GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee May 20, 2021

The Fed tees up tapering talk

Thomas Garretson, CFA – Minneapolis

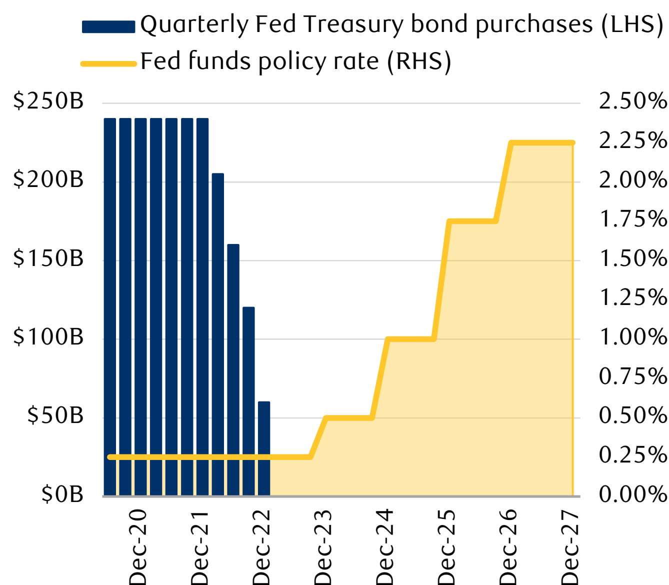
It was bound to happen sooner or later, but talk of the Fed dialing back its asset purchase program briefly rattled markets this week. While central banks will inevitably reduce support, we expect accommodation to remain in place for years.

Markets were treated to a kind of miniature "taper tantrum" this week as the minutes of the Federal Reserve's April 27–28 meeting revealed "a number of participants" were ready to talk about plans for dialing back the Fed's ongoing asset purchases at upcoming meetings, should the economy continue to make "rapid progress."

And while many observers might think—correctly, in our view—that discussing the potential to move away from accommodation is little more than stating the obvious, it is at odds with Fed Chair Jerome Powell's recent comments that the issue isn't even under discussion at this stage. This, perhaps, was the source of the markets' consternation.

So with markets already somewhat on edge given ongoing inflation fears, is "taper talk" yet another risk for investors to navigate in the coming months? After all, this week's Fed developments follow recent moves by the Bank of Canada and the Bank of England to begin the process, in various forms, of paring back their asset purchase programs.

The base case for the Fed's exit: Tapering starts early next year, rate hikes in late 2023



Source - RBC Wealth Management, Bloomberg, Federal Reserve Bank of New York Survey of Market Participants for March

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

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Priced (in USD) as of 5/20/21 market close, ET (unless otherwise stated). Produced: May 20, 2021 5:00 pm ET; Disseminated: May 20, 2021 5:03 pm ET
For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

As is typically the case with markets, the larger issue concerns what is priced in, and what is not. It's difficult to judge what the market consensus might be with respect to expectations for the Fed's exit, but the New York Fed's own Survey of Market Participants may give us the closest thing to a base case.

As the chart on the previous page illustrates, the March survey showed that most respondents expected the Fed's $240 billion in quarterly Treasury purchases to continue through the end of this year, then fall to $205 billion in the first quarter of 2022, $160 billion in the second, and ultimately decrease to zero by the end of the year. Accordingly, 2023 would remain the first window for the rate hike process to begin.

Powell has been adamant that markets would receive ample warning of the Fed's plans. While discussions are likely to pick up at the central bank's June 15–16 meeting, we don't expect any formal announcement until later in the summer. Should the Fed move more quickly than current consensus expectations, it could introduce volatility into markets, which we still think the Fed wants to avoid given the present uncertainty around the path of the economic recovery.

