GLOBAL
Insight
WEEKLY

RBC Wealth Management

Perspectives from the Global Portfolio Advisory Committee

March 25, 2021

Is 2021 the year of value stocks?

Kelly Bogdanova – San Francisco

After years in the shadow of the growth segment, value stocks have taken over leadership of the U.S. equity market. But does value have staying power? We explain five factors that should support value's continued outperformance in 2021.

The U.S. equity market is still in rally mode one year after the swift COVID-19 plunge. The S&P 500 has surged 75 percent since its March 2020 low, and has climbed 15.5 percent above the peak it reached right before the pandemic began.

As stimulus has flooded the system and pandemic risks have slowly receded, leadership within the market has shifted meaningfully, impacting portfolio performance.

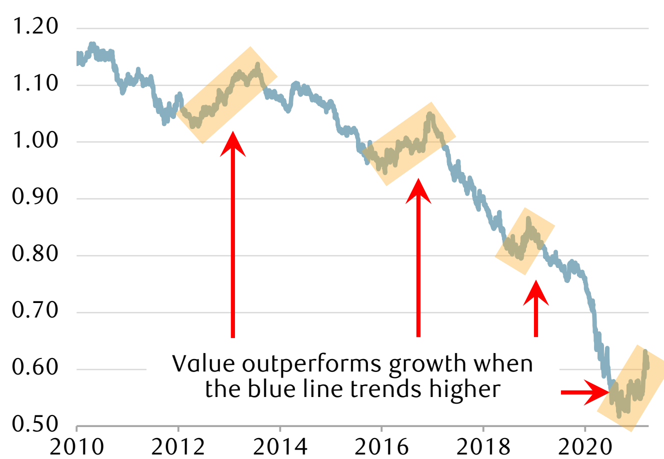
Initially during the pandemic, growth stocks dominated by a wide margin—particularly those of the largest technology-oriented firms. This segment also led during the past decade as powerful long-term secular trends took root in the digital and social media spheres. But as the growth rally progressed in 2020, valuations in the segment became increasingly expensive.

Last November, value stocks took the baton as economic recovery prospects brightened, the corporate profit outlook improved, and Treasury yields rose. With value maintaining its lead, a key consideration for portfolio positioning is: Does the move have legs?

Value's staying power has been questioned for years. The category—comprised largely of Financials and Industrials, and with a greater proportion of Telecom, Energy, Materials, and Utilities than the growth category—has

Prior periods of value outperformance were fleeting

Performance of U.S. Russell 1000 Value Index vs. Growth Index



Note: Chart shows ratio of large-cap value divided by growth

Source - RBC Wealth Management, Bloomberg; data through 3/24/21

experienced only fleeting moments of glory in the past decade, as the chart illustrates. Since the beginning of 2010, the U.S. Russell 1000 Growth Index has rallied 378 percent, while its companion Value Index has risen only 161 percent.

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

Priced (in USD) as of 3/25/21 market close, ET (unless otherwise stated). Produced: Mar. 25, 2021 4:58 pm ET; Disseminated: Mar. 25, 2021 5:15 pm ET
For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

However, there have been prior periods in history when value meaningfully outperformed growth. At this stage, we think the long-held skepticism about the value segment's potential is less warranted.

Reasons to believe in value

From our vantage point, there are five main reasons that value stocks are likely to have staying power for the rest of this year, at least.

The economic cycle favors value. The early stages of an economic recovery, when GDP growth accelerates and then becomes entrenched, are usually marked by rising Treasury yields, increasing inflation expectations, rising commodity prices, and the steepening of the yield curve (when longer-term Treasury yields rise more than short-term yields). We think these macro dynamics favor value because the segment has a meaningful share of cyclical stocks in the Financials, Industrials, Materials, and Energy sectors, which are quite sensitive to changing economic trends and should benefit as the economy reopens.

Earnings momentum could surprise. Earnings growth for the value segment is expected to exceed that of the growth segment by a wide margin in 2021, according to consensus forecasts, due to the anticipated snap-back in the economy and the cyclical nature of key value categories. While this is well known among institutional investors, we think there is upside to earnings estimates. For starters, cyclical earnings estimates are notoriously too conservative coming out of recessions. Importantly, RBC Capital Markets' U.S. economics team believes growth during the reopening could well exceed consensus GDP forecasts. If the reopening is indeed strong, S&P 500 consensus earnings and revenue estimates could be "far too low," according to our national research correspondent. Its analysts think cyclical stocks, including those in the value category, stand to benefit.

