GLOBAL Insight WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee March 11, 2021

Shapes of recovery: Regional growth snapshots

Frédérique Carrier – London

It's about one year on from when the pandemic shut down the global economy. While it will still be a long way back, the overall recovery is exceeding expectations. We look at where things stand for the world's key regions as they continue to reset economic growth.

Even though some sectors continue to suffer from the scarring effects of the pandemic, the global economy is faring better than many had feared. Not only has economic activity rebounded enthusiastically on partial reopenings last autumn, but the second wave of the virus has taken less of a toll on activity than the first, as people and businesses have adapted to life in a COVID-19 world.

Eric Lascelles, chief economist at RBC Global Asset Management, Inc., points out that while economic activity in Q1 may not be as widely above consensus expectations as it was in Q4 2020, it remains positive, signalling the recovery is exceeding projections.

We look at the particular contours of the recovery for the main regions that we monitor.

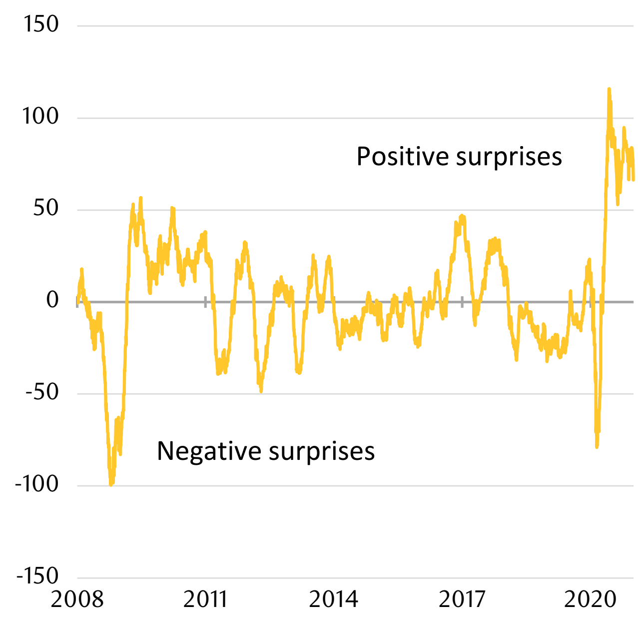
U.S.: Overly generous stimulus to fuel inflation?

President Joe Biden's $1.9 trillion relief package aims at supporting the economy, but some question whether this full amount is needed given the strength of the U.S. economic recovery.

The U.S. economy is bouncing back strongly with labour market data pointing to as many as 379,000 jobs created in February. The ISM Manufacturing Purchasing Managers' Index strengthened to a robust 60.8 in February while the

Economic surprises are still more positive than negative after wild swings

Citi Economic Surprise Index – Global



Source - Citigroup, Bloomberg, RBC Global Asset Management; data range: 3/10/08–3/9/21

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

services component continues to be firmly in expansion territory.

Yet pockets of weakness remain. Forty percent of people out of work are now labelled as “long-term unemployed,” the highest level since 2008. Lascelles points out there are also unresolved credit issues, such as 2.7 million mortgages in forbearance expiring in Q2.

While support is clearly needed, $1.9 trillion of stimulus—close to 10 percent of GDP—looks somewhat overly generous given the country’s already heavy debt load, the healthy economic recovery, and the successful vaccine rollout, according to Lascelles. Biden recently announced the U.S. is “now on track to have enough vaccine supply for every adult in America by the end of May.”

Stimulus of this magnitude risks a spike in inflation in the short term. Inflation expectations have already risen on anticipation of the package, the reopening of the economy, and concerns over supply chain disruptions. Notably, the ISM’s Manufacturing Prices Paid Index increased to 86 in February, a level only surpassed in 2008, pointing to input inflation.

While it’s reasonable to expect inflation to pick up in the short term, Lascelles suggests deflationary forces should keep inflation in check in the medium term. With the current business cycle in a very early phase, economic slack is likely to linger for the next year or two. The aging of the population and the maturing of emerging market economies also suggest to us that inflation pressures will not spiral out of control.

