GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee | April 29, 2021

The UK's growth surge

Frédérique Carrier – London

Buoyed by a vaccine programme that's racing ahead, accelerating manufacturing activity, and a resurrection of the services sector, the UK outlook has acquired a healthier glow. All this momentum is encouraging, but we're also keeping our eye on several non-COVID wrinkles that could impact growth prospects and UK equities.

The UK's vaccination programme has been a success, both in terms of procurement, with the government establishing an industry-led vaccine manufacturing taskforce early on in the pandemic, and its rollout. With 51 percent of the population now having received at least a first dose, plans to lift all restrictions on the economy on June 21 are on track.

And along with all that, the recent economic news has been very encouraging, suggesting that the hit to the economy from the lockdown has been less than feared, and that activity has already started bouncing back in anticipation of the reopening.

Underpinned by a large savings pool, with households having accumulated more than £150 billion in additional savings versus 2019—equivalent to some eight percent of GDP—retail sales excluding automotive fuel rose by a robust 4.9 percent in March compared to the previous month, and this after a 2.5 percent gain in February. RBC Global Asset Management Inc. Chief Economist Eric Lascelles points out that the IHS Markit/CIPS Flash UK Manufacturing Purchasing Managers' Index reached a multi-decade high of 60.7 in April while the flash services reading surged to 60.1. Only three months ago the latter had languished at 39.5. The services component has thus accelerated from a level consistent with a deep recession to one associated with rapid growth in short order.

This turnaround makes sense, in Lascelles' view, given the prospect of the reopening after a long period of stringent restrictions, the early success of the vaccination programme, and by virtue of significant economic underperformance both last year and in early 2021 that gives the UK economy plenty of room to play catch-up. Aggressive fiscal support since last year—amounting to a full 14 percent of GDP—also helped. The consensus GDP forecast for 2021 has increased from 4.5 percent in early February to 5.5 percent today. Next year should see more strong growth as the post-pandemic rebound continues, with RBC Capital Markets penciling in a robust 5.8 percent increase in 2022.

Worrisome wrinkles?

A number of risks are worth watching, however, as they could impact prospects beyond the current growth surge. COVID developments are key, of course, but the further souring of the UK-EU relationship and that with Scotland are risks worth monitoring. Finally, a premature return to fiscal orthodoxy could also restrain growth.

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

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UK/Europe frayed relations

Post-Brexit trade frictions have not been assuaged, and the UK's economic performance would have been even stronger had exports not been restrained by the new rules now governing UK and EU trade.

After plummeting by 42 percent in January, UK exports to the EU recovered in February though they remain much below the level when the UK was a member of the single market. This is not surprising as just under half of UK-based exporters had problems with post-Brexit trade rules and have either been tangled up in more red tape or endured higher costs, according to the British Chambers of Commerce. Meanwhile, exports to other countries have not picked up enough to offset the shortfall.

Trade with the EU may well remain below historical levels for a long time unless these issues are tackled. Realigning Britain's food and agriculture standards with those of the EU, for instance, would help revive food and farm animal exports, which have been hurt the most, falling by more than 60 percent on a year-over-year basis in January. But the souring of UK and EU relations makes such a realignment difficult and could lead the EU to take a hardline approach to giving UK financial services firms access to its market.

Scottish independence?

The UK's relations with Scotland are also being tested. The Scottish nationalist movement has gained momentum since the UK voted to leave the EU. Scotland voted overwhelmingly to remain in the EU in the June 2016 Brexit referendum. Scottish farming and fishing industries in particular have been deeply scarred by the new trading rules negotiated by Prime Minister Boris Johnson.

