GLOBAL
Insight
WEEKLY

Wealth Management
RBC

Perspectives from the Global Portfolio Advisory Committee

June 10, 2021

Running on full

Kelly Bogdanova – San Francisco

Optimism over the post-pandemic recovery has fueled the Financials sector's heady rally. We would continue to Overweight the sector in portfolios, as we see a number of catalysts that should keep the momentum going and drive the second leg of the rally.

Financials have sprinted higher since late last year when the first vaccine was approved in the U.S., which prompted optimism about the eventual economic recovery—one that is now unfolding.

This equity sector has significantly outperformed the overall market, surging 38 percent since early November 2020, double the S&P 500's gain of 19 percent and outpacing all other sectors (excluding Energy).

Is there further to go? We think so.

Certainly the recent run has been eye-popping, as the chart shows. But some additional context is useful. Actually, the sector's performance has yet to catch up to the S&P 500 going back to just before the COVID-19 earthquake hit.

Financials are still trailing the S&P 500, with a gain of 21 percent for the former and 31 percent for the latter, since the beginning of 2020—a time frame that takes into account the severe selloff during the worst stage of the COVID-19 pandemic over a year ago.

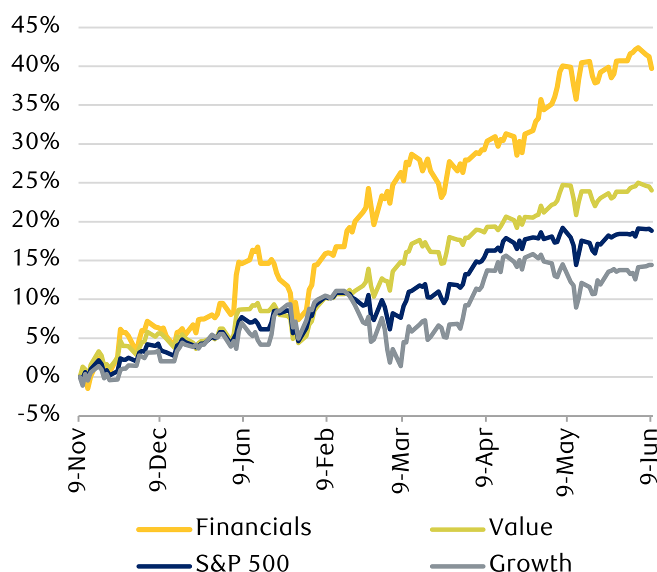
We think there is more catch-up room ahead for U.S. Financials because of numerous catalysts.

Maintaining the mojo

A number of the sector's tailwinds are related to the early stage of the economic recovery, while others are due to the

Financials have significantly outperformed

S&P 500 performance vs. Financials and other key categories



Note: The Value and Growth categories are measured by the S&P 500 Value and S&P 500 Growth indexes.

Source - RBC Wealth Management, Bloomberg; data from 11/9/20 (day of Pfizer vaccine approval) through 6/9/21

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

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Priced (in USD) as of 6/10/21 market close, ET (unless otherwise stated). Produced: June 10, 2021 5:03 pm ET; Disseminated: June 10, 2021 5:35 pm ET
For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

overall sturdy nature of banking operations in the U.S. and some breathing room on the regulatory front.

We think the following potential catalysts should push the Financials sector higher:

Early-cycle impulses: Financials tend to outperform in the early part of the economic recovery cycle, along with the overall value/cyclicals category, of which the sector is a component. The market rally associated with this stage typically has two phases—first, a sprint out of the gate (which has already occurred, but could continue), and then a consolidation period or pullback followed by a renewed rally that transpires at a slower pace (the second leg of the rally). Historically, the Financials sector has not only outperformed the S&P 500 during the sprint out of the gate but also outperformed during the second leg of the rally, according to a study by RBC Capital Markets, LLC's Head of U.S. Equity Strategy Lori Calvasina.

