GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

April 1, 2021

The recovery divide

Frédérique Carrier – London

Year 2 of COVID-19 is seeing a widening gap between Europe and the U.S. as lethargic vaccination progress and stimulus with less immediate firepower are hamstringing Europe's economic recovery. But we think growth will pick up, and explain why the environment is conducive for European equity performance.

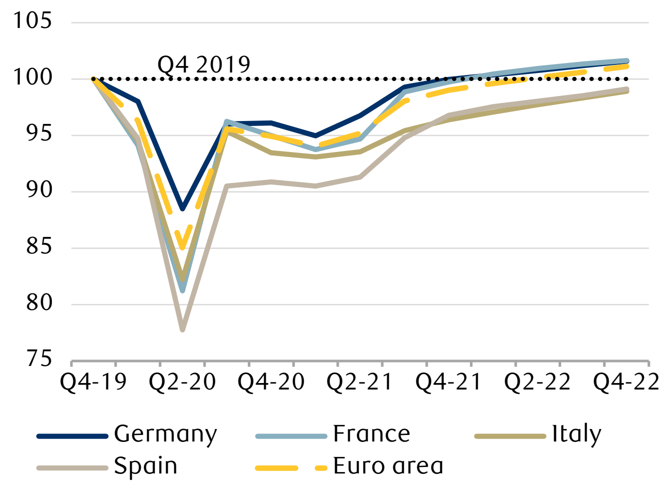
Having navigated the first stage of the COVID-19 crisis reasonably well, with an aggressive lockdown strategy that helped cap fatalities, Europe is now stumbling. Struggling to roll out vaccines, facing new virus variants, and with a fiscal stimulus injection that is more longer term in nature, its economic recovery has been lagging that of the U.S. But we believe Europe's recovery will eventually pick up and the region should benefit from global reflation, which would bode well for equities as the European stock market is well-geared to reflationary stocks. We look at the implications for portfolio strategy.

A delayed recovery

With the U.S. economy turbocharged from the recent $1.9 trillion COVID-19 relief package—RBC Capital Markets recently upgraded its 2021 U.S. GDP growth forecast to eight percent—it is not surprising that most other regions' short-term prospects pale in comparison.

Meanwhile, the new variants and a bungled vaccine programme have conspired to plunge much of the continent back into lockdown. RBC Global Asset Management Inc. Chief Economist Eric Lascelles uses Google Mobility data to illustrate the reopening divide between parts of the U.S. and Europe: Texas retail and

European Commission GDP forecasts



Source - European Commission, RBC Capital Markets; data as of Feb. 2021

recreational activity is now back to pre-pandemic norms, whereas it remains 47 percent below in France.

Yet the third COVID wave should have a lesser impact than previous ones. After all, by now, the most vulnerable have been inoculated, even though Europe has achieved a

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.

mere 15 doses per 100 people (vs. 42 doses per 100 people in the U.S.). Warmer spring temperatures may well limit the spread of the virus, while, as observed elsewhere, individuals and businesses have largely adapted to the new circumstances. Still, developments over the next few weeks will tell whether this assessment proves too optimistic.

Fiscal stimulus will help, but not to the same extent as in the U.S. this year as the EU is taking a markedly different tack. Instead of the U.S.'s approach of one-off cash injections targeting households, the EU has opted to invest in long-term competitiveness. The EU's €750 billion recovery fund, representing over five percent of the region's GDP, will focus on underpinning the recovery by deploying 40 percent of the funds for green spending and 20 percent for the digital transition, with the rest earmarked for infrastructure. The funds, which will start to be disbursed in the second half of this year, through to 2026, will only be made available to national governments if progress on certain reforms is made.

