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RBC WEALTH MANAGEMENT

Global Insight

Perspectives from the Global Portfolio Advisory Committee

U.S. ELECTIONS & MARKET MATTERS

What's next?

As the 2020 U.S. election approaches we examine how results could affect the Fed, its policies, and U.S. fixed income markets.

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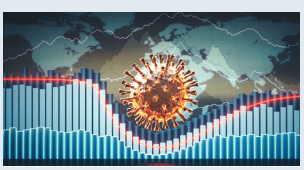

Special report available

New normal, new opportunities

Global equity

More to come

Global fixed income

Calm before the political storm

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RBC Wealth Management

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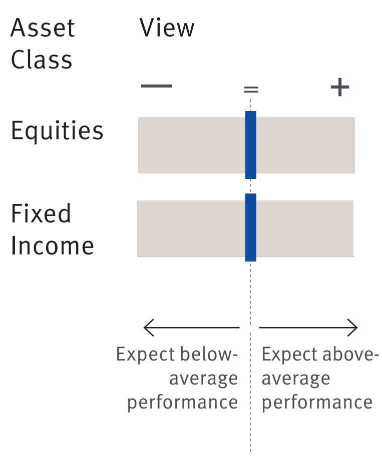

See "Views explanation" below for details

Source - RBC Wealth Management

Equities

- We are using the market pullback to move our recommended equity exposure back up to a Market Weight (benchmark) position from the modest Underweight we have been carrying.
- There are uncertainties ahead that could make for choppy, volatile trading, such as a COVID-19 second wave and U.S. election-related turbulence. However, we expect the largest economies, corporate earnings, and major equity markets to gain more ground over the next 12 months. This should be fueled by further progress taming the COVID-19 virus, the ongoing normalization of economies, and especially central banks' entrenched commitment to accommodative, ultralow interest rate policies. We think corporate earnings will exceed the 2019 high-water mark in 2022. This pace would be faster than during the 2008–09 financial crisis.

Fixed income

- The Fed's shift to an average inflation targeting regime, where policymakers would allow inflation to run above the 2% target for a period of time to make up for past shortfalls, will take time to be reflected in markets via modestly higher yields. But it also means that the Fed is likely to leave short-term rates at 0% for even longer. Though risks remain, current market valuations still offer decent risk/reward profiles in certain U.S. fixed income sectors, specifically in corporate credit. But after months of relative calm, we look for potential market volatility around the 2020 U.S. elections to present better entry points.
- We maintain our Market Weight stance in global fixed income. Global demand for "safe-haven" assets remains robust and with markets continuing to price a strong economic recovery, along with central bank support, we maintain a broad Overweight to corporate credit.

Views explanation

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

\+ Overweight implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

= Market Weight implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

– Underweight implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.

Focus article

U.S. ELECTIONS & MARKET MATTERS

What's next?

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As the 2020 U.S. election approaches we examine how results could affect the Fed, its policies, and U.S. fixed income markets.

- Election headlines may drive sentiment and volatility in the near term, but the Fed remains the principal driver of fixed income.
- Unlike the market's traditional view that a divided government is best, we believe in this cycle the most effective and coherent fiscal policy will likely come from a unified government.
- Credit markets may react negatively to a contested election. We view pullbacks during these early stages of the recovery as good opportunities to put cash to work and that would be our general approach to election noise.

U.S. fixed income markets have become a sleepy place in recent months. As Fed policy expectations—or perhaps the lack thereof—have taken root, Treasury market volatility indexes have plunged to record lows with Treasury yields remaining largely range-bound across the curve for months. U.S. investment-grade corporate bond yields haven't budged much over that timeframe either, with index yields also trading in tight ranges, mired at near-record lows below two percent.

Treasury yields have been in decline for the better part of 40 years, but with spikes along the way. In recent memory, the three episodes that saw Treasury yields move significantly higher in short order were the 2013 "taper tantrum" when the benchmark 10-year Treasury jumped from 1.6% to 3.03% on removal of Fed bond-buying plans; the 2016 election when it moved from 1.8% to 2.6% on tax cut and deregulation expectations, and then the passage of tax reform in 2017 which last drove yields to 3.25% from under 2.5%.

Now with the 2020 election the next potential major catalyst that could awaken fixed income markets from their slumber, how should investors be thinking about the risks and opportunities within fixed income at this juncture?

