GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

April 22, 2021

A taxing situation?

Kelly Bogdanova – San Francisco

The Biden corporate tax hikes look more like a matter of when, not if. So, markets are contemplating just how much they will eat into profits. But we don't think the hikes in and of themselves will be the make-or-break factor for stock performance, and we explain why the U.S. equity market should be able to absorb the hikes.

One of the biggest sources of angst among equity institutional investors is the prospect that U.S. corporate taxes could increase, according to an RBC Capital Markets survey. Such tax hikes are included in the infrastructure bill proposed by President Joe Biden. Concerns about this have even overshadowed the potential benefits of the sweeping $2 trillion, multiyear infrastructure package.

The proposal's spending provisions include: $213 billion to retrofit over two million housing units for energy efficiency; $174 billion for electric vehicle infrastructure and production incentives; $115 billion for highways, roads, and bridges; $111 billion for water infrastructure; $100 billion to expand high-speed broadband; and $100 billion to improve power infrastructure.

To help fund the package, Biden seeks to unwind some—but not all—of former President Donald Trump's corporate tax cuts that were implemented in 2017. The tax code would change in four key ways:

- Raise the corporate rate to 28 percent from 21 percent (prior to Trump, it had been 35 percent)
- Hike tax rates on multinational corporations
- Introduce a minimum tax rate on large companies
- Eliminate subsidies for fossil fuel companies (oil and natural gas), and incentivize clean energy production (wind, solar, etc.)

We think an infrastructure bill in some form has a high likelihood of passing, perhaps an 80 percent probability or even a bit more. The Senate parliamentarian has already ruled that the legislation would require a simple majority to pass, rather than a supermajority required with a filibuster. The composition of the bill will likely change as Congress puts its own stamp on the legislation, and the final votes may not take place until Q4 of this year.

How big of a sting?

Our national research correspondent estimates the proposed tax code changes would raise the S&P 500's effective tax rate to 25 percent from just under 20 percent. This would result in a six percent to seven percent hit to corporate earnings in 2022, the first year of implementation.

This is a similar range of other major investment firms, but it's not the only view. RBC Capital Markets, LLC's Head of U.S. Equity Strategy Lori Calvasina sees the potential for a bigger hit to S&P 500 earnings—in the nine percent to

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

13 percent range. She points out this is an initial estimate, as many of the plan's details are still in flux.

Not all sectors, industries, and companies would experience the same impact from corporate tax increases given the complexity of tax law and company-specific circumstances.

Companies that were the biggest beneficiaries of the Trump tax cuts could end up seeing the highest tax increases. RBC Capital Markets believes this is already starting to be factored into the market as some of these stocks have lost momentum recently.

An interesting aspect of the tax hike proposal is how it could impact multinational versus domestic firms. Key provisions focus on raising tax rates on multinationals, many of which currently pay relatively low taxes on foreign earnings. Nevertheless, when considering the complete basket of Biden's tax proposals, our national research correspondent estimates that domestic firms would still end up paying higher rates, on balance, and would likely see a greater hit to profits, as the tables below illustrate.

At this stage, there are no widespread discussions about raising tax rates on individuals to fund this particular infrastructure bill. (This could come later, in a separate follow-on bill and in other spending bills. Bloomberg reported on plans to nearly double the top capital gains rate as part of the "American Families Plan," which would increase social spending.)

However, if the corporate tax hike is limited to 25 percent instead of 28 percent—an idea one moderate Democratic senator has floated—tax increases on upper-income individuals and/or investors could be inserted into the legislation to make up the funding gap. But for now, the proposal is to fund this bill through corporate tax hikes.

Economic recovery sets the tone

Corporate tax rates are not the most important factor for investment decisions, in our view. In other words, we don't recommend jettisoning stocks in certain sectors and industries or those of domestic firms just because they might face a bigger hit to earnings. Individual business, industry, and economic fundamentals typically impact stock prices much more over the long term.

