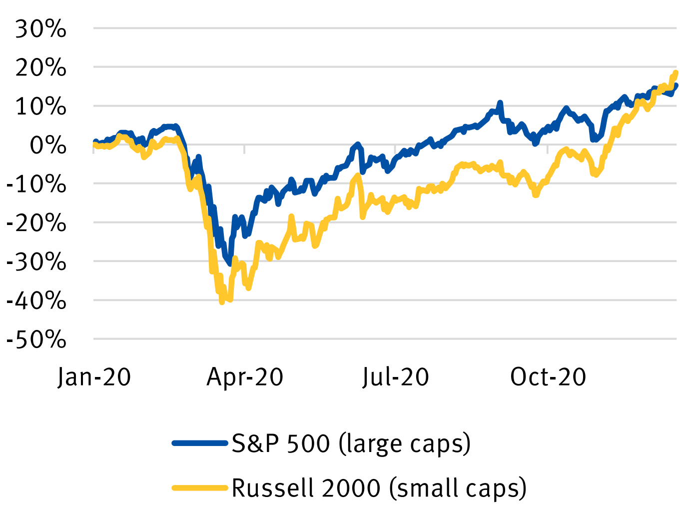
United States

Kelly Bogdanova – San Francisco

- **The U.S. equity market continues to push higher** on stimulus hopes and vaccine optimism, with the S&P 500 jumping 1.6% so far this week, reaching a new record level. **Growth stocks, including those in the Tech sector, regained momentum**. The Tech catalyst was a report by Nikkei Asia, and repeated by U.S. media outlets, about Apple's 20% increase in its iPhone production targets for 2021 compared to 2019 levels.
- **Softer economic trends, mainly due to renewed COVID-19 shutdowns, caught our attention**. Retail sales and the New York region's manufacturing data fell shy of consensus forecasts, while weekly jobless claims were lofty again. But concerns about the economy were offset by expectations that another fiscal stimulus deal would be reached sooner rather than later. If fact, the weaker data provide incentives for Washington to act.
- **The S&P 500 is on track for its fifth weekly gain in seven weeks**, and has risen 13.8% since early November. Small-capitalization stocks have fared even better, with the Russell 2000 rallying 28.6% during the same period. **U.S. equity indexes' strong rallies lately and their torrid runs since the COVID-19 lows in March raise questions about the sustainability of the moves**. RBC Capital Markets, LLC Technical Strategist Bob Dickey anticipates a pullback over the near term, potentially in January. He cites these warning signs: elevated call option buying, record-low shorting in the S&P futures market, an upswing in IPOs, increased participation of new and smaller investors, and greater optimism of investors overall.

After lagging all year, U.S. small-capitalization stocks have overtaken large caps

Year-to-date performance



Source - RBC Wealth Management, Bloomberg; data through 12/17/20

- **If a near-term setback materializes, we think the market should be able to get back on its feet**. Both the economic and earnings recoveries should persist in 2021 as the virus is tamed, and with the help of safety nets provided by ongoing supportive monetary and fiscal policies. The $169 per share consensus forecast for the S&P 500, based on Refinitiv I/B/E/S data, seems reasonable to us, and would provide roughly 20% y/y earnings growth, depending on where the final 2020 earnings data shake out. While we think some of this earnings optimism is priced into the market, we doubt that all of it has been, and **we see scope for earnings to beat expectations if the economic rebound gains momentum**.

Canada

Sayada Nabi & Richard Tan, CFA – Toronto

- As 2020 rolls to an end, we believe most investors will be happy to note that the **S&P/TSX Composite is poised to close the year in positive territory**. From a sector performance standpoint, the market remains dislocated with Technology and Materials leading the charge while Health Care and Energy emerge as relative underperformers on a year-to-date basis. However, the recent risk-on environment driven by positive vaccine news has led to **a rotation from growth to value stocks and from defensive names to cyclicals**. Incrementally, we see this shift favouring the Financials, Energy, Industrials, and Consumer Discretionary sectors. While we believe the economic outlook has improved, we also believe it's important to recognize all the remaining challenges (e.g., the current viral wave, vaccine distribution, and the January runoff elections for the U.S. Senate in the state of Georgia) that could disrupt the current flow of the markets. Overall, we're comfortable **increasing the economic sensitivity of portfolios** but would recommend doing so in phases.
- Vaccine developments have stoked optimism that a return to normalcy lies somewhere on the horizon. For many Canadian businesses, the near future is still cloudy as recent regional restrictions have disrupted activity for restaurants, gyms, and non-essential retailers. The Canadian government's fiscal response to the pandemic, notably the Canadian Emergency Wage Subsidy (CEWS), provided **CA$53 billion in support from mid-March to August which limited early waves of bankruptcies**. Unsurprisingly, the hospitality sector leaned on this program the most and CEWS covered 46% of the wages in accommodations and food services during that period. According to RBC Economics, while the fiscal support is helpful, it will not be sufficient to save all businesses, and bankruptcies should be expected to inch higher. **We believe businesses that are able to survive into the second half of 2021 will benefit from pent-up consumer demand**; according to RBC Economics,

Canadian households will have accumulated approximately CA$200 billion in unplanned savings by the end of 2020, and come 2021 they will be looking for opportunities to spend.