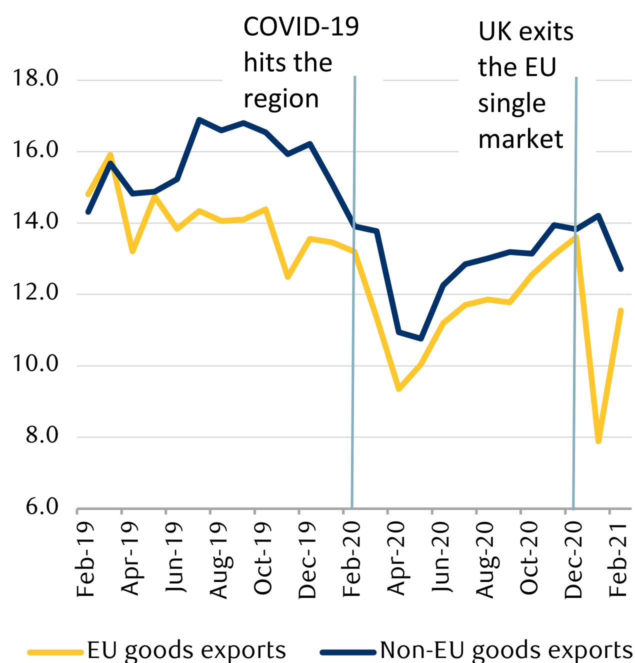
The Scottish parliamentary elections on May 6 look likely to yield a majority of pro-independence parties. A decisive victory would raise the prospect of Scotland, which contributes eight percent of the UK's GDP, breaking away from the UK with the aim of trying to join the EU as an independent country. There are many hurdles to this occurring, least of them Johnson granting the Scots a referendum and the Scottish nationalists winning it. But the uncertainty regarding this potential sequence of events could rekindle financial markets' concerns about the UK's post-Brexit future.

Fiscal rectitude

The government's intention to start to balance the books in two years' time by raising corporate taxes will be an additional burden for UK corporations. Yet 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.

February UK exports to EU bounce but remain weak

Pounds, billions



EU and non-EU goods exports, excluding non-monetary gold and other precious metals

Source - Office for National Statistics - UK trade statistics, RBC Wealth Management

Portfolio implications

We remain constructive on UK equities and would hold a Market Weight position. Over the past five years, due to the uncertainty following the Brexit referendum, UK equities endured severe outflows, which haven't yet been meaningfully reversed. The growing number of recent bids for UK-listed companies across a range of sectors over the past year highlights that global corporates and private equity are finding attractively valued assets in the UK, though the reappraisal of the UK equity market may take time.

In our opinion, UK equities still trade at attractive valuation levels in both absolute and relative terms. For instance, the MSCI United Kingdom Index trades at the widest discount to the MSCI World Index on a price-to-earnings basis in more than 20 years. Moreover, UK equities deliver the highest dividend yield globally at almost 3.5 percent.

The Materials and Financials sectors will likely be key beneficiaries of an economic recovery, while consumer-focused domestic stocks should be underpinned by the release of pent-up demand meeting high levels of consumer savings. We would maintain exposure to quality UK companies that possess an international footprint and trade at an unduly large discount to overseas-listed peers.

UNITED STATES

Ben Graham, CFA – Minneapolis

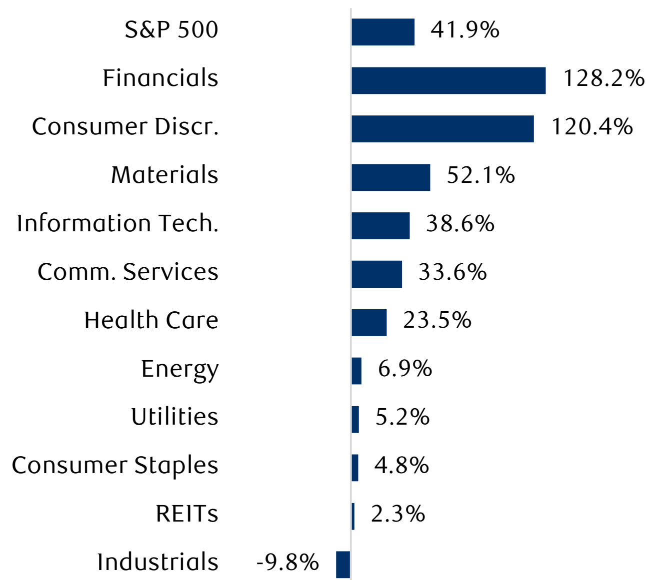
■ **U.S. equities are broadly higher as earnings season shifts to tech companies and the strong results being seen there**. The S&P 500 is up 0.8% thus far this week, while the Nasdaq has climbed 0.5%. Small caps, as measured by the Russell 2000, are 1.0% higher, with the Dow Jones the only major index in the U.S. to break the pattern and trade flat. Sector leadership is evident in Energy, Financials, and Communication Services. Health Care and Utilities are the biggest laggards.