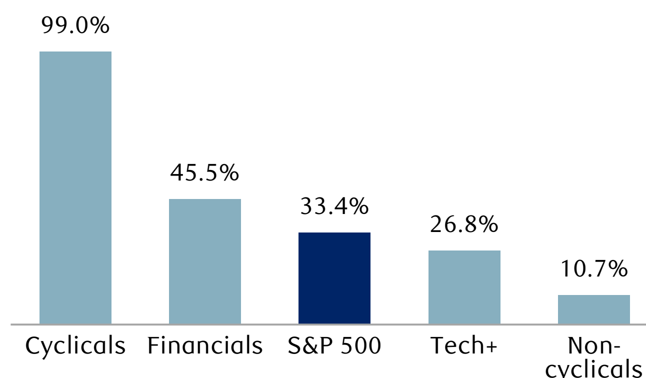
A beneficiary of inflation: When the public perceives that inflation will increase, Energy, Materials, and Financials tend to outperform the most, according to Calvasina's data going back to 2004, which is shown in a chart toward the end of this "Inflation aftershock" article. We think the buoyant May inflation data that was just released, with the Consumer Price Index jumping five percent from last year, is supportive of this catalyst.

The potential to hike dividends: The banking analyst at our national research correspondent anticipates "substantial dividend increases," including roughly 20 percent hikes for some of the largest institutions, and rising dividend payout ratios over the next 18 months. While the regulatory environment for banks is still tighter than it was before the global financial crisis in 2008–09—and will likely remain so—there has been some easing in requirements, and industry analysts anticipate the allowance of further dividend increases. This aforementioned analyst and RBC Capital Markets, LLC's Head of U.S. Bank Equity Strategy Gerard Cassidy anticipate some movement on the dividend front following the release of the Federal Reserve's Comprehensive Capital Analysis and Review (CCAR) of the banking industry, scheduled for June 24.

Fund flows firing: Strong inflows of cash have poured into Financials sector exchange-traded funds (ETFs), outpacing all other sectors in absolute dollar amounts so far this year, and edging out all other sectors as a proportion of assets under management in the past 12 months. We think the Financials sector's recent outperformance will further boost inflows from a category of ETFs that has become popular—"momentum" funds. These securities include stocks that have experienced strong price gains and earnings trends, typically over the previous 12 months. For a long time Financials barely had been represented in momentum funds due to the sector's previous underperformance; instead, these funds were dominated by technology-related stocks. But now we think that is set to change as momentum ETFs rebalance over time to include stocks that have performed well more recently.

Financials are expected to outpace the S&P 500

2021 consensus earnings growth forecasts (year-over-year)



Note: The Tech+ category represents technology-related stocks in various S&P 500 sectors

Source - National research correspondent, Refinitiv I/B/E/S, FactSet; data as of 6/3/21

Better profitability due to yield curve dynamics: While we don't foresee dramatic moves in Treasury yields over the near term, our fixed income strategists anticipate further modest steepening of the Treasury yield curve, as the 10-year yield drifts somewhat higher toward two percent by year end and short-term rates stay anchored as the Fed keeps its target rate near zero percent. Cassidy believes this will lead to higher net interest margins and net interest revenues for banks.

Improved loan growth and less excess liquidity: Abundant stimulus from the Fed and Washington has held back banks' profitability, but that should change. In a mid-May report Cassidy wrote, "Monetary and fiscal policy over the last 12+ months has led to double-digit deposit growth and has resulted in many banks having excess liquidity on their balance sheets. Loan-to-deposit ratios have plummeted, and bank profitability has been hurt as a result. Over the next 12–18 months, we expect this trend to ease-up as loan growth picks up, deficit spending falls, and the Federal Reserve's Quantitative Easing (QE) program comes to an end."

Earnings momentum and then some: Financials are expected to deliver stronger earnings growth than the S&P 500 in 2021, 45.5 percent versus 33.4 percent year over year, as the chart shows. We believe there is upside to the 2021 forecast and, importantly, Cassidy anticipates that 2022 consensus estimates for banks have room to push higher. We don't think this is fully factored into current stock prices.

Not done yet

While the U.S. Financials sector has come a long way since late last year's initial vaccine approval, we think it has room to run due to a full tank of catalysts, which should play out over the course of the next six months and longer. We would stay Overweight U.S. Financials. We also continue to favor this sector in other markets such as Canada, the UK, and Europe as similar economic dynamics are at play.