This package follows up on 2020's substantial fiscal response whereby national governments stepped up to mitigate the economic impact of the lockdowns on households and businesses via a combination of grants, support measures, and loans. Most countries made existing labour market support schemes more generous by increasing the level of payments, extending their duration, or making them easier to access. As a result, RBC Capital Markets estimates the EU fiscal deficit reached 10 percent of GDP in 2020. The stimulus proved effective as it prevented the unemployment rate from ballooning (currently 8.1 percent vs. the pre-pandemic level of 7.4 percent) and buttressed household income. Q4 2020 retail sales in the euro area were one percent higher year over year, a remarkable outcome given the hit the economy had taken.

Time will tell whether the EU's more measured approach to fiscal spending proves successful. Not to opt for a U.S.-style one-off cash injection may well be prudent given how quickly the European economy recovered following the end of the 2020 lockdowns: after Q2 2020 GDP plunged by 11.6 percent, Q3 GDP bounced back by 12.5 percent.

For now, the European Central Bank (ECB) will do its part to maintain accommodative monetary policy, having recently intervened to ensure financial conditions do not tighten.

RBC Capital Markets expects GDP growth of 4.1 percent in 2021, driven by the release of pent-up demand and household savings, which accumulated during the pandemic to the equivalent of more than three percent of GDP. Moreover, exports—more than 45 percent of GDP—should benefit from the pickup in growth in the U.S. and China. Admittedly, downside risks are lurking as growth could be compromised should new COVID-19 variants prove too difficult to control and social distancing measures need to be extended much beyond the spring.

Looking beyond 2021

The failure to provide an adequate vaccine programme is also taking a toll on European politics. This is important as both Germany and France will have national elections over the next 13 months.

For Germany, while the current conservative coalition remaining in power remains the most likely outcome, there is a rising possibility that a left-leaning coalition wins enough seats to form a government. Should the latter occur, increased regulations such as in the labour market would be a concern, as they could cap economic growth.

In France, Marine Le Pen of the far-right National Rally (the former National Front) is trying to capitalise on the situation by shedding her anti-euro rhetoric. She is instead focusing her campaign for president on hardline positions on immigration and national security. As such, a Le Pen victory at the 2022 presidential election would be less of a systemic shock than it would have been in 2017.

With the two largest EU economies facing potential changes in government, it's a welcome development that parliamentary support for Italian Prime Minister Mario Draghi continues—and with it, Italy's commitment to reforms.

Portfolio strategy

We recommend a Market Weight stance, or up to a benchmark position, in European equities. The eventual reopening of economies, fiscal support, and the ECB defending its accommodative monetary policy make for a conducive background for risk assets.

Our national research correspondent points out that European equities typically outperform when U.S. bond yields rise as they have comparatively high exposure to sectors that are beneficiaries of rising yields, such as Banks, Industrials, Consumer Discretionary, and Materials. Conversely, they have relatively lower exposure to Technology and Communication Services, sectors that tend to underperform in that environment. So, despite the EU's more subdued growth backdrop, European equities have more than kept pace with their U.S. counterparts since the rotation into value started last November.

Given the state of the recovery, the ECB is likely to embark on a monetary tightening cycle later than other central banks. This will likely weigh on the euro, in turn providing a tailwind to corporate earnings.

The MSCI Europe ex UK Index trades at a more than 20 percent discount to the S&P 500, but trades roughly in line with it on a sector-adjusted basis. We continue to favour the Industrials and Consumer Discretionary sectors as we believe they are well-positioned to benefit from both an improving global economy and long-term secular trends.

UNITED STATES

Alan Robinson – Seattle

■ U.S. stocks closed the holiday-shortened week near record highs, with the benchmark **S&P 500 Index trading above the psychologically important 4,000 for the first time**. The move was driven by solid economic data and a sense that increasing COVID-19 vaccination rates should dampen the impact of the recent uptick in case counts.

■ With the book closed on Q1 2021, **economic projections converged on a U.S. GDP growth forecast near 5%** (see chart). Strong housing data in the middle of the quarter was partly offset by global trade concerns relating to high raw material prices and global supply chain constraints exacerbated by the Suez Canal blockage, which was finally cleared during the week.

■ RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli expects this **strong cadence of quarterly growth to continue through the year**. He raised his 2021 real GDP forecast to 8.0% from 6.5%. The anchor to this call is an expectation that real consumer spending will hit double-digit growth this year, thanks to high savings levels and a release of pent-up demand as the economy reopens.

■ **The Biden administration announced details for its proposed infrastructure bill**. The American Jobs Plan seeks **$2.25 trillion in spending over eight years** on transportation, renewable energy, and manufacturing, among other things. The plan is funded by $2 trillion in corporate tax increases over 15 years, with the corporate tax rate increasing to 28% from 21%.

■ The largest components of the plan are **$620 billion to be spent on transportation infrastructure and $400 billion to expand domestic manufacturing**. Additional investments will be made in vehicle electrification, broadband access, and to modernize the electric grid. We believe it is likely that if the bill passes, most likely in Q4 2021, it will be via budget reconciliation, thus requiring only a simple majority in the Senate.

■ **While tax hikes will provide a headwind to corporate profitability**, domestically-focused sectors, such as U.S. Materials companies and manufacturers, should benefit. The U.S. dollar rose on the announcement, with the Dollar Index trading near a 5-month high at 93.4.

Q1 2021 GDP growth forecasts converge near 5%

Evolution of Atlanta Fed Q1 2021 GDPNow growth estimate

Source - RBC Wealth Management, Atlanta Fed; data through 4/1/21

CANADA

Ryan Harder – Toronto

■ **Real GDP grew 0.7% m/m in January, providing a better-than-expected start to the year for the Canadian economy**. After January's growth, Canadian GDP is down just 2.3% y/y, with the RBC Rates Strategy team expecting the economy to grow beyond its pre-pandemic level in Q2. The largest upside contributors were wholesaling activity, manufacturing, and construction, while retail trade, accommodation, and food services were a drag on growth with much of the country facing COVID-19-related restrictions over the winter. With vaccination rates increasing, the Canadian economy is likely to see some of the highest GDP growth readings in decades as the economy gradually reopens.

■ **The steepening of the yield curve has been a dominant focus for fixed income investors so far in 2021**. One aspect of a steeper curve is that with short-term rates pinned near zero, waiting in cash incurs substantial opportunity costs relative to the yields available on intermediate- or long-term bonds. This opportunity cost is another reason we believe investors should be cautious about attempting to time a top in yields, and would recommend taking a measured approach to duration management as the compensation for interest rate risk increases.

■ **The recovery in Canadian preferred shares has maintained its momentum so far in 2021**, with the S&P/TSX Preferred Share Index nearly 70% higher than the low set in mid-March 2020. The asset class has been aided by ongoing strength in risk assets and a steeper yield curve, which disproportionately benefits the majority of Canadian preferred shares that have a rate reset structure. Although the asset class continues to benefit from solid momentum, it's important to note that **valuations today are significantly richer than they've been at any point in the past 12 months**. We remain broadly constructive on Canadian preferred shares, but we encourage investors to be cognizant of the risks present in the asset class and to trim Overweight allocations as needed.

EUROPE

Thomas McGarrity, CFA – London

- **The initial public offering (IPO) of food-delivery company Deliveroo** on Wednesday, Mar. 31 was the biggest flotation on the London Stock Exchange in almost a decade. At the IPO price, the company's market value was £7.6 billion (approximately $10.5 billion); however, **the shares fell over 25% on their first day of trading**, the worst first-day performance in decades for a large UK IPO, according to Bloomberg.

- In the lead-up to the IPO, news reports from the likes of the Financial Times and Bloomberg reported numerous large institutional investors would not be participating in the IPO, with many citing **concerns connected to Deliveroo's worker practices**, in which it utilises self-employed workers as part of a "gig economy" model, which could further attract the attention of governments in the future and thus present potential regulatory risk. Without passing judgement on this particular instance, we believe **this episode underscores how social (i.e., the "S" in ESG) issues are becoming an ever-increasing consideration** for investors from an investment risk perspective rather than purely an ethical viewpoint.