■ **Strong quarters from Apple Inc. and Google parent Alphabet Inc. led earnings this week**, with both posting record revenues and profits. In fact, four of the five largest companies in the S&P 500 have now reported results, and on average, have beaten earnings expectations by 35%. With 60.8% of the S&P 500 market cap having reported quarterly earnings so far, results have been 24% better than expected and represent 42% bottom-line growth year over year. S&P 500 revenues are on track for 9% y/y growth. The best earnings growth is evident in Financials, Consumer Discretionary, and Materials. Industrials is the only sector to decline on a year-over-year basis, largely related to the impact of shutdowns and economic closure beginning in Q1 2020 but not really taking hold on a large scale until Q2 2020. We look for the industry to deliver sharp year-over-year earnings gains after this quarter ends.

■ **Key economic data, highlighted by the initial Q1 GDP release, was largely constructive in terms of furthering the evidence of a recovering U.S. economy**. U.S. GDP expanded by 6.4% in Q1, slightly higher than consensus expectations. Initial jobless claims continued to trend lower as this week's 553,000 initial filings declined week over week and pulled the four-week rolling average lower to 611,000, down from the one-month ago 721,000 level. Finally, the Fed meeting this week highlighted the central bank's ongoing dovish stance as Fed Chair Jerome Powell continued to express his opinion that inflation will prove transitory, that the Fed is not close to paring back its $120 billion per month bond-buying program, and that there are no plans to raise rates anytime soon.

The earnings recovery is underway

S&P 500 Q1 earnings growth y/y



Source - FactSet, RBC Wealth Management; data through 4/29/21

CANADA

Ryan Harder – Toronto

■ **After a sharp move higher in Q1 2021, Canadian yields have moved sideways in recent weeks**. This has been the case despite a series of very strong economic data prints, including higher-than-expected job creation, GDP growth, and retail sales. One aspect of rising yields that is often overlooked is the fact that a steeper curve comes with heightened expectations of rate hikes built in. In part because of these higher expectations, yields can decline even when other factors—such as strong economic data—might suggest otherwise. We encourage investors to remember that **a key question to ask is not whether the Bank of Canada will raise rates, but whether it will raise them faster or to a higher level than what the yield curve has already priced in**. Given the steepening of the curve in 2021, those expectations present a meaningfully higher hurdle for yields to continue increasing than they have for most of the past 12 months.

■ Retail sales in Canada added another strong economic print to the string of better-than-expected data in recent months. Sales in February increased by 4.8% m/m, beating the already elevated consensus expectations for a 4.0% increase. This marks **the highest-ever month-over-month increase in retail sales, aside from the two months of the initial rebound** in May and June of last year after the first COVID-19 lockdown ended. As the number of Canadians who are vaccinated continues to increase throughout the spring and summer, economic data is expected to remain strong. For this reason, **we believe the more reliable test of the ongoing health of the Canadian economy will come later in the year** when the data should be settling into a more consistent range.

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

■ **Banks was the best-performing sub-sector during the week, up almost 7%**, boosted by rising sovereign bond yields as well as better-than-expected Q1 results, with several of the region's lenders reporting earnings above consensus forecasts. **Central to banks' earnings beats has been the release of loan-loss provisions**.

