Equity market brief

Under pressure

Concerns about the coronavirus and to a lesser extent American politics have sent shockwaves of volatility through markets. Clarity about the impact of these developments is unlikely before late Q2. More volatility can't be ruled out. However, if the U.S. economy avoids a recession in 2020, by year end, we expect most stock markets will have advanced meaningfully from today's levels. The probabilities of a more adverse economic outcome are higher than when the year began.

Over the past few weeks there have been several things worth worrying about—chief among them the impact of the coronavirus and growing uncertainty around U.S. electoral politics. For the first eight weeks of the year investors didn't seem to care about either until, abruptly, they did. Now uncertainty has taken hold, sending global stock markets into the ditch.

Whatever the eventual outcome of the virus crisis, it will have already blown a large hole in Q1 GDP growth for China, with knock-on effects of varying degree across Asia. The impact in North America and Europe should be much smaller, in our view, but that can't be quantified with any certainty at this point.

Management guidance accompanying Q4 2019 earnings releases in January and February mostly took the form of "too early to tell." Q1 comments beginning in mid-April are likely to continue painting a cautionary and indeterminate picture. Even assuming the outbreak peaks and begins receding by early summer, clarity around the sales and earnings costs of this health catastrophe will be a long time coming.

What is likely to arrive sooner will be more fiscal stimulus from governments. From China first and foremost, but also from Japan where domestic demand was dealt a body blow by a Q4 sales tax hike that has been exacerbated by China's abrupt slowdown. In the UK and Europe, plans were already afoot for additional government spending to offset trade concerns as the final Brexit deal is negotiated and weak exports into China take a further toll on the German economy. These efforts are likely to be advanced and probably entail greater-than-previously contemplated sums.

In North America, Canada has plenty of budgetary capacity to boost spending, while in the U.S., both the Republicans and Democrats will be eager to establish their bona fides as the "economy-friendly" choice in the lead-up to a hotly contested election in the fall.

As things stand today, we expect no recession in the U.S. or Canada in 2020, but with GDP growth rates hovering around two percent, an occasional negative quarter can't be ruled out. It is also possible the coronavirus impact turns out to last longer and cut more deeply into the U.S. economy, pushing it into outright recession. That is not our base case, but the probability of this happening is certainly markedly higher than when the year began.

A weaker GDP profile could be expected to produce weaker-than-anticipated corporate earnings. And earnings estimates for 2020 have been falling, from a wildly optimistic $187 per share for the S&P 500 early last year all the way down to a recent $175 per share, which is still above the long-held, below-consensus call of RBC Capital Markets' Head of U.S. Equity Strategy Lori Calvasina for $174.

Calvasina estimates the potential cost of the virus on earnings at $4 per share, which could bring her estimate down to $170. Her estimate would fall to $167 per share if the U.S. were to endure a mild recession. Clearly, even lower numbers are possible. So, at the very least, we expect Street conviction around what earnings figure to use to calculate forward price-to-earnings (P/E) ratios will be in flux for at least the next quarter, probably longer.

In the big and unsettling stock market retrenchment of late 2018, the S&P 500 slumped from a summer peak of better

Click here for author's contact information. Priced (in USD) as of 2/27/20 market close, ET (unless otherwise stated).
For important disclosures see page 3. Produced: Feb 28, 2020 14:16ET; Disseminated: Feb 28, 2020 14:40ET

Investment and insurance products offered through RBC Wealth Management are not insured by the FDIC or any other federal government agency, are not deposits or other obligations of, or guaranteed by, a bank or any bank affiliate, and are subject to investment risks, including possible loss of the principal amount invested.

than 18x forward earnings in August down to something less than 15x at the Christmas Eve low. But that happened against a backdrop of (sharply) rising bond yields. The 10-year Treasury yield jumped from 1.50 percent in August to 1.90 percent in December that year, while corporate bond yields (BBB rated) rose by 120 basis points to 4.70 percent over the full year. Since those peaks, the Treasury yield has fallen to a new all-time low at 1.15 percent while BBB corporate yields have collapsed down to 2.70 percent.