RBC Capital Markets expects U.S. GDP growth at 6.5 percent and inflation of 2.7 percent for 2021, but it sees upside potential to this GDP forecast.

China: Low-balling growth

China’s economy was an outlier in 2020, growing as most others contracted. Consensus expectations call for another robust rebound this year, penciling in a GDP increase of over eight percent. However, the government set a surprisingly low growth target at “above six percent.” Such a low number suggests China aims to ensure quality and sustainable growth, as eight percent growth would be unlikely in 2022.

This target was announced at the recent annual “Two Sessions” confab, the country’s main political gathering. At these meetings China typically announces the concrete short-term steps needed to achieve the country’s long-term goals. Back in November 2020, China released its 14th Five-Year Plan. This laid out its goals of transforming into an advanced economy by 2035, which would require the economy to roughly double in size from 2020 levels, and achieving net-zero CO_2 emissions by 2060.

We expect the People’s Bank of China will tighten monetary policy in a gradual and managed manner to ensure the economy does not overheat.

Europe: Slow going

Europe’s vaccine rollout faces challenges. Moreover, its fiscal response has been comparatively more timid with national governments weary of yawning fiscal deficits. The €750 billion EU rescue package will help underpin growth, but the impact may be restrained given funds will be disbursed to national governments through to 2026.

Still, as lockdown measures are eventually lifted, and as the vaccine rollout gathers pace, we expect a quick rebound, helped by the release of household savings, much like we saw after the first lockdown. RBC Capital Markets expects euro area growth will reach 4.1 percent in 2021.

UK: The return of fiscal prudence

After a disastrous handling of the pandemic, the UK’s vaccine rollout has earned praise. The government plans to fully reopen the economy on June 21. Nevertheless, the economy is suffering and an additional support package worth more than 2.5 percent of GDP was recently announced.

Emboldened by reopening prospects, measures that aim to balance the books were also announced, making the UK the first country in the developed world to show such resolve. These include an increase in the corporate tax rate from 19 percent to 25 percent by 2023. For businesses, an additional tax burden is unwelcome, though a more lenient approach to regulation and competition could offset this somewhat. The government’s future attitude towards these issues in a post-Brexit world is a key factor to watch.

For now, the consensus expects the UK will see GDP growth of 4.5 percent in 2021.

Canada: Growth despite second wave

Canada appears to have managed to avoid an economic contraction during the second wave. The economy eked out growth of 0.1 percent in December and initial readings for January suggest a further 0.5 percent gain. Lascelles also points out there seems to have been additional momentum in February. He thinks the Canadian economy may well perform ahead of the Bank of Canada’s estimate of four percent GDP growth for 2021.

Portfolio strategy

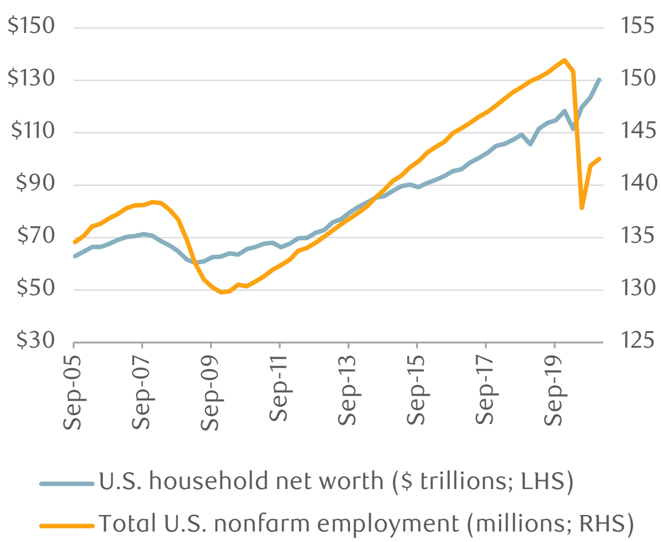
Given this generally encouraging economic growth outlook, we reiterate our Overweight stance in global equities and expect them to generate modest returns on a 12-month horizon. We believe equities can withstand the current increase in bond yields, though volatility could spike and the recent rotation into reflation-driven and value stocks is likely to continue.