UNITED STATES

Atul Bhatia, CFA – Minneapolis

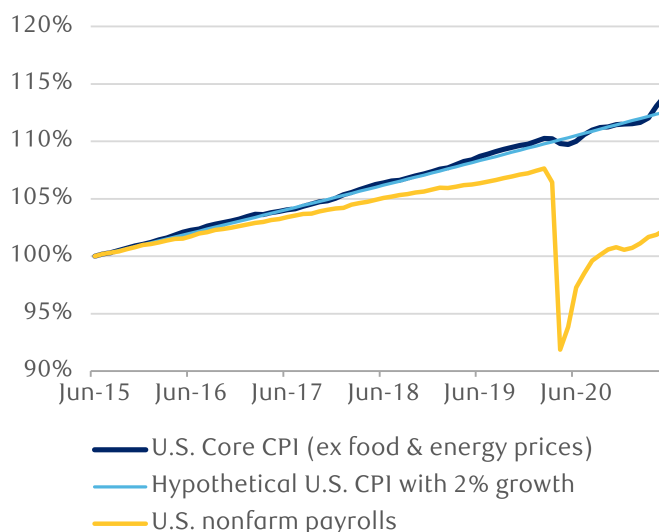
■ **Bonds rallied this week with yields on the 10-year Treasury declining below 1.5%**, the lowest closing yield since early March. **Markets held on to these gains despite the release of May Consumer Price Index (CPI)** data showing a 5% y/y increase in overall prices and a 3.8% pickup after removing food and energy prices. Similar to last month, the CPI increase was heavily influenced by used car prices—which spiked over 7% on the month—and comparisons to 2020's pandemic shutdowns. Nothing in the report looks significant enough to shift the Federal Reserve's view that inflation is transitory—a conclusion that was likely reinforced by May's 2.2% y/y decline in average weekly earnings. With higher labor income a likely prerequisite for sustained upward inflation, we believe **this week's data is unlikely to lead to monetary policy shifts**.

■ **Fixed income demand was also helped by last week's lackluster jobs report and a continuing lack of progress on infrastructure legislation.** The relatively slow pace of job creation in May—only 559,000 jobs were added compared to a nearly 8 million job deficit from pre-pandemic levels—added to the likelihood of continued Fed support, given the central bank's mandate to maximize employment consistent with stable prices. Increased government spending in the form of infrastructure could add upward price pressures and employment gains—potentially driving interest rates higher—but recent Bloomberg news reports have highlighted the large differences between the Biden administration and Senate Republicans on the spending plan.

■ **Pension funds have been a beneficiary of rising equity and debt markets.** Recent data from Milliman—an actuarial and pension consultancy—indicate that the 100 largest private pension funds are, in aggregate, nearly fully funded, with assets worth 98.8% of discounted future liabilities; the measure had been as low as 82% in July of last year. **These pension funds may serve as a source of future fixed income demand**, as fund managers may look to add bonds to lock in recent gains and match investment cash flows with expected future pension obligations.

Employment a bigger miss than prices

Absolute price index close to target; employment lags



Source - Bloomberg, RBC Wealth Management; data normalized to 6/30/15

CANADA

Luis Castillo & Simon Jones – Toronto

■ **The Bank of Canada's (BOC's) latest monetary policy announcement came and went largely as expected—uneventful.** There were no changes to policy or forward guidance with the overnight rate remaining at 0.25% and the pace of quantitative easing (QE) purchases at CA$3 billion per week. The central bank still believes that sharply rising inflation will prove transitory in nature, expected to hover near 3% throughout the summer and then ease later in the year as "base-year effects diminish and excess capacity continues to exert downward pressure." The BoC became one of the first developed central banks to dial up optimism, at its April policy meeting, by accelerating the potential timeline for rate hikes to H2 2022 (sooner than expected) and tapering QE purchases, citing improving economic conditions. However, the BoC again acknowledged the labour market remains below pre-pandemic levels. The BoC has previously stated that it's looking for jobs to not only return to pre-pandemic levels, but to exceed those levels meaningfully before a complete recovery can be achieved.

■ **The Canadian labour market slid for a second consecutive month in May**, shedding 68,000 jobs, as reported by Statistics Canada. Although a decline was anticipated given the mounting COVID-19 containment measures nationally, the losses were nearly three times greater than consensus estimates. From an industry perspective, **manufacturing was hit especially hard** as it continues to grapple with ongoing supply-chain disruptions. Accommodation and food services, along with retail trade, continued to give up the gains made during the hiring spree between the second and third waves of the virus. As lockdown restrictions begin to ease, spurred by declining case counts and increased vaccination rates, RBC Economics expects these latter industries could begin recovering in June of this year. In all, the Canadian labour market remains approximately 571,000 jobs short of its pre-pandemic levels.