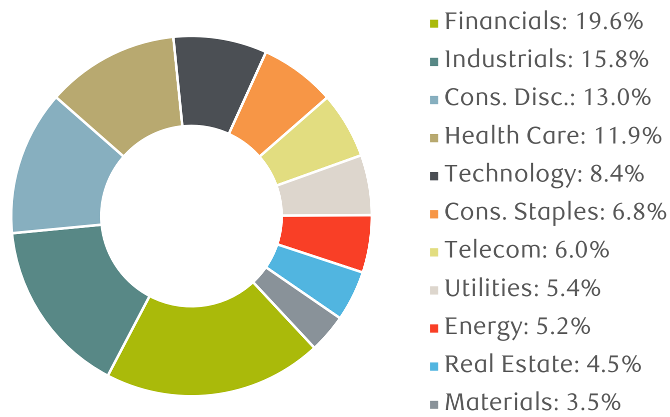
Value is still less expensive than normal relative to growth. Despite growth's underperformance since last November, the value segment still looks inexpensive versus growth in light of historical norms, according to RBC Capital Markets' price-to-earnings (P/E) analysis. This is corroborated by the firm's comprehensive valuation model, which incorporates 34 different metrics.

Dividends are more abundant—and in demand. The current dividend yield of the Russell 1000 Value Index is 2.0 percent, well above that of the Russell 1000 Growth Index at 0.8 percent. We think equity dividends will be in demand among individual investors amid the low bond yield environment, regardless of whether yields drift up further. Bond reinvestment rates aren't what they were five years ago, and anecdotal evidence indicates that investors are using dividend-paying stocks to help fill the income gap.

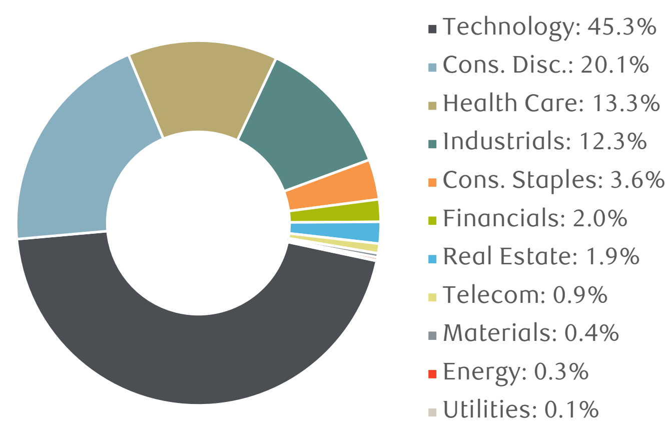
Momentum funds could add fuel. Even though value has outperformed recently, so-called "momentum funds" have yet to fully embrace the move. These funds tend to follow market trends, increasing positions in segments and stocks that are doing well in order to "ride the wave," so to speak. But they typically add exposure with a lag—meaning after trends have started to take hold. We think momentum funds will increase their exposure to value in the months ahead.

Major sector differences between U.S. value and growth indexes

Russell 1000 Value Index sector breakdown



Russell 1000 Growth Index sector breakdown



Source - RBC Wealth Management, Bloomberg; data through 3/23/21

Don't undervalue value stocks

Beyond this year, RBC Capital Markets' equity strategy team believes value stocks' longer-term staying power will depend on the magnitude of economic growth—the longer GDP growth can stay above trend, the better value's potential to put together a longer winning streak. Fiscal stimulus and ultra-loose monetary policies are tailwinds and should lift GDP at healthy rates this year and next, but it is unclear how these dynamics will play out in 2023 and beyond.

While well balanced portfolios should include both value and growth exposure, we would continue to Overweight value for the time being, and would pay particular attention to cyclical sectors such as Financials, Materials, Industrials, and Energy that should benefit as the economy opens up further. We believe value stocks have the ability to outperform growth stocks this year, at least.

UNITED STATES

Atul Bhatia, CFA – Minneapolis

■ **The Federal Reserve will require banks to fully implement the supplementary leverage ratio** (SLR) beginning Apr. 1, 2021. Banks have been operating in the pandemic under a Fed waiver allowing them to exclude Treasuries and excess reserves from their asset base when calculating SLR capital levels. The Fed's decision last week not to extend the exemption will **potentially reduce bank demand for Treasuries and increase downward pressure on deposit rates**, as institutions face a higher cost of capital for these assets. The move by the Fed is a technical one, but it reflects the varied tools the central bank has to influence financial conditions, beyond merely moving interest rate targets.