Infrastructure bill: Corporate taxes seem set to rise

Major provisions	Trump Tax Cuts and Jobs Act	Biden tax proposals
Corporate tax rate	Reduced from 35% to 21%	Increase to 28%
Multinational reforms	Repatriation and territorial tax relief; Minimum tax on foreign earnings (GILTI, BEAT)	Double minimum tax on foreign earnings (GILTI); Eliminate FDII; Replace BEAT with SHIELD; Global minimum tax (e.g., OECD); Prevent corporate inversions
Minimum tax on "book" profit on "large" firms	No	Yes, at 15%
Clean energy		Clean energy incentives; Eliminate fossil fuel subsidies

Source - National research correspondent, Tax Cuts and Jobs Act of 2017. Details of the Biden tax proposals are not currently available. Preliminary analysis based on the "Made in America Tax Plan" (4/7/21), Biden campaign proposals, and analysis of The Tax Foundation and Tax Policy Center.

We think the U.S. equity market can absorb corporate tax hikes without major disruptions, but perhaps with some rotation and consolidation along the way. We're not being dismissive; profits will be constrained. It's just that we think the timing of corporate tax hikes and economic momentum are more important considerations. The economy is in the early stages of a potentially powerful recovery. The tax hikes would take place into this momentum, not during the middle of a recession—the worst time to raise taxes. Economic momentum and related profit margin expansion could outrun at least part of the negative earnings impact from corporate tax hikes in the first year of implementation.

In our view, the market's ultimate path is going to be more influenced by the pace and durability of the economic recovery, rather than whether corporate taxes are raised. We think the economic outlook is favorable, and therefore would remain Overweight equities.

Biden proposal: Examples of corporate tax hikes by type of firm

Multinational large-cap firms

Company	% of foreign Sales	% of foreign Earnings	Effective tax rate Last FY	Effective tax rate Biden proposal	Earnings impact
Apple	60%	57%	14%	18%	-4%
Microsoft	49%	55%	17%	22%	-6%
Alphabet	53%	22%	16%	22%	-7%
Facebook	58%	27%	12%	17%	-5%
Visa	54%	33%	21%	25%	-5%

Domestic large-cap firms

Company	% foreign sales	Effective tax rate Last FY	Effective tax rate Biden proposal	Earnings impact
UnitedHealth	3%	24%	31%	-9%
Home Depot	8%	24%	30%	-8%
Verizon	0%	23%	30%	-8%
T-Mobile	0%	22%	28%	-8%
Lowe's	6%	25%	31%	-9%

Source - National research correspondent, FactSet. Universe: U.S. largest 500 companies (ex Financials, Real Estate, Regulated Utilities, and Inversions). Effective tax rate last fiscal year (FY) is as reported. This analysis estimates impact of raising the corporate tax rate to 28%, a 15% minimum tax on book profits, and a minimum tax on foreign earnings of 21%. Actual tax rates can be different based on each company's tax situation and application of details.

UNITED STATES

Atul Bhatia, CFA – Minneapolis

■ **No major policy shifts are anticipated at next week's Federal Reserve Board meeting**; instead, we expect the central bank to reiterate its commitment to continuing accommodation at current levels until employment has fully recovered and inflation is well established at the 2% target level. We believe **the Fed's approach makes a rate hike unlikely before 2023** at the earliest, as the U.S. economy is more than 10 million jobs below its pre-pandemic trajectory and inflation readings are well below 2%.

■ **One area where we believe the Fed may be active in the near term is the T-bill market**. Since mid-February, the Treasury Department has increasingly redeemed maturing bills instead of rolling them over. This move has helped the government come into compliance with congressional debt ceiling limits, but it has created problems for money market funds and investors who are restricted to government debt. The result has been **consistent negative yields in the T-bill market and pressure on other short-term, high-quality investments**. The Fed may decide—potentially at next week's meeting—to alleviate the rate pressure, possibly by selling some of its own T-bill holdings. Although such a move would tend to push yields higher, it would not be a rate hike in the monetary policy sense but rather an expression of the Fed's distaste for negative rates.

■ With Fed officials in their traditional pre-meeting quiet period and a dearth of meaningful economic data releases, **Treasury markets have been quiet and stable this week**. The slow trading environment had created some concerns in the run-up to yesterday's auction of **20-year government debt**, a maturity that had seen low demand in prior auctions. However, **this week's sale was well received, despite yields being 0.20% below their mid-March highs**. Bloomberg reported, citing bidders, that strong foreign demand helped the sale. With more than $13 trillion in global debt now trading at negative yields, currency-hedged Treasury returns are still attractive, in our view.