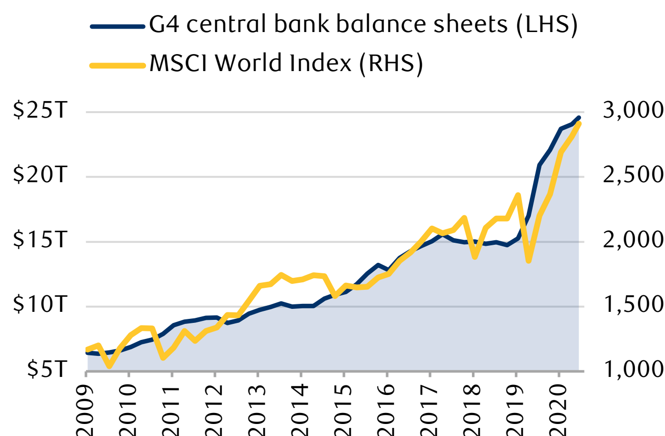
If central banks are pulling back, should you?

But as markets look to the Fed's June meeting for the next policy clues, they're also watching the European Central Bank amid rumblings that it, too, could be at the point of dialing back purchases in light of growing optimism around the vaccine rollout in Europe and an improving regional growth outlook. A move in that direction would put at least four of the major global central banks on the path toward some form of policy pullback.

As the chart above shows, there has been an apparent correlation between global stock prices and the balance sheets of major global central banks. However, we maintain that too much has been made of this relationship, and that central banks exiting stage left isn't necessarily a risk for risk assets such as stocks and corporate bonds. But it is certainly something to be cognizant of.

Beneath the surface, the actual relationship between stocks and central bank balance sheets has been tenuous at best over the years. The last time U.S. markets had to contend with fears around the Fed ceasing its asset purchases was at the end of 2014, and while many feared at the time this would put the market rally in jeopardy, the S&P 500 went on to deliver returns greater than 30% from 2015 through 2018. The same was true at the end of 2017, when the Fed's balance sheet actually began to contract while risk assets continued to perform strongly, broadly speaking.

As central banks plot their exits, are markets at risk?



Source - RBC Wealth Management, Bloomberg, G4 central banks are the Federal Reserve (U.S.), European Central Bank, Bank of Japan, and Bank of England

Erring on the side of caution

At the end of the day, and regardless of how strong the global recovery from the pandemic may be, we believe central banks aren't going anywhere anytime soon. Even if the Fed does wind down its asset purchases by the end of next year, the central bank will very likely continue to reinvest interest earned and maturing bonds, keeping its balance sheet flat as it did from 2015 through 2017. We don't anticipate the outright sale of bond holdings.

The lessons of the central bank experience in the aftermath of the global financial crisis showed that the costs of removing accommodation too early can be far greater than the costs of moving too late. Nowhere was this seen more clearly than in the case of the European Central Bank's decision to raise rates in 2011, only to find itself forced to reverse course almost immediately, an episode that culminated in negative policy rates just a few years later.

While central banks develop their exit plans, and with headline risks around the issue likely to only grow in the months ahead, we believe investors can expect ample policy support will likely remain in place over any reasonable time horizon.

UNITED STATES

Ben Graham, CFA – Minneapolis

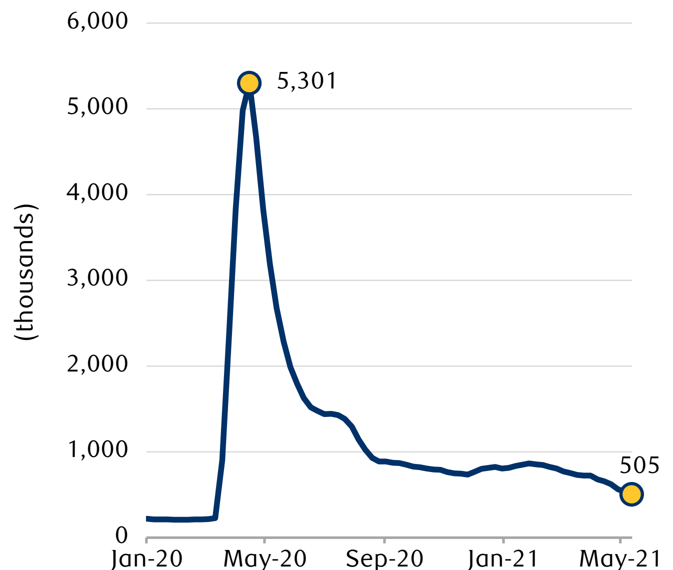
- **U.S. equities continued to move marginally lower this week, while the CBOE Volatility Index (VIX) has risen** from its mid-April low of just under 17 to a reading of nearly 24 earlier in the week. The S&P 500 is down 0.4% this week, and the Dow Jones Industrial Average is down 0.9%. Small caps, as measured by the Russell 2000, are down 0.8% this week, while the Nasdaq is the one index to buck this declining trend with a gain of 0.8%. The Nasdaq's leadership comes as Information Technology and Communication Services stocks lead all other sectors while Energy, Financials, and Industrials lag. These **sector moves have propelled growth stocks to outperform value stocks** this week, despite the latter's year-to-date lead of 10 percentage points.