Low and falling bond yields not only potentially stimulate growth, they also support P/E ratios. At the end of the day, we don't expect the P/E damage of this correction will be as big as that endured in 2018. But we also think it will take some time to fully play out, probably months, conceivably quarters. The damage to all equity markets globally is likely to be directly related to the damage done to the U.S. economy in particular, in our view.

In the February edition of Global Insight, our parting thoughts in the "Global equity" commentary were: "… concerns around the coronavirus outbreak will probably go on suppressing investor attitudes for some months to come. As well, American politics will likely deliver occasional market volatility from the start of the primary season in February through at least to the Democratic convention in mid-July." That volatility has driven share prices down further and more rapidly than we expected. If the U.S. economy avoids a recession in 2020, by year end, we expect most stock markets will have advanced meaningfully from today's levels.

Author

Jim Allworth – Vancouver, Canada
jim.allworth@rbc.com; RBC Dominion Securities, Inc.

Disclosures and Disclaimer

Analyst Certification

All of the views expressed in this report accurately reflect the personal views of the responsible analyst(s) about any and all of the subject securities or issuers. No part of the compensation of the responsible analyst(s) named herein is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the responsible analyst(s) in this report.

Important Disclosures

In the U.S., RBC Wealth Management operates as a division of RBC Capital Markets, LLC. In Canada, RBC Wealth Management includes, without limitation, RBC Dominion Securities Inc., which is a foreign affiliate of RBC Capital Markets, LLC. This report has been prepared by RBC Capital Markets, LLC. which is an indirect wholly-owned subsidiary of the Royal Bank of Canada and, as such, is a related issuer of Royal Bank of Canada.

Non-U.S. Analyst Disclosure: Jim Allworth, an employee of RBC Wealth Management USA's foreign affiliate RBC Dominion Securities Inc., contributed to the preparation of this publication. This individuals is not registered with or qualified as a research analyst with the U.S. Financial Industry Regulatory Authority ("FINRA") and, since he is not an associated person of RBC Wealth Management, he may not be subject to FINRA Rule 2241 governing communications with subject companies, the making of public appearances, and the trading of securities in accounts held by research analysts.

In the event that this is a compendium report (covers six or more companies), RBC Wealth Management may choose to provide important disclosure information by reference. To access current disclosures, clients should refer to https://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2 to view disclosures regarding RBC Wealth Management and its affiliated firms. Such information is also available upon request to RBC Wealth Management Publishing, 60 South Sixth St, Minneapolis, MN 55402.

References to a Recommended List in the recommendation history chart may include one or more recommended lists or model portfolios maintained by RBC Wealth Management or one of its affiliates. RBC Wealth Management recommended lists include the Guided Portfolio: Prime Income (RL 6), the Guided Portfolio: Dividend Growth (RL 8), the Guided Portfolio: ADR (RL 10), and the Guided Portfolio: All Cap Growth (RL 12). RBC Capital Markets recommended lists include the Strategy Focus List and the Fundamental Equity Weightings (FEW) portfolios. The abbreviation 'RL On' means the date a security was placed on a Recommended List. The abbreviation 'RL Off' means the date a security was removed from a Recommended List.

Distribution of Ratings

For the purpose of ratings distributions, regulatory rules require member firms to assign ratings to one of three rating categories - Buy, Hold/Neutral, or Sell - regardless of a firm's own rating categories. Although RBC Capital Markets, LLC ratings of Top Pick/Outperform, Sector Perform, and Underperform most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis.

Explanation of RBC Capital Markets, LLC Equity Rating System

An analyst's "sector" is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst's view of how that stock will perform over the next 12 months relative to the analyst's sector average.

Distribution of Ratings - RBC Capital Markets, LLC Equity Research
As of December 31, 2019

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	765	51.97	225	29.41
Hold [Sector Perform]	625	42.46	127	20.32
Sell [Underperform]	82	5.57	5	6.10

Ratings:

Top Pick (TP): Represents analyst's best idea in the sector; expected to provide significant absolute total return over 12 months with a favorable risk-reward ratio. **Outperform (O):** Expected to materially outperform sector average over 12 months. **Sector Perform (SP):** Returns expected to be in line with sector average over 12 months. **Underperform (U):** Returns expected to be materially below sector average over 12 months. **Restricted (R):** RBC policy precludes certain types of communications, including an investment recommendation, when RBC is acting as an advisor in certain merger or other strategic transactions and in certain other circumstances. **Not Rated (NR):** The rating, price targets and estimates have been removed due to applicable legal, regulatory or policy constraints which may include when RBC Capital Markets is acting in an advisory capacity involving the company.