■ **Returns on cash held in short-term instruments were under pressure before the Fed move, with the yield on 1- and 3-month Treasury bills turning negative this week**. The supply of T-bills has dropped by more than $200 billion so far this year, as the Treasury Department reduces its cash balances and comes into compliance with debt ceiling limits. Negative T-bill yields are not a new phenomenon—rates were negative as recently as March 2020—and we expect the supply situation to be resolved in the coming months. Returns on cash are unlikely to push significantly higher, however, until excess banking reserves decline to more normal, pre-pandemic levels.

■ **Supply chain disruptions continue, as a grounded container ship temporarily closed traffic at the Suez Canal** this week. The Suez difficulties are felt primarily in the energy sector, as the canal remains a key transit point for oil and petroleum products. Separately, **semiconductor shortages have caused automakers to cut production runs**, with the estimated impact reaching as high as 1.5 million units globally for 2021, according to a Bloomberg report. These supply chain issues—which may increase as the economic reopening accelerates—complicate the interpretation of inflation data, as shortages can push prices higher. This supply-driven inflation is typically short-lived and has historically been given little weight by monetary policy officials.

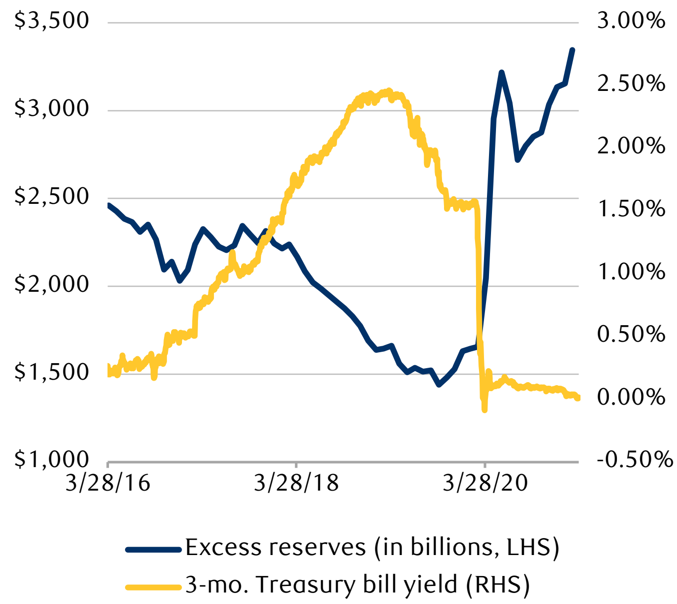
CANADA

Carolyn Schroeder & Arete Zafiriou – Toronto

■ **Canada's national wealth rose to a record CA$12.42 trillion in Q4 2020**. Statistics Canada reported household wealth was up 3.7% over the quarter and 9.3% over the course of the year, bolstered by government support and higher asset prices. While wages and salaries dropped CA$36 billion between Q4 2019 and Q4 2020, the fall was more than offset by the CA$117 billion increase in government transfers. Financial asset holdings increased CA$291 billion y/y amid the rebound in equity markets. Residential real estate rose 3.4% over the quarter, surpassing CA$6 trillion for the first time. Even accounting for the CA$110 billion increase in mortgage debt over the past year, net household equity in real estate added CA$531 billion to household wealth in 2020. The household savings rate remained in double-digit territory for the third consecutive quarter. As a result, currency and deposit holdings expanded over CA$48 billion in the last quarter, to end the year CA$205 billion higher.

■ It's been a year since the World Health Organization declared a global pandemic and much has changed since then, including **the way Canadians shop**. According to RBC Economics, **three key trends have emerged**. First, **without virus containment measures, consumers will spend**. Consumer spending on merchandise bounced back after winter lockdowns as retail store-fronts reopened and the latest downturn was less severe with households and businesses having adapted to contactless purchase options. Second, **nesting matters** in an increasingly physically distant world. Canadian household spending accounted for 17% of total spending before COVID-19 and one year later it is 21%. As the service sector reopens, some of that cash will likely be re-directed to spending outside of the home. Finally, **retail digitalization is here to stay**. The pandemic has kept many businesses operating under restrictions and stores have responded by increasing e-commerce infrastructure and sales, helping to accelerate a trend that was already in place before the pandemic.

