GLOBAL Insight WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

February 4, 2021

A low bar for high growth?

Thomas Garretson, CFA – Minneapolis

Away from much of the market noise and volatility in recent weeks, incoming data continues to suggest to us that the fundamental backdrop for the U.S. economy remains on remarkably solid footing.

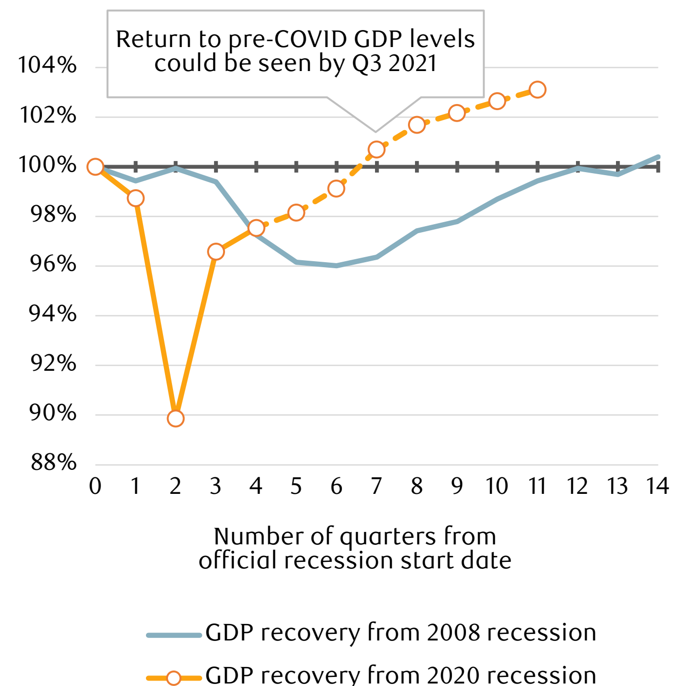
After last week's solid GDP report, data this week quelled near-term concerns that activity may be heading for a slowdown to start the first quarter, with Purchasing Managers' Indexes, jobless claims, construction spending, and durable goods orders all trending in the right direction.

While debate goes on in Washington over the ultimate size and structure of a third fiscal aid package, there is more likelihood it will come in at a number well north of the $750 billion–$1 trillion markets and analysts have generally been expecting.

And as RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli stated in a note this week "the size of the stimulus is less relevant to the path of economic activity and more relevant for the magnitude of the change. In other words, economic activity is going up and it is already going to be fairly strong. More stimulus just makes the already strong number stronger."

How much stronger? As the chart shows, consensus expectations as of the January Bloomberg survey had the U.S. economy on track to recover to pre-pandemic levels of economic activity by Q3 2021. RBC Capital Markets is looking for growth of 5.3% this year, after what looks to be a 2.5% drop in activity in 2020 once the final numbers are in. A stimulus package closer to the proposed $1.9 trillion could take that growth number north of 6%; the difference

Strong policy response likely to fuel faster U.S. recovery



Note: Dashed line shows Bloomberg consensus forecast; real GDP shown as percentage of pre-recession levels in Q4 2007 and Q4 2019.
Source - RBC Wealth Management, Bloomberg

For perspectives on the week from our regional analysts, please see pages 3–4.

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For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

between the U.S. economy recovering not to pre-pandemic levels this year, but to pre-pandemic trend growth—as if the pandemic had never struck. A far cry from the more than three years it took the U.S. economy to recover from the financial crisis in 2008.

Of course, much of this depends on the path of COVID-19 and the ongoing rollout of vaccines. But on that front, the rollout continues to gather steam with 34.9 million vaccine doses administered in the U.S. through February 3, exceeding the 26.6 million confirmed COVID-19 cases since the onset of the pandemic, while the trend in new cases is trending notably lower.

Purchasing managers remain confident

But the economic outlook isn't just supported by prospects for fiscal aid. This week, purchasing manager surveys for both the manufacturing and service sectors continue to point to strong demand, according to the Institute for Supply Management. While the headline indexes both remain well-above the breakeven level of 50, which indicates expansion, it's in the details that a sustained recovery appears to be firmly in place.