UNITED STATES

Atul Bhatia, CFA – Minneapolis

- **The Federal Reserve meets next week to discuss monetary policy.** The central bank is widely expected to leave rates unchanged and to continue purchasing $120 billion per month in government and agency bonds. It may choose to change the composition of its bond holdings to emphasize longer maturities, potentially matched with sales of shorter-term securities. This last measure could help alleviate **a lack of supply in the Treasury bill market that has pushed one-month rates down to only 0.02%**. Market participants are also watching to see if the Fed will extend **a waiver on banks' Supplementary Liquidity Ratio (SLR) limits**. Failure to extend the waiver—which allows banks to exclude some of their accounting reserves and all Treasury holdings from the regulatory requirement—could pressure large banks to shed certain deposits and Treasury bonds.
- **Inflation in February was well contained**, with the Consumer Price Index (CPI) rising only 0.4% from the prior month and 1.7% from the prior year. The rise in core CPI—which excludes food and energy prices—was only 0.1% from January 2021 and 1.4% from February 2020. **Readings for the remainder of the year will likely be skewed** by the comparison to data gathered during the pandemic shutdowns and supply chain interruptions of 2020.
- **Nonfarm payrolls grew by 379,000 jobs in February**, the largest single-month gain since October 2020. The pandemic's toll on U.S. employment is now 9.5 million lost jobs. **Despite the ongoing labor market weakness, consumer balance sheets remain strong overall**; data from the Fed shows that U.S. households' net worth grew by 12% in 2020. With limited spending options for their newfound wealth, households accumulated $1.6 trillion in excess savings during the pandemic, compared to pre-pandemic consumption patterns.

U.S. household balance sheets strong despite labor market weakness



Source - RBC Wealth Management, Bloomberg; quarterly data through December 2020

CANADA

Ryan Harder – Toronto

- **Market expectations for higher inflation going forward have helped push Government of Canada bond yields roughly back in line with pre-pandemic levels.** With the Bank of Canada (BoC) stating it expects to keep interest rates on hold until 2023, short-term yields have remained close to zero even while intermediate- and longer-term yields rise, resulting in a steeper yield curve. Although rising yields hurt existing bond prices, we think it ultimately improves the long-term return prospects for investors who have an investment horizon longer than the average duration of their portfolios. We believe this steeper curve offers the opportunity to modestly extend duration and lock in higher forward-looking yields. The curve has also resulted in the proliferation of bonds with market prices under par, which for taxable money is more efficient than bonds priced at or above par, as the pull to par is taxed more favourably (capital gain) than coupon payments (income).
- **The BoC made no changes at this week's meeting**, keeping the overnight lending rate steady at 0.25% while maintaining asset purchases at a rate of at least CA$4 billion per week. The BoC's statement hinted at a possible tapering of asset purchases in the near future, saying "the pace of net purchases of Government of Canada bonds will be adjusted as required." Market reaction to the meeting was modest, with yields ending Wednesday slightly lower, but largely in step with the move in U.S. bond yields. The next meeting, scheduled for Apr. 21, will come alongside growth projection and economic forecast updates to the BoC's quarterly Monetary Policy Report, which is likely to offer more insight into the BoC's framework on when it expects to start easing off asset purchases.

EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- At its Governing Council meeting on Mar. 11, **the European Central Bank (ECB) pledged to increase the pace of its asset purchase programme** in light of the recent tightening of financial conditions. After the

Reserve Bank of Australia, the ECB is the second central bank to intervene in markets to tackle the recent surge in bond yields. The German 10-year Bund yield retreated on the news; it is now below the February high, and is likely to settle below that level.