- **U.S. retail companies started to report quarterly earnings this week that were broadly ahead of consensus estimates** and provided a few insights into the current consumer backdrop. Home Depot showed excellent growth on a same-store sales increase of nearly 31% y/y—an industry-leading level, but not the only large beat. Walmart, Target, and Lowe's all showed strong consumer trends in the quarter. Another key takeaway from Home Depot's reporting, and one that we have observed across the retail industry, was **the ability to fully pass on inflationary inputs to consumers**. Lumber and copper were the most inflationary items for Home Depot this quarter, as lumber prices have more than quadrupled year over year. However, demand remained robust and the pricing trends did not dampen volumes.

- **Weekly initial jobless claims continued their steady move lower**, with the 444,000 reported for the week ending May 15 coming in lower than expected and below the prior week's 478,000. This brings the four-week moving average to a post-pandemic low of 505,000. The four-week moving average has fallen from 5.3 million, but remains ahead of pre-pandemic levels in the low-to-mid 200,000s.

Jobless claims continue to decline, but remain above pre-COVID levels

Weekly initial jobless claims, 4-week average



Source - RBC Wealth Management, FactSet; data through 5/20/21

CANADA

Carolyn Schroeder & Richard Tan, CFA – Toronto

- As we approach the midyear mark, it's clear that **momentum is in the camp of cyclicals**. Copper has been topical, in part, due to its extremely strong growth with commodities prices up nearly 90% y/y. **A component of that momentum has been driven by the green energy transition** in which copper is often required as an input for electric vehicles and the buildout of renewable energy sources. Then there is the supply side of the equation, where inventories remain low, which, in turn, should support higher prices in the near term. **RBC Capital Markets is forecasting a global supply deficit in 2021** before the market flips into a supply surplus position from 2022 through 2024. With respect to copper equities, most have delivered strong returns, but we note that these companies account for less than 3% of the S&P/TSX Composite. As with most commodity-driven businesses, we would recommend managing position sizes accordingly as they often come with above-average volatility.

- **Canadian home resales declined 12.5% m/m in April** after successively setting new record highs through the fall of 2020 and initial months of 2021. Despite easing in the past three months, supply-demand conditions remain tight. **Canada's composite benchmark price (MLS Home Price Index) rose another CA$17,000 (2.4%) between March and April**, pushing up the increase to CA$135,000 (23.1%) since April 2020. Trends in Ontario dominate the national story though prices continue to climb in most other markets big and small. Ontario's cottage country is seeing competition among buyers, although small Southern Ontario markets and Ottawa were not far behind. In Western Canada, buyers had to pay materially more for homes in British Columbia, including the Fraser Valley and Victoria. **RBC Economics expects a gradual rise in longer-term interest rates, deteriorating affordability, tighter mortgage stress tests, and the resumption of office work to cool demand** while setting the stage for a moderation in the rate of price increases later this year.

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

- IHS Markit flash **Purchasing Managers' Indexes (PMIs) data for the UK and the euro area are due to be released on Friday**, May 21. In the UK, the flash PMI data will have come too early to capture the latest stage of the reopening of the economy. Nonetheless, **consensus expects the services PMI to signal a continued strong recovery rate**.