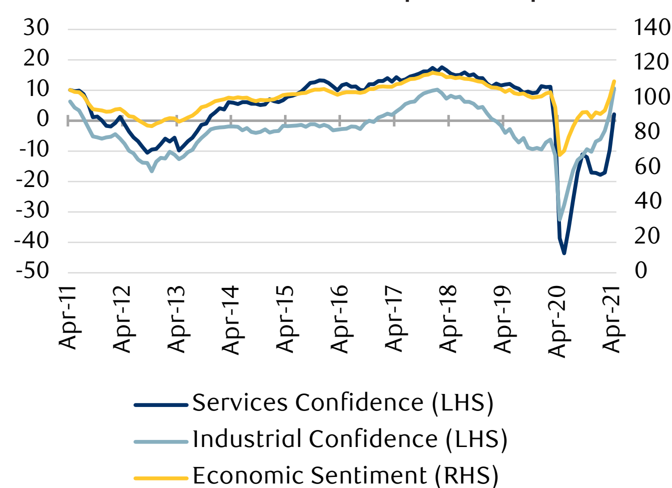
Banks built up sizeable reserve buffers through 2020 as a precaution against potential soured loans as a result of the pandemic. However, given the brightening outlook for the economy, many are starting to release funds from their bad loan reserves. For example, in the instances of UK-listed banks HSBC and Lloyds Banking Group, consensus estimates were for further loan-loss provisions to be made, but both wrote back impairment charges in the UK, reducing their bad loan reserves in light of the improved UK economic outlook (as outlined in the feature article).

- **Consensus earnings revisions have been rising for banks recently**, helped by falling loan-loss provisions. Provided the economic recovery remains on track, we believe the release of provisions can remain a tailwind for banks' earnings in the quarters ahead, supporting further positive earnings revisions for the sub-sector.

- **The Italian parliament approved Prime Minister Mario Draghi's €261 billion spending plan to revive the economy**, drawing from the EU's €750 billion recovery fund of which Draghi's country is the largest beneficiary. The stimulus package, representing some 14% of Italy's GDP, **will focus on six areas, including green infrastructure projects and digitisation**. The spending will be accompanied by a tough reform programme tackling public administration and the legal system in particular. It will be challenging to implement. Moreover, Draghi's tenure will likely end in 2023 whereas his spending plan runs until 2026. His programme could thus be put in jeopardy after he leaves. Yet, this is an opportunity for the country to improve its meek growth profile, in our opinion.

- Meanwhile, **the European Commission's economic sentiment indicator rose to 110.3 points in April, much above expectations and March's 100.9 level**. All large countries posted an improvement in sentiment. Industrial confidence is now at a record high while the services sector saw a notable improvement. That the recovery in sentiment continued despite the April lockdowns suggests to us the economy should gain momentum as lockdowns are eased.

European Commission sentiment indicators surge



Source - Bloomberg, RBC Wealth Management; monthly data through April 2021

ASIA PACIFIC

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

- **Asia equities traded broadly higher during the week** as investors expect another round of fiscal stimulus in the U.S., and the Federal Reserve's pledge to keep interest rates low could drive more inflows to emerging markets.

- **Chinese regulators announced on Monday they are conducting an antitrust investigation on food-delivery giant Meituan** (3690 HK). This is the second antitrust probe into a big tech company in China. According to the current regulation, companies can be fined 1%–10% of their annual revenue. But the markets don't expect Meituan to face a harsher penalty than Alibaba's 4% of 2019 domestic revenue.

- **Chinese authorities are investigating the IPO process of Ant Group**, a company that was expected to be listed in China and Hong Kong last year. Key questions raised by regulators include: why was Ant's IPO fast-tracked and did the company make sufficient disclosures and receive preferential treatment in the allocation of its stock code? An unsubstantiated report in Bloomberg said regulators will continue to support Ant's listing once the probe is completed and the company overhauls its business.

- **Samsung Electronics Co. (005930 KS) reported net income of KRW7.1 trillion for Q1 2021**, beating the KRW6.7 trillion Bloomberg estimate. However, the company **warned of continued semiconductor shortages** as the global economy recovers from the COVID-19 pandemic. Samsung said it **will step up production** to address the shortages and expects chip earnings to increase substantially in Q2.

- **Japan's retail sales increased 1.2% m/m in March**, higher than economists' 0.6% estimate even as businesses continued to operate under reduced hours. The positive numbers point to increasing resilience in spending despite emergency guidelines limiting activity, and it prompted an upgrade in the economy ministry's assessment of the trend.