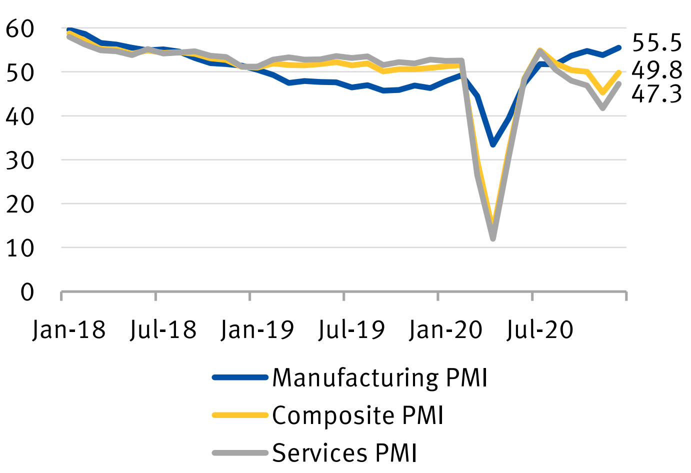
Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **The euro area's flash Purchasing Managers' Index (PMI) for December pointed to the economy performing better than widely expected.** The manufacturing component rose to its highest level in over two-and-a-half years with German manufacturing activity benefitting from a recovery in Chinese demand. The flash Services PMI recovered notably in December, thanks in particular to the reopening of non-essential French shops. With the introduction of additional lockdown measures in Germany this week, the final euro area PMI release is likely to be revised downwards somewhat.
- The European Central Bank (ECB) published its updated guidance on dividends for European banks. **While the ECB lifted its de facto dividend ban, it has asked European banks to refrain from paying out dividends until the end of September 2021**. Banks that meet the ECB's criteria on profits and capital face strict limits on FY2020 payouts. These restrictions are disappointing, in our view, and will likely result in fairly material shortfalls to consensus dividend expectations in the short term. We believe the expectation for the resumption of dividends has been one of the positive catalysts helping European bank stocks re-rate recently. The trend toward normalized dividends during 2021 remains intact, in our opinion, though it has been pushed out to Q4 2021.

Eurozone manufacturing at the highest level since mid-2018

Markit Eurozone Purchasing Managers' Indexes



Note: The final datapoints represent flash figures for December 2020, which are subject to revision. PMI above 50 indicates expansion, below 50 indicates contraction.
Source - RBC Wealth Management, Bloomberg

- In the UK, the flash Composite PMI for December rose above 50 thanks to a boost to manufacturing activity from stockpiling ahead of the end of the UK's Brexit transition period on Dec. 31. The rebound in services was tepid despite the reopening of the economy. Accordingly, **we believe the flash Composite PMI probably overstates the true pace of the UK's recovery**.
- **Sterling rose to almost 1.36 versus the U.S. dollar, its highest level in more than two years**, as hopes increased that the UK could agree to a post-Brexit trade deal with the EU in the coming days following comments from European Commission President Ursula von der Leyen that there is a "path to an agreement."

Asia Pacific

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

- **MSCI announced it will delete seven Chinese stocks from its MSCI Global Investable Market Indexes** after the Trump administration banned U.S. investment in companies the U.S. has identified as having links to the Chinese military. **S&P, Dow Jones, and FTSE Russell announced similar steps** this month. MSCI stated it had consulted with 100 investment managers in the U.S. and elsewhere who said the Trump administration's order would make it difficult for many institutions to buy funds or other products containing those stocks. However, **MSCI also announced it would introduce new, parallel indexes** that include those stocks, allowing funds that aren't restricted by the U.S. rules to continue to own them.
- **The Chinese regulator fined Alibaba Group (9988 HK) and China Literature (772 HK)** over a pair of years-old acquisitions, and said it is reviewing a planned merger, led by Tencent (700 HK), of two major Chinese game-streaming companies in which Tencent owns stakes. Alibaba was fined RMB 500,000 (US$76,500) for failing to seek approval before increasing its stake in department store chain Intime Retail Group Co. to 73.79% in 2017. China Literature was also fined RMB 500,000 for failing to seek approval for its acquisition of New Classics Media in 2018. While the penalty amounts are small, we believe they signal **China's intention to tighten oversight of internet-sector deals**.
- **The Bank of Japan (BoJ) said it will buy U.S. dollars** from Japan's Ministry of Finance as it takes further precautions to ensure it can carry out operations more smoothly amid the pandemic. The BoJ plans to buy about US$6 billion by the end of March. The move will likely increase the BoJ's foreign currency assets by about 10%. While the BoJ didn't elaborate on the reasoning behind the move, we believe it is **unlikely to influence the course of monetary policy** as the bank didn't release the information as a decision made by its policy board.