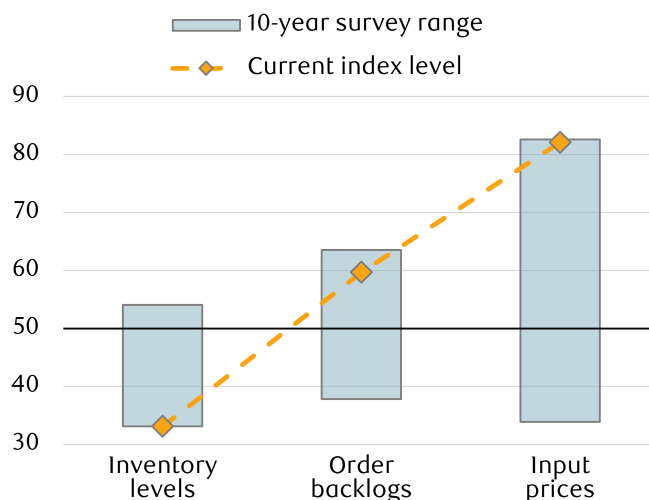
As one respondent stated: "Business is very good. Customer inventories are low, with a significant order backlog through April. Supply base is struggling to keep up with demand, disrupting our production here and there. Raw material lead times have been extended. COVID-19 continues to cause challenges throughout the supply chain. Huge logistics challenges, especially in getting product through ports and in getting containers. We are seeing significant cost increases in logistics and raw materials."

The chart shows that this kind of sentiment is widespread across U.S. manufacturing. The index on customer inventory levels is near the lowest on record—another factor supportive of the growth outlook as companies will need to bring inventories back to more-normal levels to meet projected demand later in the year. At the same time, manufacturers have lofty levels of order backlogs to work through in the coming months and quarters which should, at a minimum, maintain activity. The pricing story is where things get interesting, as rising input costs across the board, from apparel to paper, and plastics to primary metals, have pushed the ISM Manufacturing Report on Business Prices Index near the highest levels on record.

That should boost inflationary impulses through the producer side, but how much of that is passed along to the consumer remains to be seen. But with still-high unemployment, we think it's minimal over the near term. However, as the economy reopens further, and with supply chain constraints likely to continue, we think this dynamic will be one to watch.

U.S. manufacturing: Demand remains robust

Low inventories, rising backlogs support growth outlook, but cost pressures building



Source - RBC Wealth Management, Bloomberg, Institute for Supply Management. Levels above 50 indicate expansion, below 50 contraction.

Market signals abound

Just more than a year removed from inverted Treasury yield curves, where short-term rates are higher than long-term rates, which signals heightened recession risks, markets are now focused on steepening yield curves, yet another sign of an improving growth and inflation outlook.

This week, one of the benchmark indicators, the yield spread between 2-year Treasury notes and 10-year Treasury notes, crossed above 1% for the first time since late 2016, when growth optimism was improving ahead of tax reform expectations. Despite recent market volatility, markets continue to trade on the growth and reflation theme that has prevailed for some time.

Fed impact

Of course, downside risks remain, and uncertainty remains abnormally elevated, particularly around the Fed as stronger growth and higher inflation are already fueling fears the Fed could dial back asset purchases. But as Fed Chair Jerome Powell noted last week, the Fed already largely expects these types of inflationary pressures to play out over the course of the year, but essentially characterized them as "transitory" phenomena. We expect Fed policy to remain as is for the balance of 2021.

The data continues to show the value of a robust policy response from both the fiscal and monetary front, and of not pulling back prematurely, and while much of the outlook remains dependent on the path of COVID-19, with plenty still to be done, the tailwinds suggest to us plenty of reason for optimism.