Short-term yields held down by cash balances



Source - RBC Wealth Management, Bloomberg; data through 3/24/21

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

- News was mixed out of Europe. **The IHS Markit Eurozone Composite Purchasing Managers' Index (PMI) for March climbed into expansionary territory at 52.5**. This was driven by a surge in the Manufacturing PMI to a record high of 62.4. The services component improved, though it remained in contractionary territory. All readings were comfortably above consensus expectations. The surprisingly strong showing corroborates our observation that **the economy is weathering the COVID-19 crisis better than feared**, as individuals and businesses adapt to new conditions.

- Yet with many countries in the region extending lockdowns and social distancing measures in an attempt to fight the new COVID-19 variants, we believe **further improvement is likely to be postponed**, with the services sector likely to suffer most.

- **In the UK, the March PMIs also surpassed consensus expectations as businesses start to set up for reopening later in the spring**. The Composite PMI jumped seven points to 56.6 with services registering the biggest improvement. Manufacturing also saw an upturn, but to a lesser extent—possibly due to global shipping and supply chain issues and to the difficulty of adapting to the new trade regime now that seamless exports to the EU are no longer possible.

- **Intel's announcement that it will spend $20 billion to build two new semiconductor factories boosted the European semiconductor equipment manufacturers**, including ASML and ASM International, whose shares rose 6% and 4%, respectively, during the week. These gains helped the Technology sector outperform during the week.

- At the industry level, the semiconductor group has been one of the strongest performers in Europe year-to-date, up almost 20% in euro terms. **We believe the long-term growth prospects for the semiconductor industry remain bright** as megatrends such as 5G, artificial intelligence, electric vehicles, and high-performance computing fuel ever-increasing demand for smaller, faster, and more powerful chips. Accordingly, chips are becoming even more essential to the global economy.

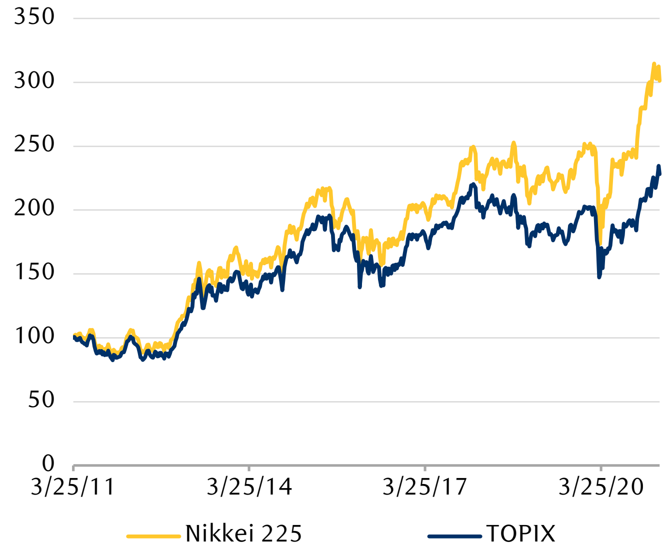
ASIA PACIFIC

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

- **Asia Pacific equity markets traded mostly lower during the week, led by Japan and Hong Kong**. The Nikkei 225 (NKY) has underperformed the region and its TOPIX (TPX) counterpart after the Bank of Japan (BoJ) announced it will only buy exchange-traded funds (ETFs) that track the broader TPX gauge. While the BoJ has been purchasing a smaller share of NKY ETFs since 2018, the latest development came as a surprise. Analysts now expect the historical relative outperformance (10-year total returns as of Mar. 24, 2021: NKY +264.9%, TPX +181.3%) to gradually narrow.

Shift by Bank of Japan may lead TOPIX to outperform

Index levels normalized to 100 as of Mar. 25, 2011



Source - RBC Wealth Management, Bloomberg; data through 3/25/21

- **The au Jibun Bank Flash Japan Manufacturing Purchasing Managers' Index (PMI) rose to a seasonally adjusted 52.0 in March** from 51.4 in February as the pace of expansion of Japan's factory activity increased. Meanwhile, the services sector remained gloomier with the PMI mostly unchanged month over month at 46.5. While we still expect some softening in real GDP growth in Q1 2021, due to the COVID-19 state of emergency, we think there will be a strong bounce from Q2 onward on the back of the global economic recovery.

- In another sign of a growing regulatory oversight on the China tech companies, **the People's Bank of China will be looking to establish a joint venture (JV) with local tech giants** to oversee the data they collect from millions of Chinese consumers, according to Bloomberg. A part of the proposal is the JV eventually forming strategic alliances with government-backed institutions to facilitate data sharing. For now, it remains unclear what the scope of the new entity would be, what types of data it would manage, and from what sources.