- **The STOXX Europe 600 Index rose over 3.5% during the week**, and now sits around 2.5% below its all-time high that was set prior to the pandemic in February 2020. Technology and renewables stocks bounced following their recent pullback on the back of the sharp rise in bond yields.
- **While the banks subsector lagged during the week as bond yields fell, it has been one of the best-performing subsectors within the STOXX Europe 600 year-to-date**, up almost 18%, versus the index up just over 6%, in euro terms. Notably, the STOXX Europe 600 Banks Index remains around 15% down from its pre-pandemic levels. The banks group is the most positively correlated subsector to rising inflation expectations and bond yields and, hence we see scope for continued outperformance in the months ahead given the improving economic growth outlook, as outlined in the feature article.
- **RBC Capital Markets believes the banks remain attractive** on a relative basis, as well as selectively on an absolute basis. It notes that while valuations appear "optically fair," they do not factor in excess capital. RBC Capital Markets estimates that excess capital on average is equal to 12% of Pan-European banks' market capitalisation, which is suppressing returns on equity at present. In our view, these high capital levels are likely to lead to increased shareholder returns in the form of higher dividends once dividend restrictions are lifted by regulators, which we expect will be the case in Q4 2021.

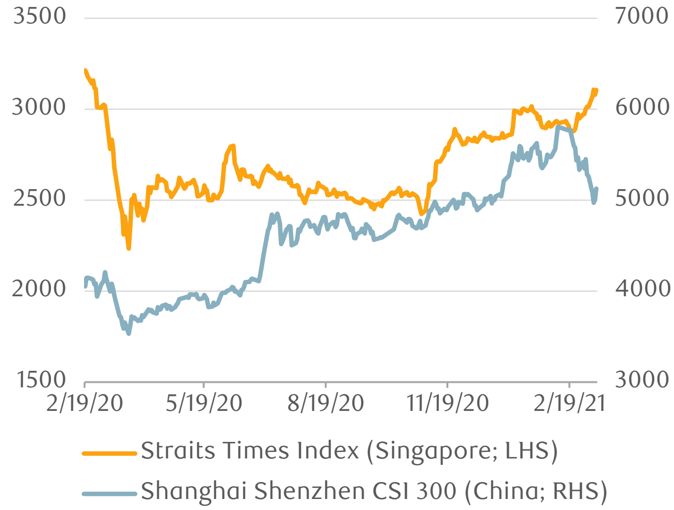
ASIA PACIFIC

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

- **Asia Pacific equity markets were mixed this week.** The Straits Times Index, in which the three Singapore banks make up the bulk, led the pack as investors rotated into cyclical names. At the other end of the spectrum, China A shares fell dramatically.
- **The Shanghai Shenzhen CSI 300 Index has fallen close to 14% from its Feb. 18 peak.** State-backed funds intervened on Tuesday, according to a Bloomberg report, but achieved only limited success. **To some extent, the recent pullback has been induced by the government** with officials repeatedly warning of asset bubbles and saying that curbing risks in the financial system is this year's key policy goal. Following the strong rally since the March 2020 low, analysts believe investors' attention will be on the outlook for accommodative fiscal and monetary policies and the extent of the growth-value rotation.

Singapore outperforms on rotation

Will Chinese intervention close the gap?



Source - RBC Wealth Management, Bloomberg

- As part of the "Two Sessions" parliamentary meeting, **the Chinese government announced that (1) China will target GDP growth of over 6% for the year**, below many economists' estimates, **(2) no new bonds will be issued in response to the pandemic, and (3) deficit and inflation targets will be lower than last year**. Economists believe the targets are relatively conservative but noted the targets will provide room for policymakers to take more stringent measures to contain risks in stocks and the property market.
- **Cathay Pacific Airways** (293 HK), flag carrier of Hong Kong, **reported a net loss of HK$21.65 billion for 2020**, a period the carrier described as "the most challenging 12 months of its more than 70-year history." Cathay expects to operate at well below 50% passenger capacity in 2021, and will continue with its cash-preservation measures.