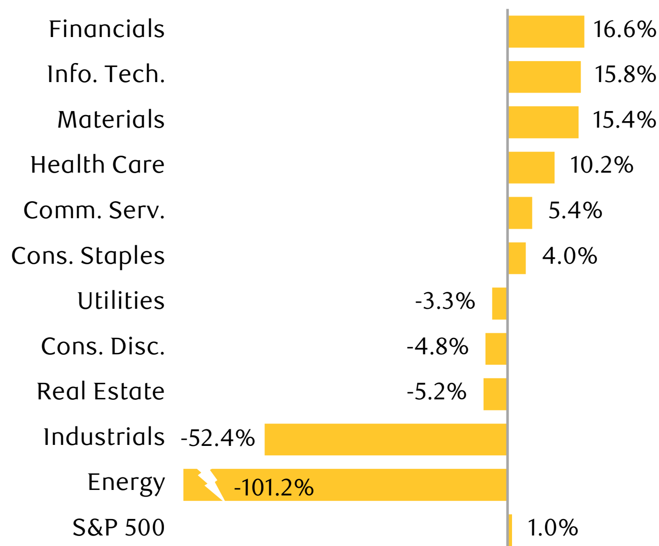
UNITED STATES

Ben Graham, CFA – Minneapolis

- **U.S. trading volumes remained elevated as February began**, and stocks have quickly rebounded following late January's equity market swoon. The S&P 500 is up 4.2% so far this week, while the Tech- and Health Care-heavy Nasdaq has climbed 5.4%. The Dow Jones has climbed the least of the U.S. majors while still grinding 2.5% higher. The small-cap Russell 2000 is 6.2% higher thus far this week. **Leadership is evident in the Energy, Communication Services, Financials, and Information Technology sectors**. Risk-off bond proxies is the most challenged area so far this week, with Health Care, Utilities, and bond proxies the worst-performing sectors in the market.
- **Earnings season has been generally better than hoped for** with more than 70% of the S&P 500 having reported results. **Fourth-quarter profits are on track for 1.0% y/y growth**, a significant feat considering the year-ago (Q4 2019) comparison was the final quarter without a COVID-19 impact. Financials and Tech are delivering the best earnings growth in the quarter with quarterly gains of 17% and 16%, respectively, while the biggest positive surprise factors belong to Consumer Discretionary and Energy companies due to the upside in the most cyclical names in each sector. Unsurprisingly, small caps are lagging large in terms of absolute growth this quarter, but the rate of improvement has been better for small caps, assisting in their recent outperformance. Also, U.S. exporters are outgrowing domestically focused companies for the first time since Q4 2018 after seven straight quarters of the reverse.
- **Initial jobless claims fell for the third straight week** as the reported result of 779,000 was 86,000 less than consensus expectations. The four-week moving average has started to move lower again, with the biggest decline in Illinois, while California had the largest increase.

Earnings on track for growth, but COVID impact still evident

S&P 500 Q4 2020 earnings, y/y



Note: Energy is truncated due to magnitude of decline
Source - RBC Wealth Management, FactSet; data through 2/4/21

CANADA

Carolyn Schroeder & Arete Zafiriou – Toronto

- Despite escalating COVID-19 containment measures, **the Canadian economy continued to grow as monthly GDP estimates surprised to the upside** in November (+0.7% m/m) and December (+0.3% m/m), according to Statistics Canada's flash estimate. Although lockdowns are taking a toll on hospitality and travel services, other sectors are growing because restrictions have been more targeted through the second wave of the pandemic. As a result, **the Canadian manufacturing sector has continued to recover**, as has activity in certain pockets of the services sector such as professional services. Although near-term GDP is tracking above prior assumptions, the medium-term outlook is still highly reliant on the rollout and effectiveness of vaccines. According to RBC Economics, a slowing virus spread means that restrictions could begin to be gradually eased as early as this month, and that may be enough to prevent a decline in overall GDP in Q1.
- **Canadian consumer spending started the year off on a soft note** as COVID-19 lockdowns and other containment measures that were imposed at the end of 2020 carried through into 2021. Debit and credit card spending was down 9% y/y in the first week of January and down 5% y/y in the second week, according to RBC Economics. Apparel, gifts, and jewelry expenditures were particularly weak, down 27% y/y as of the middle of the month. Other retail spending (including electronics and household goods) has been recovering, up 18% y/y in mid-January. Spending on entertainment, art, and movies was down 23% y/y as of Jan. 14, a slight improvement from the 33% y/y decline at the end of December. Unsurprisingly, the travel sector remains the biggest laggard, with spending 85% lower than a year ago. Although restaurants continue to be hurt by the pandemic, with dining expenditures down 26% y/y, grocery spending has increased by double digits over the past year.