Put simply, we don't see a scenario around the 2020 U.S. election that is likely to cause similar market moves, whether up or down, as the Fed will remain the biggest influence on markets for some time. But the prospects for further fiscal stimulus and other proposed policies under various scenarios could add some directionality to yields and credit markets, while potentially introducing some volatility for investors to take advantage of.

What's next?

What's the scenario?

Summary of potential election-related impacts on U.S. fixed income markets

	President/Senate/House			
	D/D/D	D/R/D	R/R/D	Our thoughts
FOMC makeup	=	=	↓	Precedents suggest few changes under Biden; recent nominations by Trump suggest loyalists put in place, Fed independence eroded
Fed policy path	↑	=	↓	The Fed will remain at 0% for years, but fiscal impulse under a blue wave likely helps to pull forward the next rate hike cycle
Deficits	↑	=	=	A unified government is the clearest path to greater deficits; congressional gridlock limits scope for further stimulus
GDP	↗	=	=	Greater fiscal impulse amid higher deficits under unified government adds a modest boost to the growth outlook
Treasury yields	↗	↗	=	The biggest factor that will drive Treasury yields is the path of Fed policy rates, again dependent on fiscal support; fading trade war fears under D/R/D may also send yields modestly higher
TIPS (inflation expectations)	↗	=	↗	The Fed wants higher inflation to achieve its new 2% average inflation target, fiscal stimulus aids that; trade wars & tariffs under R/R/D may drive different types of inflationary pressures
Credit markets	↓	=	=	Under D/D/D, higher corporate taxes may increase the attractiveness of the tax shield from debt, boosting debt issuance and leverage from already elevated levels

Note: D = Democratic control, R = Republican control; symbols indicate qualitative estimates of positive (↑, ↗), neutral (=), and negative (↓) impacts.

Source - RBC Wealth Management

Risks and opportunities around the election

The table above attempts to summarize how we're thinking about the various election scenarios and potential market impacts. While markets have historically, and debatably, preferred a divided government for its tendency to provide policy stability, we think the opposite may be true this time around with a unified government better able to deal with high unemployment and the long economic recovery ahead.

All that matters, and the buzzword of the moment, is fiscal stimulus. And we think the clearest path toward that is via a unified government. At the moment, the "blue wave" scenario, where the Democratic Party controls the legislative and executive branches, remains the most likely based on polling and market indicators. The Democratic platform has pledged massive new spending programs, and higher taxes to pay for them, but on net should be a positive for the trajectory of the economic recovery. And while the issue of higher taxes may cause some market indigestion, we tend to think the actual appetite to raise taxes in the early years of a Biden administration given a weak economy may actually be quite low. As a priority, we think it likely falls to years three or four.

Because Republicans didn't actually publish a party platform at this year's national convention, we don't have much idea as to what the party's priorities and objectives would be, though the GOP has largely voiced concern about debt levels and little need to do more in terms of fiscal support. The Tax Cuts and Jobs Act, scheduled to expire in 2025, could be extended—a modest net positive for the economic outlook. Tough issues around trade and tariffs will continue to weigh on economic activity and sentiment.

Finally, the issue of a contested election remains. As in the aftermath of the 2000 election, we would broadly expect Treasury yields to trend lower on risk-off sentiment. Risk assets, including investment-grade and high-yield corporate bonds could come under pressure in this scenario, but during the early stages of an economic recovery, we would generally view any market pullbacks as opportunities to put money to work.

The next administration will have scope to reshape the Fed

For all intents and purposes, the results of the election—no matter the outcome—will have little bearing on the near-term trajectory of Fed policy. But the longer-term ramifications could be quite significant. Fed Chair Jerome Powell's term runs through early 2022, as do many of the terms of the seven-member Fed Board of Governors, where two seats remain vacant. While we don't necessarily expect major impacts on U.S. fixed income markets in the near term, the longer-term ramifications of these appointments could be highly significant.

Under a Biden administration, and regardless of whether Republicans hold the Senate, we would expect few changes and for Powell to remain on as Fed chair—as both President Clinton and President Obama left in place Republican appointees, Alan Greenspan and Ben Bernanke, respectively. Beyond that, the desire for continuity amid what is likely to be an ongoing economic recovery will likely take precedence. That said, the Democratic focus on regulation could make the vice chair for supervision position, created under the 2010 Dodd-Frank act and currently held by Trump-appointee Randal Quarles, the most likely seat to be replaced.