- **Tencent Holdings (700 HK) reported better-than-expected FYQ4 2020 earnings**. The strong results were overshadowed by concerns about Beijing cracking down on large tech companies. We believe an unsubstantiated report by Reuters of a recent meeting between Tencent's founder and the regulators further concerned investors. While management tried to downplay the impact of a potential revamp of Tencent's US$120 billion Fintech business during the earnings call, the stock continues to trend lower to trade near a two-month low.

MARKET Scorecard

Data as of March 25, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,909.52	2.6%	4.1%	57.9%	39.7%
Dow Industrials (DJIA)	32,619.48	5.5%	6.6%	53.9%	27.8%
Nasdaq	12,977.68	-1.6%	0.7%	75.7%	69.9%
Russell 2000	2,183.12	-0.8%	10.5%	96.6%	44.3%
S&P/TSX Comp	18,651.10	3.3%	7.0%	41.9%	16.1%
FTSE All-Share	3,804.75	2.8%	3.6%	22.6%	-3.0%
STOXX Europe 600	423.08	4.5%	6.0%	35.0%	13.0%
EURO STOXX 50	3,832.57	5.4%	7.9%	36.9%	16.1%
Hang Seng	27,899.61	-3.7%	2.5%	18.6%	-2.2%
Shanghai Comp	3,363.59	-4.1%	-3.2%	20.9%	10.5%
Nikkei 225	28,729.88	-0.8%	4.7%	47.0%	37.0%
India Sensex	48,440.12	-1.3%	1.4%	69.8%	28.1%
Singapore Straits Times	3,141.71	6.5%	10.5%	25.4%	-1.3%
Brazil Ibovespa	113,749.90	3.4%	-4.4%	51.8%	21.4%
Mexican Bolsa IPC	47,012.37	5.4%	6.7%	32.3%	10.1%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.631%	22.7	71.8	76.4	-76.7
Canada 10-Yr	1.464%	10.9	78.7	56.2	-8.5
UK 10-Yr	0.729%	-9.1	53.2	28.4	-25.7
Germany 10-Yr	-0.384%	-12.4	18.5	-12.2	-35.6
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.55%	-0.9%	-3.0%	2.5%	16.3%
U.S. Investment-Grade Corp	2.25%	-1.6%	-4.5%	13.3%	21.3%
U.S. High-Yield Corp	4.34%	-0.2%	0.5%	30.7%	18.0%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,727.50	-0.4%	-9.0%	6.8%	30.7%
Silver (spot $/oz)	25.08	-5.9%	-5.0%	73.3%	61.4%
Copper ($/metric ton)	8,973.25	-1.8%	15.8%	85.2%	41.6%
Oil (WTI spot/bbl)	58.49	-4.9%	20.5%	208.0%	-0.5%
Oil (Brent spot/bbl)	61.82	-6.5%	19.3%	125.7%	-8.0%
Natural Gas ($/mmBtu)	2.57	-7.3%	1.2%	54.9%	-6.7%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	92.8850	2.2%	3.3%	-8.1%	-3.8%
CAD/USD	0.7927	1.0%	0.9%	12.5%	6.2%
USD/CAD	1.2615	-1.0%	-0.9%	-11.1%	-5.9%
EUR/USD	1.1763	-2.6%	-3.7%	8.1%	4.0%
GBP/USD	1.3735	-1.4%	0.5%	15.6%	4.1%
AUD/USD	0.7581	-1.6%	-1.5%	27.2%	6.6%
USD/JPY	109.1900	2.5%	5.8%	-1.8%	-0.7%
EUR/JPY	128.4300	-0.2%	1.8%	6.1%	3.2%
EUR/GBP	0.8564	-1.2%	-4.2%	-6.5%	-0.1%
EUR/CHF	1.1058	0.8%	2.3%	4.0%	-1.5%
USD/SGD	1.3491	1.2%	2.0%	-6.8%	-0.1%
USD/CNY	6.5463	1.0%	0.3%	-5.7%	-2.4%
USD/MXN	20.6674	-0.9%	3.8%	-13.6%	8.7%
USD/BRL	5.6452	0.7%	8.6%	49.4%	46.5%

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 0.9% return means the Canadian dollar rose 0.9% vs. the U.S. dollar year to date. USD/JPY 109.19 means 1 U.S. dollar will buy 109.19 yen. USD/JPY 5.8% return means the U.S. dollar rose 5.8% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 3/25/21.

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As of December 31, 2020

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
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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