MARKET
Scorecard

Data as of April 29, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,211.47	6.0%	12.1%	43.3%	43.1%
Dow Industrials (DJIA)	34,060.36	3.3%	11.3%	38.3%	28.3%
Nasdaq	14,082.55	6.3%	9.3%	58.0%	72.8%
Russell 2000	2,295.46	3.4%	16.2%	68.7%	43.6%
S&P/TSX Comp	19,255.92	3.0%	10.5%	26.4%	16.0%
FTSE All-Share	3,977.04	3.8%	8.3%	18.0%	-2.5%
STOXX Europe 600	438.77	2.1%	10.0%	26.4%	12.1%
EURO STOXX 50	3,996.90	2.0%	12.5%	33.4%	14.1%
Hang Seng	29,303.26	3.3%	7.6%	18.9%	-2.0%
Shanghai Comp	3,474.90	1.0%	0.1%	23.1%	13.5%
Nikkei 225	29,053.97	-0.4%	5.9%	47.0%	30.5%
India Sensex	49,765.94	0.5%	4.2%	52.1%	27.4%
Singapore Straits Times	3,221.58	1.8%	13.3%	25.1%	-5.4%
Brazil Ibovespa	120,065.80	2.9%	0.9%	44.4%	24.8%
Mexican Bolsa IPC	48,897.79	3.5%	11.0%	32.6%	8.8%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.634%	-10.6	72.1	100.7	-89.1
Canada 10-Yr	1.563%	0.5	88.6	99.7	-15.9
UK 10-Yr	0.843%	-0.2	64.6	55.8	-31.4
Germany 10-Yr	-0.193%	9.9	37.6	30.2	-19.6
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.53%	0.8%	-2.6%	-0.3%	16.7%
U.S. Investment-Grade Corp	2.18%	1.1%	-3.6%	4.4%	22.4%
U.S. High-Yield Corp	4.04%	1.0%	1.9%	20.0%	19.6%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,772.65	3.8%	-6.6%	3.5%	38.5%
Silver (spot $/oz)	26.10	6.9%	-1.1%	70.7%	75.0%
Copper ($/metric ton)	9,880.25	12.4%	27.5%	88.8%	54.3%
Oil (WTI spot/bbl)	65.01	9.9%	34.0%	331.7%	2.4%
Oil (Brent spot/bbl)	68.56	7.9%	32.4%	204.2%	-4.8%
Natural Gas ($/mmBtu)	2.91	11.4%	14.5%	55.5%	12.1%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	90.6250	-2.8%	0.8%	-9.0%	-7.4%
CAD/USD	0.8142	2.3%	3.7%	13.0%	9.6%
USD/CAD	1.2282	-2.2%	-3.5%	-11.5%	-8.7%
EUR/USD	1.2122	3.3%	-0.8%	11.5%	8.4%
GBP/USD	1.3940	1.1%	2.0%	11.8%	7.8%
AUD/USD	0.7766	2.2%	0.9%	18.4%	10.1%
USD/JPY	108.9100	-1.6%	5.5%	2.1%	-2.5%
EUR/JPY	132.0300	1.7%	4.6%	13.8%	5.7%
EUR/GBP	0.8696	2.2%	-2.7%	-0.3%	0.6%
EUR/CHF	1.1015	-0.5%	1.9%	4.0%	-3.4%
USD/SGD	1.3259	-1.4%	0.3%	-6.1%	-2.6%
USD/CNY	6.4722	-1.2%	-0.8%	-6.8%	-3.9%
USD/MXN	20.0452	-1.9%	0.7%	-15.6%	5.4%
USD/BRL	5.3447	-5.1%	2.8%	41.4%	35.5%

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 0.81 means 1 Canadian dollar will buy 0.81 U.S. dollar. CAD/USD 3.7% return means the Canadian dollar rose 3.7% vs. the U.S. dollar year to date. USD/JPY 108.91 means 1 U.S. dollar will buy 108.91 yen. USD/JPY 5.5% return means the U.S. dollar rose 5.5% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 4/29/21

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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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