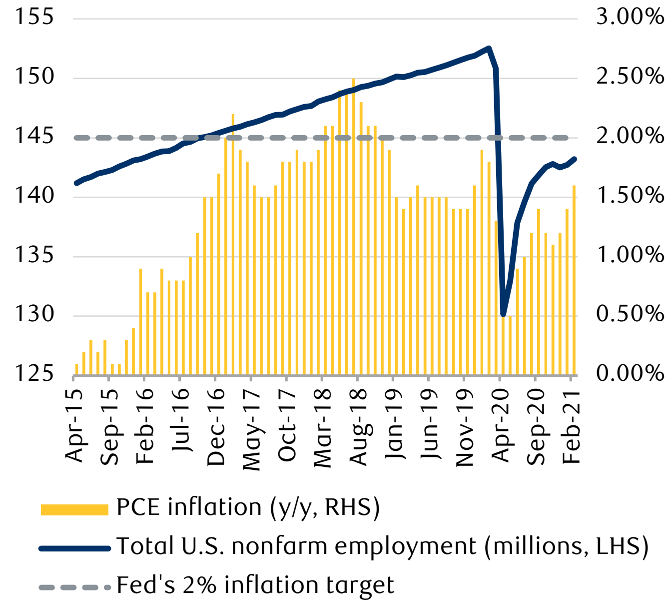
CANADA

Carolyn Schroeder & Richard Tan, CFA – Toronto

■ Earlier this week, **the Bank of Canada (BoC) kept its overnight policy rate unchanged at 0.25%** as widely anticipated. Recall that the BoC stipulated it would hold the overnight rate at the effective lower bound until slack in the economy is absorbed and the inflation target of 2% is sustainably achieved. The BoC now believes these conditions could be met in H2 2022, which appears to be consistent with expectations in the fixed income market

Fed's dual mandate requires accommodation

Job losses and low inflation likely to drive policy



Source - RBC Wealth Management, Bloomberg; data through 2/28/21

where longer-term bond yields have moved higher year to date. Furthermore, **the BoC reiterated its plan to trim its weekly bond purchasing program** to CA$3 billion from CA$4 billion starting the week of April 26, reflecting the progress made in the economic recovery thus far. The announcement boosted the Canadian dollar against the U.S. dollar, adding to its relative strength since the beginning of the year.

■ **Canada's first federal budget in two years included stimulus to help the economy along its path of recovery amidst the pandemic.** The budget proposes to spend roughly CA$100 billion over three years, amounting to 4%–5% of GDP. While new tax measures were limited, a stronger-than-expected economic backdrop is expected by the Government of Canada (GoC) to deliver enough additional revenue to finance more than half of that new spending. **One notable new tax measure is a limitation of "excessive" interest deductions for businesses** which will limit interest deductions to 40% in the first year and 30% thereafter. **Notably absent were demand-side measures addressing the extremely strong housing market** across the country with the exception of a 1% tax on vacant housing owned by foreign non-residents effective Jan. 1, 2022. Budget deficits are CA$354 billion for 2020–21 and projected at CA$155 billion for 2021–22, CA$50 billion for the next two years, and shortfalls expected by the GoC to exceed 1% of GDP in the following years. As a result, the debt-to-GDP ratio is only expected by the GoC to shrink modestly from 51.2% in the current fiscal year to 49.2% at the end of the forecast period, well above the 31% pre-pandemic level.

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

- Ahead of the U.S.-led virtual climate summit, both the EU and the UK raised the bar on climate leadership. **EU members made legally binding the commitment to cut greenhouse gas emissions by 55% compared to 1990 levels by 2030** and to net-zero emissions by 2050.

- **While being lauded for this achievement, the European Commission (EC) was heavily criticized for delaying its landmark classification system for emission-generating industries**. This labelling system is meant to establish a standard in sustainable finance, helping investors to discern which activities truly protect the environment. Under pressure from lobbying groups and national governments, the EC delayed its labelling decision for gas and nuclear technologies, and included forestry and bioenergy as forms of green economic activity, drawing vociferous protests from scientists and non-government organizations.

- **In the UK, Prime Minister Boris Johnson announced even more ambitious targets**, now aiming to cut emissions by 78% compared to 1990 levels by 2035 (up from 68%). **While this is laudable, the UK is already falling behind its previous target** and a scheme to help decarbonize homes was shelved earlier this year. Detailed policies and funding to make this ambition a reality still need to be formulated.

- Both episodes in the EU and the UK point to the challenges in implementing climate change policies.