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

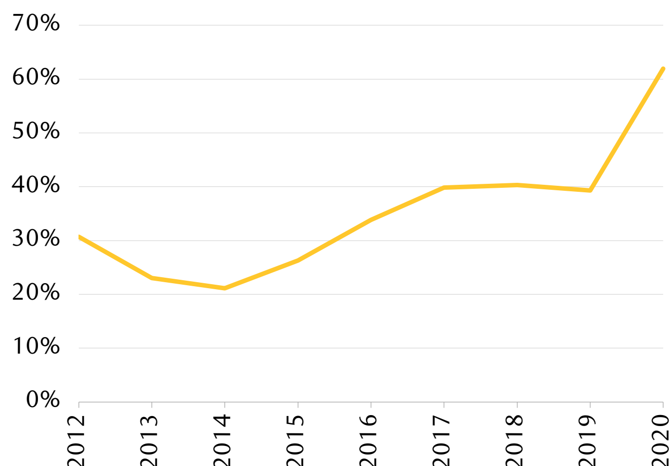
- **The next and final step of the UK's planned reopening of its economy is in doubt**, with it looking increasingly likely there will be a delay to the June 21 target date for a "full reopening" and removal of all outstanding social contact restrictions amid increasing cases of the Delta COVID-19 variant. The Times reported that the easing of restrictions could be delayed by two weeks, while The Guardian reported the delay could be up to a month. Any delay would be another blow to the hospitality industry as the outstanding restrictions primarily relate to indoor hospitality (e.g., nightclubs) and large-scale events (e.g., weddings). **Prime Minister Boris Johnson plans to announce the government's final decision on Monday (June 14).**

- **We believe the UK equity market can take a relatively short delay (i.e., two weeks to a month) in stride.** We view any short-term weakness on the back of reopening concerns as an opportunity to add to favoured domestically-focused UK stocks, whose outlooks remain underpinned by the release of pent-up demand meeting high levels of consumer savings. **The recovery in UK domestic activity post the initial lockdown restrictions easing has been strong**, helping to push consensus expectations for GDP growth in 2021 to above 6% y/y vs. around 4.5% three months ago.

- As widely expected, **the European Central Bank (ECB) kept monetary policy unchanged**, leaving the deposit rate at -0.5%. Moreover, the Governing Council expects net purchases under the Pandemic Emergency Purchase Programme to continue to be conducted at a significantly higher pace over Q3 than during the first months of 2021, based on a joint assessment of financing conditions and the inflation outlook.

- **ECB projections for GDP growth were markedly increased for this year and next**, to 4.6% and 4.7%, respectively, compared to the March forecasts of 4% for 2021 and 4.1% for 2022. **Inflation expectations were also upgraded** to 1.9% and 1.5% for the same periods (from 1.5% and 1.2%), an increase ECB President Christine Lagarde qualifies as temporary. She reiterated that there is no evidence of wage increases, leaving her to conclude there is no reason to believe the increase in inflation will last.

ECB balance sheet assets as % of euro area GDP



Source - Bloomberg

ASIA PACIFIC

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

- On June 9, **the Biden administration revoked Trump-era bans on Chinese-owned apps, including TikTok and WeChat**, but said it will conduct its own review of apps that may pose a risk to Americans' personal data. One day later, the Chinese and U.S. commerce ministers agreed to push forward trade and investment links in their first call under the Biden administration. The call was the third between senior officials in recent weeks. Last week, **President Joe Biden signed an executive order that prohibits American investment in 59 Chinese companies**, effective Aug. 2.

- **China and Hong Kong equity markets didn't react much to these developments.** Having gone through the Trump era, investors already expect a more confrontational relationship between the two countries and thus have somewhat digested all these moves.

- **China's producer price index climbed 9% in May** from a year earlier, driven by price increases for oil, metals, and chemicals, beating the Bloomberg consensus estimate of an 8.5% increase. However, consumer inflation increased only 1.3% y/y, missing the 1.6% estimate. **A similar situation was seen in Japan where producer prices gained 4.9% y/y** in May, beating the consensus projection of 4.5%. Data shows companies are feeling pressure from rising commodity prices in China and Japan. **However, the cost pressure has yet to clearly push up prices at the consumer level**, partly because demand is still sluggish and companies are hesitant to pass on rising costs to end users.