- The £1.5 billion ($2.1 billion) raised by Deliveroo with its IPO helped contribute to the London Stock Exchange's best-ever Q1 for IPOs by value, according to Bloomberg, with more than £7 billion raised, the highest quarterly figure since Q2 2014.

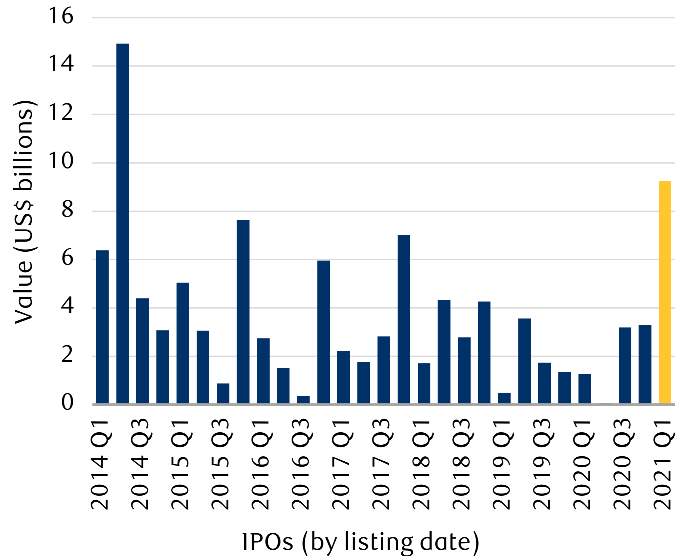
- Swiss wealth management and investment banking firm **Credit Suisse was the worst performer on the STOXX Europe 600 Index during the week**. The company's share price sunk over 18% since Monday's open, following the news of the **downfall of U.S.-based hedge fund Archegos Capital Management, which defaulted on margin calls made by Credit Suisse** as well as other banks. Credit Suisse stated on Monday that while being too early to quantify the exact size of the loss associated with exiting all the positions attached to Archegos, it could be "highly significant and material" to its Q1 results. Unconfirmed press reports from the Financial Times and Bloomberg, referencing people close to the bank as well as industry analysts, estimated the loss to be in the region of $3 billion to $4 billion.

ASIA PACIFIC

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

- Japan equities outperformed their Asian peers in Q1 2021 by the widest margin since late 2016, supported by the Japanese market's significant weighting of stocks expected to benefit from a global economic recovery. The Tokyo Stock Price Index (TOPIX) was up 8.3% in the first three months of 2021, compared with a gain of less than 2% in the MSCI Asia Pacific Index. TOPIX also booked its fourth consecutive quarterly gain, its longest winning streak since 2015.

The best quarter for UK IPOs by value for almost seven years



Source - RBC Wealth Management, Bloomberg

- **Japan's large manufacturers turned optimistic for the first time since September 2019**. The Bank of Japan's quarterly Tankan survey showed sentiment at large manufacturers of cars, electronics, and other products improved to 5 in March, breaking above zero for the first time since fall 2019. The positive result indicates optimists outnumber pessimists, and the figure was stronger than the zero consensus forecast by economists.

- **Hong Kong Exchanges & Clearing Ltd. (388 HK) proposed expanding the availability of secondary listings**, which are now only available to high-growth and innovative firms, to all companies with one-vote-per-share investment structures. The proposal would lower the minimum market capitalization to HK$3 billion, provided the company has a listing track record of five years. The current market capitalization requirement is HK$40 billion, or HK$10 billion with revenue of HK$1 billion. The move aims to attract more Chinese ADR companies to list in Hong Kong.

- **Chinese smartphone maker Xiaomi is moving into the electric car industry**. The company will invest $10 billion over the next decade in a subsidiary focused on the "smart electric vehicle" business. The new unit will be led by CEO Lei Jun directly, with an initial investment of RMB 10 billion ($1.5 billion).