- **With respect to the euro area**, lockdowns have unsurprisingly weighed on services activity in recent months, but activity is beginning to improve. Last month's PMIs suggested that the decline in services sector activity was already bottoming out, with **the headline services reading moving above 50 (a level that indicates expansion) for the first time since August 2020**. With both Italy and Spain having eased social distancing restrictions in recent weeks, and activity in France likely having picked up in advance of the ending of national lockdown restrictions on Wednesday, May 19, services sector activity in the euro area looks set to recover further this month; consensus expects the services PMI reading to rise to 52.5, from 50.5 in April.

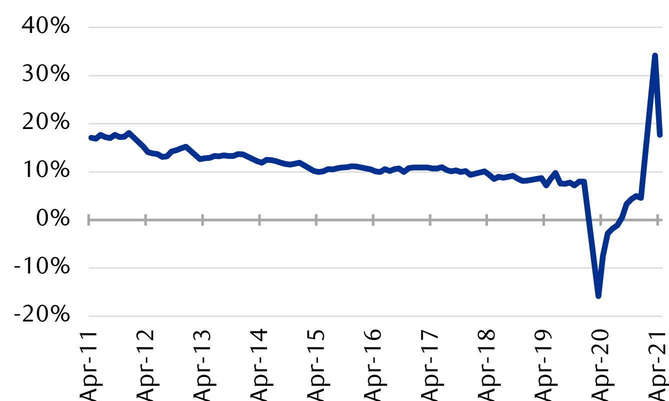
- **On the manufacturing front, advance indicators point to activity remaining strong in May**, with little change expected in the PMI month over month. Given the strength of the European manufacturing sector in recent months, we think it is reasonable to expect that the pace of growth will begin to slow in the coming months.

- According to the minutes of its recent meeting, **the European Central Bank (ECB) has been focused on the strength of the recovery**. The ECB now sees the risks to activity as being marginally tilted "to the upside" in the medium term. The vaccine rollout has accelerated sharply, with the rolling two-week average of doses administered per 100 people reaching 11.3 in Germany, 11.2 in Spain, and 10.2 in Italy, compared to 9.9 in the UK. This bodes well for the reopening of economies.

- This has sparked **debate as to whether the ECB could start to discuss reducing the pace of its Pandemic Emergency Purchase Programme**, which it had upped to "significantly higher" a few months ago. We think the next meeting, on June 10, will be one to watch closely. Rising euro area sovereign bond yields, which result in higher borrowing costs, will likely be a primary focus for the ECB given its determination to "preserve favourable financing conditions." For now, **markets are not expecting the ECB to begin raising its Deposit Rate until around mid-2023**—lagging the U.S. Federal Reserve and the Bank of England.

China economic activity moderated

Year-over-year retail sales



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

ASIA PACIFIC

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

- **Asia Pacific equity markets have traded higher during the week**, one week after the MSCI Asia Pacific Index fell more than 3%. The rebound has been mostly led by India, Taiwan, and Singapore.

- For the third time this month, **Singapore's government tightened safe distancing measures**, in response to a rise in community cases. Measures under Phase 2 (Heightened Alert), while more restrictive than the reopening protocols, are significantly less restrictive than the circuit breaker measures implemented more than a year ago. Depending on how long the measures remain in place and if more stringent restrictions will be introduced, **we expect the reopening trades**—retail, aviation, hospitality, public transport, and banking—**to remain under pressure**. Meanwhile, the flight to safety could see renewed interest in supermarkets, industrial REITs, and stock exchanges.

- **Latest macro data suggests China economic activity moderated in April**, following record expansion in Q1 2021. Fixed-asset investment grew 19.9% YTD, in line with consensus expectations. Industrial output rose 9.8% y/y, slightly below the median estimate for a 10% increase. Retail sales expanded 17.7% y/y, far slower than a projected 25% rise. **Senior Beijing officials have recently described the recovery as "unbalanced and unstable,"** and have pledged further efforts to drive a rebound in domestic demand.

- **Alibaba Group** (9988 HK) **FYQ4 2021 results were largely in line with consensus expectations** with the top line slightly ahead. The company's core commerce remained solid, but Cloud growth decelerated after Alibaba lost a major client. **The company announced its intention to use all incremental profits for FY2022 to support merchants**. The big investment plan has triggered numerous earnings downgrades. Some analysts, however, believe this could be the final round of negative earnings revisions for FY2022.