EUROPE

Thomas McGarrity, CFA, Alastair Whitfield, & Frédérique Carrier – London

- In an attempt to avoid snap elections in the midst of the pandemic, **Italy's president Sergio Mattarella asked former European Central Bank President Mario Draghi to form a new government**. If Draghi succeeds, which we will know over the next few days and is our core scenario, it will fall to him to decide how to spend Italy's €209 billion share of the EU's recovery fund. If he fails, snap elections are likely. For now, markets are cheering him on, assuming he will succeed and the funds will be disbursed wisely. **Yields on Italian sovereign bonds—BTPs—tightened and Italian equities outperformed** on the news.
- Unsurprisingly, **eurozone economic indicators suggest the economy is still in contraction territory**, though performance was marginally better than consensus expectations. The services sector continued to suffer from extended and tightened social distancing measures. Manufacturing remains a bright spot, particularly in Germany.
- This week, **the Bank of England (BoE) voted unanimously to maintain its 0.1% benchmark rate and government asset purchases at £875 billion**. At the same time, the BoE published its latest economic forecasts—Q1 GDP falling 4% q/q, with 2021 GDP growth of 5% vs. the 7.25% estimate in November. Despite this, a swift recovery is expected by the BoE during the remainder of the year, with inflation expectations also revised higher to meet the 2% target level over its forecast horizon.
- Given negative interest policy has been widely discussed previously, **the BoE highlighted that banks would need six months to prepare for a negative rate environment and has advised such preparations be made**. However, with the central bank pointing to a rapid economic rebound supported by the current vaccination programme, we see the possibility of negative interest rates being even more unlikely, unless there is a material change in the outlook for the UK recovery as a result of the evolution of the pandemic.
- Shares of UK domestic-focused banks **Lloyds Banking Group** and **Natwest Group** rose over 5% following the BoE's announcement.

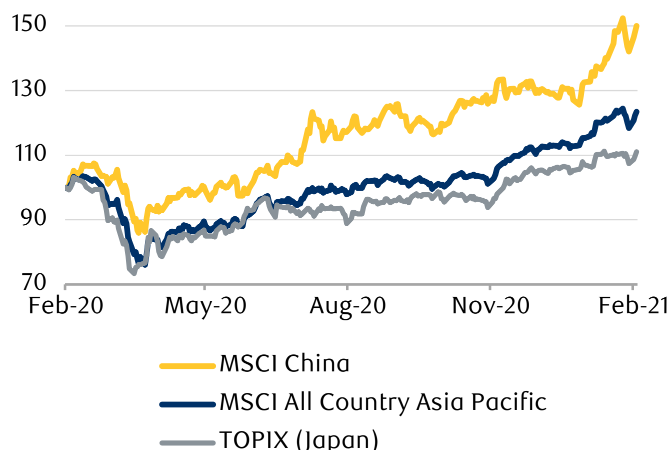
ASIA PACIFIC

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

- **Asian stocks rose during the week, with Vietnamese and Japanese equities leading the rally**. Consumer Discretionary and Financials stocks accounted for the biggest subsector boosts to the MSCI Asia Pacific Index.

China continues to lead the Asia Pacific region

Performance since 2/1/20, indexed to 100



Source - RBC Wealth Management, FactSet; data through 2/3/21

- **Japan extended a state of emergency** covering Tokyo and other major metropolitan areas to Mar. 7. The current emergency measure has been in effect since early January for 11 areas, including Tokyo and Osaka, which account for about 60% of the economy's total output.
- The Caixin China Services Purchasing Managers' Index (PMI) fell to 52 in January from 56.3 in December 2020. **Total new orders received by Chinese services companies expanded at a softer rate in January while export orders increased at the weakest pace in three months**. We think the weakening recovery momentum is mainly due to the winter's virus surge, quieter activity ahead of Chinese New Year, and a slowdown in external orders after strong holiday demand.
- Bloomberg reported that **Ant Group and Chinese regulators have agreed on a restructuring plan that will turn Ant into a financial holding company**, making it subject to capital requirements similar to those for banks. Ant may put all its businesses into the holding company, including its technology businesses such as blockchain and food delivery. According to the report, becoming a financial holding company will make Ant subject to stricter regulations, which could affect its growth and market value.
- Bloomberg research shows that **Chinese companies' credit stress is most acute in the provinces of Liaoning, Qinghai, and Henan**. Firms in those three regions issued new bonds equal to less than 30% of the debt that matured over the last three months. Firms in other provinces, such as Anhui and Zhejiang, were in a much better position, issuing 251% and 171% more bonds than maturing debt, respectively. The ratio was 116% nationwide in January.