MARKET
Scorecard

Data as of March 31, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,972.89	4.2%	5.8%	53.7%	40.2%
Dow Industrials (DJIA)	32,981.55	6.6%	7.8%	50.5%	27.2%
Nasdaq	13,246.87	0.4%	2.8%	72.0%	71.4%
Russell 2000	2,220.52	0.9%	12.4%	92.6%	44.2%
S&P/TSX Comp	18,700.67	3.5%	7.3%	39.8%	16.1%
FTSE All-Share	3,831.05	3.5%	4.3%	23.3%	-3.7%
STOXX Europe 600	429.60	6.1%	7.7%	34.2%	13.3%
EURO STOXX 50	3,919.21	7.8%	10.3%	40.6%	16.9%
Hang Seng	28,378.35	-2.1%	4.2%	20.2%	-2.3%
Shanghai Comp	3,441.91	-1.9%	-0.9%	25.1%	11.4%
Nikkei 225	29,178.80	0.7%	6.3%	54.2%	37.6%
India Sensex	49,509.15	0.8%	3.7%	68.0%	28.0%
Singapore Straits Times	3,165.34	7.3%	11.3%	27.6%	-1.5%
Brazil Ibovespa	116,633.70	6.0%	-2.0%	59.7%	22.2%
Mexican Bolsa IPC	47,246.26	6.0%	7.2%	36.7%	9.2%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.746%	34.1	83.3	107.6	-65.9
Canada 10-Yr	1.560%	20.5	88.3	86.3	-5.7
UK 10-Yr	0.845%	2.5	64.8	48.9	-15.5
Germany 10-Yr	-0.292%	-3.2	27.7	17.9	-22.2
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.60%	-1.2%	-3.4%	0.7%	15.9%
U.S. Investment-Grade Corp	2.29%	-1.9%	-4.8%	8.6%	20.9%
U.S. High-Yield Corp	4.31%	-0.1%	0.6%	23.5%	18.2%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,708.06	-1.5%	-10.0%	8.3%	32.2%
Silver (spot $/oz)	24.42	-8.4%	-7.5%	74.8%	61.5%
Copper ($/metric ton)	8,770.25	-4.0%	13.2%	77.6%	35.2%
Oil (WTI spot/bbl)	59.16	-3.8%	21.9%	188.9%	-1.6%
Oil (Brent spot/bbl)	63.54	-3.9%	22.7%	179.4%	-7.1%
Natural Gas ($/mmBtu)	2.61	-6.0%	2.6%	58.8%	-2.1%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	93.2300	2.6%	3.7%	-5.9%	-4.2%
CAD/USD	0.7961	1.4%	1.4%	12.0%	6.3%
USD/CAD	1.2562	-1.4%	-1.3%	-10.7%	-5.9%
EUR/USD	1.1728	-2.9%	-4.0%	6.3%	4.5%
GBP/USD	1.3787	-1.0%	0.9%	11.0%	5.8%
AUD/USD	0.7594	-1.5%	-1.3%	23.9%	7.0%
USD/JPY	110.7400	3.9%	7.3%	3.0%	-0.1%
EUR/JPY	129.8800	0.9%	2.9%	9.5%	4.4%
EUR/GBP	0.8507	-1.9%	-4.8%	-4.2%	-1.2%
EUR/CHF	1.1080	1.0%	2.5%	4.5%	-0.7%
USD/SGD	1.3455	1.0%	1.8%	-5.4%	-0.8%
USD/CNY	6.5528	1.1%	0.4%	-5.6%	-2.4%
USD/MXN	20.4292	-2.0%	2.6%	-13.7%	5.2%
USD/BRL	5.6281	0.4%	8.3%	48.9%	43.6%

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 1.4% return means the Canadian dollar rose 1.4% vs. the U.S. dollar year to date. USD/JPY 110.74 means 1 U.S. dollar will buy 110.74 yen. USD/JPY 7.3% return means the U.S. dollar rose 7.3% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 3/31/21

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Buy [Outperform]	762	55.46	299	39.24
Hold [Sector Perform]	559	40.68	179	32.02
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