- Semiconductor equipment maker **ASML reported Q1 results that beat consensus expectations, and raised its sales growth guidance for 2021 to "towards 30%"** on a year-over-year basis, up from around 12% three months ago. The CEO stated ASML is seeing a significant increase in demand across all market segments since the beginning of the year from the build-up of digital infrastructure connected to secular growth trends such as 5G, artificial intelligence, and high-performance computing solutions.

- Elsewhere, **Kering and Hermès** followed European luxury goods peer LVMH (from last week) in reporting Q1 results substantially ahead of consensus forecasts. **Nestlé** delivered Q1 organic sales growth of 7.7% y/y, more than double the growth rate estimated by the consensus (+3.3%). **Credit Suisse** announced it had raised around CHF 1.9 billion (approximately $2 billion) via the issuance of convertible notes to bolster its balance sheet following the booking of a negative charge of CHF 4.4 billion in Q1, as well as the expectation of additional losses of CHF 600 million in Q2, related to the downfall of U.S.-based hedge fund Archegos Capital Management.

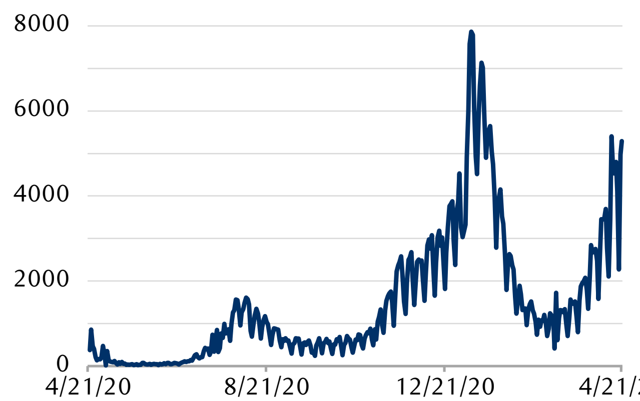
ASIA PACIFIC

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

- **Asia Pacific equity markets have traded mostly lower as of midweek with Japan leading the decline**. The Nikkei 225 has slipped this week as **the number of new COVID-19 cases is rising again**, just three months before the start of the Olympic Games in Tokyo. Local media outlets have reported that **the government is considering tougher measures** for the city, Osaka prefecture, and neighboring Hyogo prefecture, as experts warned that mutant strains of the virus are driving new outbreaks and straining health services. Should a third state of emergency be declared, we would expect the economic recovery to be pushed into the second half of 2021 from Q2 2021.

Japan facing a new wave of COVID-19 cases

Daily new cases



Source - RBC Wealth Management, Bloomberg; data through 4/21/21

- **President Xi Jinping of China**, speaking via video at the beginning of the Boao Forum for Asia in the southern island province of Hainan, called for greater global economic integration and **warned against decoupling while calling on the U.S. and its allies to avoid "bossing others around."** President Xi added that "any effort to build barriers and decouple works against economic and market principles and would only harm others without benefiting oneself." **Observers mostly believe the message is being targeted at the U.S.** for its efforts at reducing dependence on Chinese supply chains and withholding exports of goods such as advanced computer chips.

- **The Chinese government is considering a plan that would allow the People's Bank of China (PBoC) to take on more than 100 billion yuan of assets from China Huarong Asset Management Co.**, helping the state-owned company clean up its balance sheet and refocus on its core business of managing distressed debt, according to a Bloomberg report. Analysts believe the news suggests the PBoC is looking at ways to provide bailout solutions for Huarong, and this should give hope the Huarong saga will be dealt with in an orderly fashion that is less likely to result in bondholders incurring losses.