Risk Rating:

The **Speculative** risk rating reflects a security's lower level of financial or operating predictability, illiquid share trading volumes, high balance sheet leverage, or limited operating history that result in a higher expectation of financial and/or stock price volatility.

Valuation and Risks to Rating and Price Target

When RBC Wealth Management assigns a value to a company in a research report, FINRA Rules and NYSE Rules (as incorporated into the FINRA Rulebook) require that the basis for the valuation and the impediments to obtaining that valuation be described. Where applicable, this information is included in the text of

our research in the sections entitled "Valuation" and "Risks to Rating and Price Target", respectively.

The analyst(s) responsible for preparing this research report have received (or will receive) compensation that is based upon various factors, including total revenues of RBC Capital Markets, LLC, and its affiliates, a portion of which are or have been generated by investment banking activities of RBC Capital Markets, LLC and its affiliates.

Other Disclosures

Prepared with the assistance of our national research sources. RBC Wealth Management prepared this report and takes sole responsibility for its content and distribution. The content may have been based, at least in part, on material provided by our third-party correspondent research services. Our third-party correspondent has given RBC Wealth Management general permission to use its research reports as source materials, but has not reviewed or approved this report, nor has it been informed of its publication. Our third-party correspondent may from time to time have long or short positions in, effect transactions in, and make markets in securities referred to herein. Our third-party correspondent may from time to time perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this report.

RBC Wealth Management endeavors to make all reasonable efforts to provide research simultaneously to all eligible clients, having regard to local time zones in overseas jurisdictions. In certain investment advisory accounts, RBC Wealth Management or a designated third party will act as overlay manager for our clients and will initiate transactions in the securities referenced herein for those accounts upon receipt of this report. These transactions may occur before or after your receipt of this report and may have a short-term impact on the market price of the securities in which transactions occur. RBC Wealth Management research is posted to our proprietary Web sites to ensure eligible clients receive coverage initiations and changes in rating, targets, and opinions in a timely manner. Additional distribution may be done by sales personnel via e-mail, fax, or regular mail. Clients may also receive our research via third-party vendors. Please contact your RBC Wealth Management Financial Advisor for more information regarding RBC Wealth Management research.

Conflicts Disclosure: RBC Wealth Management is registered with the Securities and Exchange Commission as a broker/dealer and an investment adviser, offering both brokerage and investment advisory services. RBC Wealth Management's Policy for Managing Conflicts of Interest in Relation to Investment Research is available from us on our website at https://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2. Conflicts of interests related to our investment advisory business can be found in Part 2A Appendix 1 of the Firm's Form ADV or the RBC Advisory Programs Disclosure Document. Copies of any of these documents are available upon request through your Financial Advisor. We reserve the right to amend or supplement this policy, Part 2A Appendix 1 of the Form ADV, or the RBC Advisory Programs Disclosure Document at any time.

The author is employed by RBC Wealth Management USA, a division of RBC Capital Markets, LLC, a securities broker-dealer with principal offices located in Minnesota and New York, USA.

Research Resources

This document is produced by the Global Portfolio Advisory Committee within RBC Wealth Management's Portfolio Advisory Group. The RBC WM Portfolio Advisory Group provides support related to asset allocation and portfolio construction for the firm's Investment Advisors / Financial Advisors who are engaged in assembling portfolios incorporating individual marketable securities. The Committee leverages the broad market outlook as developed by the RBC Investment Strategy Committee, providing additional tactical and thematic support utilizing research from the RBC Investment Strategy Committee, RBC Capital Markets, and third-party resources.

Third-party disclaimers

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and Standard & Poor's Financial Services LLC ("S&P") and is licensed for use by RBC. Neither MSCI, S&P, nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

References herein to "LIBOR", "LIBO Rate", "L" or other LIBOR abbreviations means the London interbank offered rate as administered by ICE Benchmark Administration (or any other person that takes over the administration of such rate).