Under a status quo scenario where Republicans hold the White House and the Senate, the outlook for the Fed is less clear. President Trump's recent Fed board nominees—Stephen Moore, Herman Cain, and Judy Shelton—have been more of the loyalist variety than his earlier nominations that included technocrats such as Powell, Vice Chair Richard Clarida, and Quarles. Though recent nominees have all withdrawn or failed to find bipartisan support in the Senate, it's likely a trend that would continue, and Senate opposition may fade during a second term. Most notably, Powell could be replaced as he has often been a target of the president's attacks since his term began in 2018.

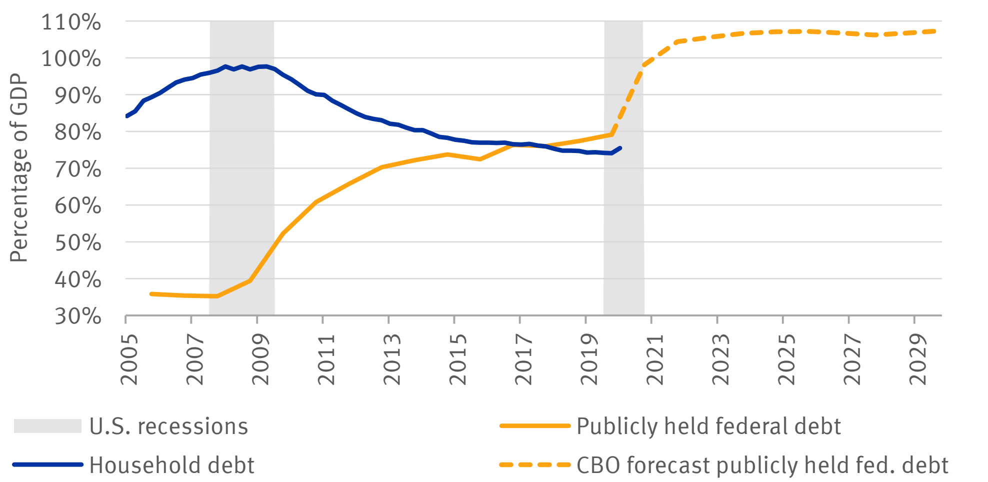
The impact is hard to quantify as the Fed is already expected to remain on easy street throughout the next term, whoever may preside over it, but President Trump has often called for negative rates, and should the Fed become more politicized then policy decisions could become more divorced from the economic outlook.

Deficits matter, just not really

Of course, already massive fiscal and monetary stimulus, amid calls for even more, will undoubtedly raise fears around growing debt burdens. As the chart below shows, the Congressional Budget Office now forecasts publicly held federal debt to approach 110% of GDP in the aftermath of the pandemic, though not shown, it would be the highest since World War II.

Trading places

As federal debt has risen, household debt has declined



Source - RBC Wealth Management, Bloomberg, Congressional Budget Office

Another way to think about this issue, however, is that debt burdens have shifted from consumer balance sheets to the federal balance sheet. As the chart also shows, in the decade after the 2009 financial crisis the U.S. household debt obligations fell from nearly 100% of GDP, to around 75%, largely driven by lower mortgage-related debt. Over the same period, publicly held federal debt rose from around 50% to about 80%.

While some may harbor reservations and fears about rising debt levels, that shift should be a net-positive in terms of systemic risks, in our view, as the federal government obviously has greater capacity and more avenues to address debt service than the U.S. consumer, not least of which is the ability to print its own money. And sure, citizens can too, but it's rather illegal.

We continue to believe that deficits and overall levels of publicly held federal debt are not a material concern for investors over the near and intermediate term. In terms of Treasury yields, higher Treasury supply alone is not sufficient to send yields higher, based on historical correlations. Factors such as the path of Fed policy rates, growth, and inflation expectations matter to a much greater degree.

We expect the Fed to continue buying Treasuries at an $80 billion monthly pace, at least, while a weaker dollar has improved the currency-hedged attractiveness of U.S. debt yields, which should keep foreign demand robust, while money market funds will be another source of significant ongoing demand.