MARKET
Scorecard

Data as of February 4, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,871.74	4.2%	3.1%	17.4%	42.1%
Dow Industrials (DJIA)	31,055.86	3.6%	1.5%	7.8%	23.0%
Nasdaq	13,777.74	5.4%	6.9%	45.5%	87.5%
Russell 2000	2,202.42	6.2%	11.5%	32.9%	45.1%
S&P/TSX Comp	18,041.97	4.1%	3.5%	3.0%	15.6%
FTSE All-Share	3,706.20	1.8%	0.9%	-10.4%	-4.0%
STOXX Europe 600	409.54	3.5%	2.6%	-2.1%	13.8%
EURO STOXX 50	3,642.12	4.6%	2.5%	-2.4%	15.1%
Hang Seng	29,113.50	2.9%	6.9%	9.1%	4.0%
Shanghai Comp	3,501.86	0.5%	0.8%	25.8%	33.7%
Nikkei 225	28,341.95	2.5%	3.3%	22.8%	35.7%
India Sensex	50,614.29	9.4%	6.0%	24.1%	38.4%
Singapore Straits Times	2,905.58	0.1%	2.2%	-8.0%	-8.8%
Brazil Ibovespa	119,260.80	3.6%	0.2%	3.2%	21.0%
Mexican Bolsa IPC	44,167.58	2.7%	0.2%	-2.0%	1.0%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.138%	7.2	22.4	-46.2	-158.6
Canada 10-Yr	0.965%	7.6	28.8	-36.9	-99.7
UK 10-Yr	0.440%	11.3	24.3	-12.6	-83.7
Germany 10-Yr	-0.454%	6.4	11.5	-5.5	-63.1
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.21%	-0.3%	-1.0%	4.8%	18.7%
U.S. Investment-Grade Corp	1.90%	-0.4%	-1.7%	6.0%	24.9%
U.S. High-Yield Corp	4.12%	0.4%	0.8%	7.6%	18.3%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,792.99	-3.0%	-5.6%	15.5%	36.6%
Silver (spot $/oz)	26.33	-2.4%	-0.3%	49.6%	65.9%
Copper ($/metric ton)	7,851.50	-0.1%	1.3%	40.3%	27.7%
Oil (WTI spot/bbl)	56.23	7.7%	15.9%	13.3%	3.1%
Oil (Brent spot/bbl)	58.91	5.4%	13.7%	9.2%	-5.8%
Natural Gas ($/mmBtu)	2.97	15.7%	16.9%	58.5%	11.5%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	91.5300	1.0%	1.8%	-6.6%	-4.5%
CAD/USD	0.7796	-0.4%	-0.7%	3.5%	2.2%
USD/CAD	1.2827	0.4%	0.8%	-3.4%	-2.2%
EUR/USD	1.1963	-1.4%	-2.1%	8.3%	4.6%
GBP/USD	1.3670	-0.3%	0.0%	4.9%	4.9%
AUD/USD	0.7600	-0.6%	-1.2%	12.8%	5.2%
USD/JPY	105.5500	0.8%	2.2%	-3.6%	-3.9%
EUR/JPY	126.2700	-0.7%	0.1%	4.4%	0.5%
EUR/GBP	0.8751	-1.2%	-2.1%	3.2%	-0.3%
EUR/CHF	1.0819	0.1%	0.1%	1.1%	-5.2%
USD/SGD	1.3372	0.6%	1.1%	-2.4%	-1.2%
USD/CNY	6.4718	0.7%	-0.8%	-6.8%	-4.1%
USD/MXN	20.3879	-0.9%	2.4%	9.2%	6.7%
USD/BRL	5.4323	-0.7%	4.5%	43.8%	48.2%

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.

Examples of how to interpret currency data: CAD/USD 0.77 means 1 Canadian dollar will buy 0.77 U.S. dollar. CAD/USD -0.7% return means the Canadian dollar fell 0.7% vs. the U.S. dollar year to date. USD/JPY 105.55 means 1 U.S. dollar will buy 105.55 yen. USD/JPY 2.2% return means the U.S. dollar rose 2.2% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 2/4/21.

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As of December 31, 2020

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Buy [Outperform]	828	54.83	299	36.11
Hold [Sector Perform]	615	40.73	166	26.99
Sell [Underperform]	67	4.44	12	17.91

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