MARKET
Scorecard

Data as of May 20, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,159.12	-0.5%	10.7%	40.0%	46.4%
Dow Industrials (DJIA)	34,084.15	0.6%	11.4%	38.7%	32.7%
Nasdaq	13,535.74	-3.1%	5.0%	44.4%	75.7%
Russell 2000	2,207.76	-2.6%	11.8%	63.9%	44.8%
S&P/TSX Comp	19,542.95	2.3%	12.1%	30.3%	19.2%
FTSE All-Share	4,003.09	0.5%	9.0%	20.1%	0.0%
STOXX Europe 600	441.90	1.0%	10.7%	28.9%	17.1%
EURO STOXX 50	3,999.91	0.6%	12.6%	35.9%	18.7%
Hang Seng	28,450.29	-1.0%	4.5%	16.6%	2.4%
Shanghai Comp	3,506.94	1.7%	1.0%	21.6%	22.2%
Nikkei 225	28,098.25	-2.5%	2.4%	36.4%	31.9%
India Sensex	49,564.86	1.6%	3.8%	60.8%	26.0%
Singapore Straits Times	3,109.81	-3.4%	9.4%	21.4%	-3.0%
Brazil Ibovespa	122,700.80	3.2%	3.1%	50.9%	33.4%
Mexican Bolsa IPC	49,907.36	4.0%	13.3%	38.5%	14.7%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.627%	0.1	71.4	94.7	-78.9
Canada 10-Yr	1.543%	-0.3	86.6	98.2	-14.5
UK 10-Yr	0.839%	-0.3	64.2	61.0	-21.6
Germany 10-Yr	-0.109%	9.3	46.0	35.9	-2.2
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.57%	-0.3%	-2.9%	-0.7%	16.4%
U.S. Investment-Grade Corp	2.21%	-0.3%	-3.9%	3.5%	22.0%
U.S. High-Yield Corp	4.23%	-0.2%	1.8%	17.2%	19.5%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,877.34	6.1%	-1.1%	7.4%	46.9%
Silver (spot $/oz)	27.76	7.1%	5.1%	58.1%	91.8%
Copper ($/metric ton)	9,980.00	1.5%	28.8%	84.2%	66.2%
Oil (WTI spot/bbl)	62.05	-2.4%	27.9%	83.6%	-1.7%
Oil (Brent spot/bbl)	64.88	-3.5%	25.3%	81.5%	-9.9%
Natural Gas ($/mmBtu)	2.95	0.5%	16.1%	66.4%	10.3%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	89.7640	-1.7%	-0.2%	-9.4%	-8.3%
CAD/USD	0.8291	1.9%	5.6%	15.2%	11.3%
USD/CAD	1.2061	-1.8%	-5.2%	-13.2%	-10.2%
EUR/USD	1.2229	1.7%	0.1%	11.4%	9.5%
GBP/USD	1.4187	2.6%	3.8%	15.9%	11.5%
AUD/USD	0.7771	0.7%	1.0%	17.8%	12.5%
USD/JPY	108.7800	-0.5%	5.4%	1.2%	-1.2%
EUR/JPY	133.0200	1.2%	5.4%	12.7%	8.2%
EUR/GBP	0.8619	-0.9%	-3.6%	-3.9%	-1.8%
EUR/CHF	1.0978	0.0%	1.5%	3.6%	-2.5%
USD/SGD	1.3307	0.0%	0.7%	-5.8%	-3.3%
USD/CNY	6.4348	-0.6%	-1.4%	-7.3%	-6.9%
USD/MXN	19.8659	-1.9%	-0.2%	-14.4%	4.2%
USD/BRL	5.2832	-2.8%	1.6%	39.8%	29.0%

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 0.82 means 1 Canadian dollar will buy 0.82 U.S. dollar. CAD/USD 5.6% return means the Canadian dollar rose 5.6% vs. the U.S. dollar year to date. USD/JPY 108.78 means 1 U.S. dollar will buy 108.78 yen. USD/JPY 5.4% return means the U.S. dollar rose 5.4% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 5/20/21

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As of March 31, 2021

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Rating	Count	Percent	Count	Percent
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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