All talk

Turning now from the hypothetical to the demonstrable—what has the Fed actually done roughly six months into its historic efforts to prop up the economy and markets? Well, in some respects, not a whole lot. And in many respects, it should have been expected as monetary policy is mostly about jawboning:

> *"When I was at the Federal Reserve, I occasionally observed that monetary policy is 98 percent talk and only two percent action. The ability to shape market expectations of future policy through public statements is one of the most powerful tools the Fed has."* – Ben Bernanke

And this seemingly applies to the Fed's various lending facilities established in conjunction with Treasury as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. When announced, the numbers were eye-popping. Over $2 trillion across a handful of facilities, with the potential to increase to as much as $5 trillion if needed.

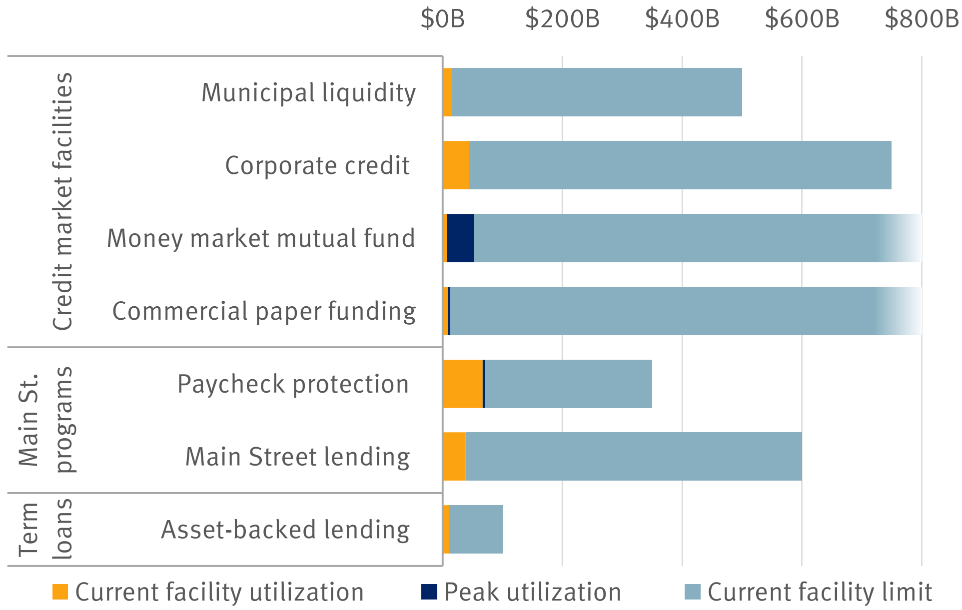
As the chart on the following page shows, across the board the actual uptake has been minimal, totaling roughly $200 billion. Absent another market meltdown, we suspect this will continue to be the case. Corporate bond buying has received the most headlines, but the Fed is barely present in corporate markets at the moment, buying just $20 million per day in a market with daily volumes over $20 billion. But the Fed's facilities, as intended, acted as a backstop for markets allowing companies, municipalities, and others to issue debt as they normally would, limiting the actual need for the Fed's help.

On the topic of light utilization of the Fed facilities, Powell and Treasury Secretary Steven Mnuchin addressed this in recent congressional testimony, and both showed willingness to reallocate funds and/or modify facility terms, particularly the Main Street Lending Program, to best address the ongoing recovery, which could be the next course of action.

Fixed income strategy

When rates are historically low, the fear is that they can only go higher—and for decades this has likely caused some investors to pursue suboptimal fixed income portfolio strategies despite ever-lower rates. Reinvestment risk will be the biggest

With little wear and tear, trillion-dollar Fed facilities remain in like-new condition



Note: Money market mutual fund and commercial paper funding facilities have no technical limits; utilization numbers include equity contributions from Treasury, actual lending may be lower.

Source - RBC Wealth Management, Bloomberg, Federal Reserve

challenge with the Fed now expected to keep short-term rates at zero percent through at least 2023, and likely through 2025, in our view. Therefore, the name of the game will be locking in yield and coupons where possible.

We remain comfortable with taking on prudent additional risk within fixed income portfolios to supplement income amid Fed support, stronger liquidity profiles for many corporations due to elevated levels of recent new debt issuance, and a progressing U.S. economic recovery.

We recently shifted to a slightly negative outlook on U.S. investment-grade corporate bonds with yields under two percent. We remain positive on high-yield corporate bonds where index yields remain at 5.8%. We also remain positive on preferred shares. Though they're somewhat exposed to stock market volatility, the lack of material interest rate risk for the foreseeable future with the Fed on hold may increase the attractiveness of the sector.