Disclaimer

The information contained in this report has been compiled by RBC Wealth Management, a division of RBC Capital Markets, LLC, from sources believed to be reliable, but no representation or warranty, express or implied, is made by Royal Bank of Canada, RBC Wealth Management, its affiliates or any other person as to its accuracy, completeness or correctness. All opinions and estimates contained in this report constitute RBC Wealth Management's judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Every province in Canada, state in the U.S., and most countries throughout the world have their own laws regulating the types of securities and other investment products which may be offered to their residents, as well as the process for doing so. As a result, the securities discussed in this report may not be eligible for sale in some jurisdictions. This report is not, and under no circumstances should be construed as, a solicitation to act as securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. Nothing in this report constitutes legal, accounting or tax advice or individually tailored investment advice. This material is prepared for general circulation to clients, including clients who are affiliates of Royal Bank of Canada, and does not have regard to the particular circumstances or needs of any specific person who may read it. The investments or services contained in this report may not be suitable for you and it is recommended

that you consult an independent investment advisor if you are in doubt about the suitability of such investments or services. To the full extent permitted by law neither Royal Bank of Canada nor any of its affiliates, nor any other person, accepts any liability whatsoever for any direct, indirect or consequential loss arising from, or in connection with, any use of this report or the information contained herein. No matter contained in this document may be reproduced or copied by any means without the prior written consent of Royal Bank of Canada in each instance. Additional information is available upon request.

To U.S. Residents: This publication has been approved by RBC Capital Markets, LLC, Member NYSE/FINRA/SIPC, which is a U.S. registered broker-dealer and which accepts responsibility for this report and its dissemination in the United States. RBC Capital Markets, LLC, is an indirect wholly-owned subsidiary of the Royal Bank of Canada and, as such, is a related issuer of Royal Bank of Canada. Any U.S. recipient of this report that is not a registered broker-dealer or a bank acting in a broker or dealer capacity and that wishes further information regarding, or to effect any transaction in, any of the securities discussed in this report, should contact and place orders with RBC Capital Markets, LLC. International investing involves risks not typically associated with U.S. investing, including currency fluctuation, foreign taxation, political instability and different accounting standards.

To Canadian Residents: This publication has been approved by RBC Dominion Securities Inc. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. ®Registered trademark of Royal Bank of Canada. Used under license. RBC Wealth Management is a registered trademark of Royal Bank of Canada. Used under license.

RBC Wealth Management (British Isles): This publication is distributed by RBC Europe Limited and RBC Investment Solutions (CI) Limited. RBC Europe Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority (FCA registration number: 124543). Registered office: Riverbank House, 2 Swan Lane, London, EC4R 3BF, UK. RBC Investment Solutions (CI) Limited is regulated by the Jersey Financial Services Commission in the conduct of investment business in Jersey. Registered office: Gaspé House, 66-72 Esplanade, St Helier, Jersey JE2 3QT, Channel Islands, registered company number 119162.

To Hong Kong Residents: This publication is distributed in Hong Kong by Royal Bank of Canada, Hong Kong Branch which is regulated by the Hong Kong Monetary Authority and the Securities and Futures Commission ('SFC'), and RBC Investment Services (Asia) Limited, which is regulated by the SFC.

To Singapore Residents: This publication is distributed in Singapore by the Royal Bank of Canada, Singapore Branch, a registered entity licensed by the Monetary Authority of Singapore. This material has been prepared for general circulation and does not take into account the objectives, financial situation, or needs of any recipient. You are advised to seek independent advice from a financial adviser before purchasing any product. If you do not obtain independent advice, you should consider whether the product is suitable for you. Past performance is not indicative of future performance. If you have any questions related to this publication, please contact the Royal Bank of Canada, Singapore Branch. Royal Bank of Canada, Singapore Branch accepts responsibility for this report and its dissemination in Singapore.

© RBC Capital Markets, LLC 2020 – Member NYSE/FINRA/SIPC
© RBC Dominion Securities Inc. 2020 – Member Canadian Investor Protection Fund
© RBC Europe Limited 2020
© Royal Bank of Canada 2020
All rights reserved