MARKET Scorecard

Data as of April 22, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,134.98	4.1%	10.1%	47.7%	42.2%
Dow Industrials (DJIA)	33,815.90	2.5%	10.5%	44.0%	27.6%
Nasdaq	13,818.41	4.3%	7.2%	62.7%	72.4%
Russell 2000	2,232.61	0.5%	13.1%	85.8%	43.1%
S&P/TSX Comp	19,031.64	1.8%	9.2%	33.2%	14.8%
FTSE All-Share	3,965.04	3.5%	7.9%	24.9%	-2.9%
STOXX Europe 600	439.63	2.3%	10.2%	33.2%	12.6%
EURO STOXX 50	4,014.80	2.4%	13.0%	41.6%	14.7%
Hang Seng	28,755.34	1.3%	5.6%	20.3%	-4.0%
Shanghai Comp	3,465.11	0.7%	-0.2%	21.8%	7.8%
Nikkei 225	29,188.17	0.0%	6.4%	52.5%	31.4%
India Sensex	48,080.67	-2.9%	0.7%	53.2%	24.4%
Singapore Straits Times	3,187.78	0.7%	12.1%	25.0%	-5.1%
Brazil Ibovespa	119,371.50	2.3%	0.3%	47.9%	26.2%
Mexican Bolsa IPC	49,092.31	3.9%	11.4%	43.4%	8.2%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.540%	-20.1	62.7	92.1	-104.9
Canada 10-Yr	1.518%	-4.0	84.1	90.2	-26.9
UK 10-Yr	0.740%	-10.5	54.3	41.3	-45.7
Germany 10-Yr	-0.252%	4.0	31.7	15.5	-27.7
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.49%	1.0%	-2.4%	0.1%	17.0%
U.S. Investment-Grade Corp	2.17%	1.2%	-3.5%	5.0%	22.6%
U.S. High-Yield Corp	4.06%	0.7%	1.6%	19.8%	19.3%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,783.35	4.4%	-6.1%	4.0%	39.9%
Silver (spot $/oz)	26.11	6.9%	-1.1%	73.0%	73.9%
Copper ($/metric ton)	9,459.50	7.6%	22.1%	85.1%	46.4%
Oil (WTI spot/bbl)	61.46	3.9%	26.7%	400.5%	-6.5%
Oil (Brent spot/bbl)	65.56	3.2%	26.6%	221.8%	-11.5%
Natural Gas ($/mmBtu)	2.75	5.4%	8.3%	41.8%	9.0%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	91.2890	-2.1%	1.5%	-9.1%	-6.2%
CAD/USD	0.7998	0.5%	1.8%	13.3%	6.8%
USD/CAD	1.2503	-0.5%	-1.7%	-11.7%	-6.3%
EUR/USD	1.2014	2.4%	-1.7%	11.0%	6.7%
GBP/USD	1.3839	0.4%	1.2%	12.2%	6.6%
AUD/USD	0.7707	1.4%	0.2%	21.9%	8.0%
USD/JPY	107.9700	-2.5%	4.6%	0.2%	-3.5%
EUR/JPY	129.7300	-0.1%	2.8%	11.2%	3.0%
EUR/GBP	0.8682	2.0%	-2.9%	-1.1%	0.1%
EUR/CHF	1.1017	-0.5%	1.9%	4.8%	-3.6%
USD/SGD	1.3289	-1.2%	0.5%	-6.9%	-2.0%
USD/CNY	6.4901	-1.0%	-0.6%	-6.5%	-3.3%
USD/MXN	19.9557	-2.3%	0.2%	-18.5%	6.0%
USD/BRL	5.4503	-3.3%	4.8%	44.2%	38.5%

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 1.8% return means the Canadian dollar rose 1.8% vs. the U.S. dollar year to date. USD/JPY 107.97 means 1 U.S. dollar will buy 107.97 yen. USD/JPY 4.6% return means the U.S. dollar rose 4.6% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 4/22/21

Authors

Kelly Bogdanova – San Francisco, United States
kelly.bogdanova@rbc.com; RBC Capital Markets, LLC

Atul Bhatia, CFA – Minneapolis, United States
atul.bhatia@rbc.com; RBC Capital Markets, LLC

Carolyn Schroeder – Toronto, Canada
carolyn.schroeder@rbc.com; RBC Dominion Securities Inc.

Richard Tan, CFA – Toronto, Canada
richard.tan@rbc.com; RBC Dominion Securities Inc.

Frédérique Carrier – London, United Kingdom
frederique.carrier@rbc.com; RBC Europe Limited

Thomas McGarrity, CFA – London, United Kingdom
thomas.mcgarrity@rbc.com; RBC Europe Limited

Jasmine Duan – Hong Kong, China
jasmine.duan@rbc.com; RBC Investment Services (Asia) Limited

Nicholas Gwee, CFA – Singapore
nicholas.gwee@rbc.com; Royal Bank of Canada, Singapore Branch

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As of March 31, 2021

			Investment Banking Services Provided During Past 12 Months	
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Buy [Outperform]	762	55.46	299	39.24
Hold [Sector Perform]	559	40.68	179	32.02
Sell [Underperform]	53	3.86	4	7.55

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