MARKET SCORECARD

Data as of December 17, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,722.48	2.8%	15.2%	16.6%	46.2%
Dow Industrials (DJIA)	30,303.37	2.2%	6.2%	7.2%	28.4%
Nasdaq	12,764.75	4.6%	42.3%	44.7%	89.0%
Russell 2000	1,978.05	8.7%	18.6%	19.3%	43.5%
S&P/TSX Comp	17,652.94	2.7%	3.5%	3.4%	22.9%
FTSE All-Share	3,705.40	4.6%	-11.7%	-11.3%	0.3%
STOXX Europe 600	397.28	2.0%	-4.5%	-4.3%	15.7%
EURO STOXX 50	3,560.87	2.0%	-4.9%	-4.9%	16.2%
Hang Seng	26,678.38	1.3%	-5.4%	-4.2%	2.3%
Shanghai Comp	3,404.87	0.4%	11.6%	12.7%	31.1%
Nikkei 225	26,806.67	1.4%	13.3%	11.4%	24.6%
India Sensex	46,890.34	6.2%	13.7%	13.4%	29.3%
Singapore Straits Times	2,858.02	1.9%	-11.3%	-10.7%	-8.2%
Brazil Ibovespa	118,400.60	8.7%	2.4%	5.1%	37.0%
Mexican Bolsa IPC	44,326.05	6.1%	1.8%	-0.2%	9.9%

Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot $/oz)	1,886.59	6.2%	24.3%	27.8%	51.4%
Silver (spot $/oz)	26.05	15.0%	45.9%	53.1%	77.6%
Copper ($/metric ton)	7,813.50	3.2%	27.1%	26.6%	28.2%
Oil (WTI spot/bbl)	48.36	6.7%	-20.8%	-20.6%	-3.0%
Oil (Brent spot/bbl)	51.57	8.4%	-21.9%	-22.0%	-13.5%
Natural Gas ($/mmBtu)	2.66	-7.6%	21.7%	14.8%	-24.5%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.935%	9.6	-98.3	-94.6	-192.2
Canada 10-Yr	0.742%	7.1	-96.0	-89.1	-130.4
U.K. 10-Yr	0.287%	-1.8	-53.5	-47.5	-97.9
Germany 10-Yr	-0.570%	0.1	-38.5	-27.5	-82.6

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.17%	-0.2%	7.2%	7.3%	19.6%
U.S. Invest Grade Corp	1.81%	-0.2%	9.2%	9.4%	26.2%
U.S. High Yield Corp	4.40%	1.2%	6.4%	6.9%	16.6%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	89.7930	-2.3%	-6.8%	-7.6%	-7.5%
CAD/USD	0.7860	2.3%	2.1%	3.4%	5.4%
USD/CAD	1.2723	-2.1%	-2.1%	-3.3%	-5.1%
EUR/USD	1.2269	2.9%	9.4%	10.0%	8.1%
GBP/USD	1.3575	1.9%	2.4%	3.4%	7.5%
AUD/USD	0.7627	3.9%	8.6%	11.3%	6.2%
USD/JPY	103.1000	-1.2%	-5.1%	-5.8%	-8.6%
EUR/JPY	126.5000	1.7%	3.9%	3.6%	-1.2%
EUR/GBP	0.9038	1.0%	6.8%	6.4%	0.5%
EUR/CHF	1.0847	0.1%	-0.1%	-0.8%	-3.7%
USD/SGD	1.3258	-1.2%	-1.5%	-2.2%	-3.4%
USD/CNY	6.5338	-0.7%	-6.2%	-6.6%	-5.3%
USD/MXN	19.7861	-2.0%	4.5%	4.5%	-1.5%
USD/BRL	5.0665	-5.5%	25.7%	34.1%	29.8%

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 16:35 pm ET 12/17/20.

Examples of how to interpret currency data: CAD/USD 0.78 means 1 Canadian dollar will buy 0.78 U.S. dollar. CAD/USD 2.1% return means the Canadian dollar rose 2.1% vs. the U.S. dollar year to date. USD/JPY 103.10 means 1 U.S. dollar will buy 103.10 yen. USD/JPY -5.1% return means the U.S. dollar fell 5.1% vs. the yen year to date.

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Sell [Underperform]	81	5.44	11	13.58

Ratings:

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