MARKET Scorecard

Data as of March 11, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,939.34	3.4%	4.9%	43.7%	41.5%
Dow Industrials (DJIA)	32,485.59	5.0%	6.1%	37.9%	26.6%
Nasdaq	13,398.67	1.6%	4.0%	68.5%	77.3%
Russell 2000	2,338.54	6.2%	18.4%	85.0%	51.0%
S&P/TSX Comp	18,844.57	4.3%	8.1%	32.1%	17.0%
FTSE All-Share	3,841.18	3.7%	4.6%	16.9%	-1.8%
STOXX Europe 600	424.17	4.7%	6.3%	27.3%	13.6%
EURO STOXX 50	3,845.64	5.8%	8.2%	32.4%	16.4%
Hang Seng	29,385.61	1.4%	7.9%	16.5%	3.1%
Shanghai Comp	3,436.83	-2.1%	-1.0%	15.8%	13.5%
Nikkei 225	29,211.64	0.8%	6.4%	50.5%	38.3%
India Sensex	51,279.51	4.4%	7.4%	43.7%	38.4%
Singapore Straits Times	3,106.01	5.3%	9.2%	11.6%	-2.7%
Brazil Ibovespa	114,983.80	4.5%	-3.4%	35.0%	17.3%
Mexican Bolsa IPC	47,673.82	6.9%	8.2%	23.3%	13.8%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.532%	12.7	61.9	66.2	-110.8
Canada 10-Yr	1.437%	8.2	76.0	78.0	-31.8
UK 10-Yr	0.735%	-8.5	53.8	43.9	-44.4
Germany 10-Yr	-0.334%	-7.4	23.5	40.8	-40.3
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.51%	-0.7%	-2.8%	0.6%	16.5%
U.S. Investment-Grade Corp	2.23%	-1.4%	-4.4%	3.8%	21.4%
U.S. High-Yield Corp	4.43%	-0.3%	0.3%	14.3%	17.8%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,723.42	-0.6%	-9.2%	5.4%	33.3%
Silver (spot $/oz)	26.12	-2.0%	-1.1%	55.9%	70.6%
Copper ($/metric ton)	8,875.75	-2.9%	14.5%	60.8%	37.9%
Oil (WTI spot/bbl)	66.02	7.3%	36.1%	100.2%	16.3%
Oil (Brent spot/bbl)	69.73	5.4%	34.6%	94.8%	4.7%
Natural Gas ($/mmBtu)	2.67	-3.8%	5.0%	42.0%	-3.8%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	91.3990	0.6%	1.6%	-5.3%	-6.0%
CAD/USD	0.7978	1.6%	1.6%	9.9%	6.9%
USD/CAD	1.2535	-1.6%	-1.5%	-9.0%	-6.4%
EUR/USD	1.1985	-0.7%	-1.9%	6.3%	6.6%
GBP/USD	1.3990	0.4%	2.3%	9.1%	6.4%
AUD/USD	0.7787	1.1%	1.2%	20.1%	10.1%
USD/JPY	108.4900	1.8%	5.1%	3.8%	-2.4%
EUR/JPY	130.0300	1.1%	3.1%	10.4%	4.0%
EUR/GBP	0.8567	-1.2%	-4.1%	-2.5%	0.2%
EUR/CHF	1.1080	1.0%	2.5%	4.8%	-2.5%
USD/SGD	1.3394	0.5%	1.3%	-4.0%	-1.4%
USD/CNY	6.4938	0.2%	-0.5%	-6.5%	-3.5%
USD/MXN	20.6100	-1.2%	3.5%	-3.6%	6.2%
USD/BRL	5.5398	-1.1%	6.6%	46.6%	44.2%

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 0.79 means 1 Canadian dollar will buy 0.79 U.S. dollar. CAD/USD 1.6% return means the Canadian dollar rose 1.6% vs. the U.S. dollar year to date. USD/JPY 108.49 means 1 U.S. dollar will buy 108.49 yen. USD/JPY 5.1% return means the U.S. dollar rose 5.1% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 3/11/21.

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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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