- **Japan Prime Minister Yoshihide Suga said he wants to finish inoculating citizens who are willing to receive a COVID-19 vaccine by October or November.** Japan has given nearly 20 million first and second doses of vaccines. After a slow start, the pace of inoculations has picked up since May, and Japan has vaccinated about 11% of its population with at least one dose. Tokyo and other major urban areas are still under a state of emergency, which is set to run to June 20, though it could be extended.

MARKET
Scorecard

Data as of June 10, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,239.18	0.8%	12.9%	32.9%	46.9%
Dow Industrials (DJIA)	34,466.24	-0.2%	12.6%	27.7%	32.2%
Nasdaq	14,020.33	2.0%	8.8%	39.9%	79.2%
Russell 2000	2,311.41	1.9%	17.0%	57.5%	51.7%
S&P/TSX Comp	20,049.47	1.6%	15.0%	27.7%	23.6%
FTSE All-Share	4,044.01	0.7%	10.1%	15.6%	0.3%
STOXX Europe 600	454.56	1.7%	13.9%	23.5%	20.2%
EURO STOXX 50	4,096.07	1.4%	15.3%	24.4%	21.0%
Hang Seng	28,738.88	-1.4%	5.5%	14.7%	4.2%
Shanghai Comp	3,610.86	-0.1%	4.0%	22.7%	26.6%
Nikkei 225	28,958.56	0.3%	5.5%	25.2%	37.0%
India Sensex	52,300.47	0.7%	9.5%	52.7%	31.5%
Singapore Straits Times	3,162.50	-0.1%	11.2%	12.9%	-0.8%
Brazil Ibovespa	130,076.20	3.1%	9.3%	37.4%	33.5%
Mexican Bolsa IPC	50,886.33	0.0%	15.5%	33.0%	16.7%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.437%	-15.7	52.4	71.1	-71.2
Canada 10-Yr	1.371%	-11.5	69.4	80.3	-15.0
UK 10-Yr	0.747%	-4.8	55.0	48.0	-9.2
Germany 10-Yr	-0.256%	-6.9	31.3	7.5	-3.7
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.46%	0.5%	-1.8%	-0.2%	17.7%
U.S. Investment-Grade Corp	2.07%	0.8%	-2.1%	3.1%	24.3%
U.S. High-Yield Corp	3.91%	0.6%	2.9%	12.5%	20.8%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,898.40	-0.4%	0.0%	9.2%	43.0%
Silver (spot $/oz)	28.01	-0.1%	6.1%	54.6%	90.5%
Copper ($/metric ton)	9,952.75	-2.9%	28.4%	69.1%	69.8%
Oil (WTI spot/bbl)	70.29	6.0%	44.9%	77.5%	32.0%
Oil (Brent spot/bbl)	72.42	4.5%	39.8%	73.5%	16.3%
Natural Gas ($/mmBtu)	3.16	5.7%	24.3%	77.3%	33.9%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	90.0460	0.2%	0.1%	-6.2%	-6.9%
CAD/USD	0.8267	-0.3%	5.3%	10.9%	9.7%
USD/CAD	1.2097	0.3%	-4.9%	-9.8%	-8.8%
EUR/USD	1.2173	-0.4%	-0.4%	7.0%	7.6%
GBP/USD	1.4177	-0.2%	3.7%	11.2%	11.8%
AUD/USD	0.7752	0.2%	0.8%	10.8%	11.4%
USD/JPY	109.3200	-0.2%	5.9%	2.1%	0.8%
EUR/JPY	133.0800	-0.7%	5.5%	9.2%	8.5%
EUR/GBP	0.8587	-0.2%	-3.9%	-3.8%	-3.7%
EUR/CHF	1.0892	-0.9%	0.7%	1.5%	-2.7%
USD/SGD	1.3237	0.2%	0.1%	-4.3%	-3.1%
USD/CNY	6.3932	0.4%	-2.1%	-7.9%	-7.8%
USD/MXN	19.6862	-1.3%	-1.1%	-9.9%	2.5%
USD/BRL	5.0617	-3.0%	-2.6%	34.0%	30.2%

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 5.3% return means the Canadian dollar rose 5.3% vs. the U.S. dollar year to date. USD/JPY 109.32 means 1 U.S. dollar will buy 109.32 yen. USD/JPY 5.9% return means the U.S. dollar rose 5.9% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 6/10/21

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As of March 31, 2021

			Investment Banking Services Provided During Past 12 Months	
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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