The 2020 U.S. election is likely to prove to be one of the more contentious events in recent history. While the broad impact on fixed income markets may ultimately be relatively muted given the ongoing influence of Fed policy and market backstops, it could open up opportunities in a low-yield world for fixed income investors with a game plan.

New normal, new opportunities

The COVID-19 pandemic is impacting millions of people and businesses around the world. It is also bringing forth technological changes and trends, and presenting some novel investment opportunities. A team of analysts at RBC Wealth Management has published a series of articles examining long-term secular trends in a post-COVID-19 world. The 15 articles listed below cover a wide range of themes that are emerging as a result of social distancing, the work-from-home imperative, health care developments, corporate implications, and broader societal change. These articles have been compiled into a report titled *New normal, new opportunities*. We believe identifying post-COVID trends and understanding their investment implications will be critical to navigating the road ahead, and we hope you find this report useful.

Work-from-home

E-commerce: Stuck at home? Some online retail therapy always helps!

Placing more irons in the fintech fire

Cloud computing: Cloud genie is accelerating out of the bottle

5G communications networks: Enabling next-generation technology

Video streaming: Cord-cutting in the time of COVID-19

Nesting: Homebodies for now

Corporate implications

Cybersecurity and digital content: A digital defense is the best corporate offense

Automation: Technology advancements lead to new products and higher productivity

The importance of resilient companies in portfolio construction

Healthcare

Drug discovery & diagnostics: They might be just what the doctor ordered

Telemedicine: Stepping out of the shadows to take centre stage

Societal themes

How will COVID-19 impact the fading globalization theme?

Surging government debt and deficits

Speed bump in the secular growth of the sharing economy

Ground zero in the COVID-19 upheaval: The future of travel and leisure

More to come

The economy continued its V-shaped recovery over the summer and, until recently, so did much of the stock market. However, starting in September, several indexes including those of the U.S., Canada, and Japan peaked and have been consolidating or correcting for several weeks. Europe's market began its consolidation back in July, while the UK market, encumbered with a new Brexit deadline, has been losing ground since June.

For a global portfolio we are using this period of consolidation to move our recommended equity exposure up to a full benchmark weighting from the modest Underweight we have been carrying.

There exists plenty of potential for near-term market volatility—e.g., a second wave of COVID-19 infections, the U.S. election, festering trade disputes—yet we expect the economy, corporate earnings, and the stock market will gain more ground over the coming 12 months. This will be fueled by further progress taming the COVID-19 virus, the ongoing normalisation of the global economy, and especially the entrenched commitment to an accommodative, ultralow interest rate policy on the part of major central banks, led by the Fed.

Leveling off

While the developed economies continue to post mostly strong numbers, we expect the coming months will see the dynamic "restart" phase give way to an extended stretch of more grudging growth. That translates into the year-over-year GDP comparisons looking quite strong out to Q3 2021 but the much more closely watched quarter-over-quarter growth rates looking much bumpier and less convincing.

Equity views

Region	Prior	Current
Global	–	↑ =
United States	–	↑ =
Canada	–	–
Continental Europe	=	=
United Kingdom	–	–
Asia (ex-Japan)	+	+
Japan	=	=

\+ Overweight = Market Weight – Underweight
Source - RBC Wealth Management

For several years following the last recession, many were reluctant to acknowledge that the economic downturn had ended despite data clearly showing that the economy had resumed growing in the summer of 2009 and never looked back. This time, we expect all economic data in 2021 and probably 2022 will be viewed within the context of a vocal debate about whether the current downturn has ended, closely followed by conjecture about whether a "double-dip" recession is in the offing.

As things stand, that's not what we expect. Rather, we see the slower, bumpier growth of next year allowing most of the developed economies to regain their late 2019 high-water marks by mid-2022 and their previous trajectories sometime in 2023.

Earnings are likely to follow the same directional path. For this year, we look for S&P 500 earnings per share to come in around $130, down sharply from last year's $163 per share. For 2021, we see earnings rebounding to $155, and on to

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$170 for 2022. All our earnings estimates are lower than the current Street consensus.

With 2021 projected earnings not back to their 2019 peak but the U.S. stock market averages recently trading above their 2019 highs, the argument can be made the U.S. market is excessively valued. Other markets, still well below their December 2019 highs, not so much.

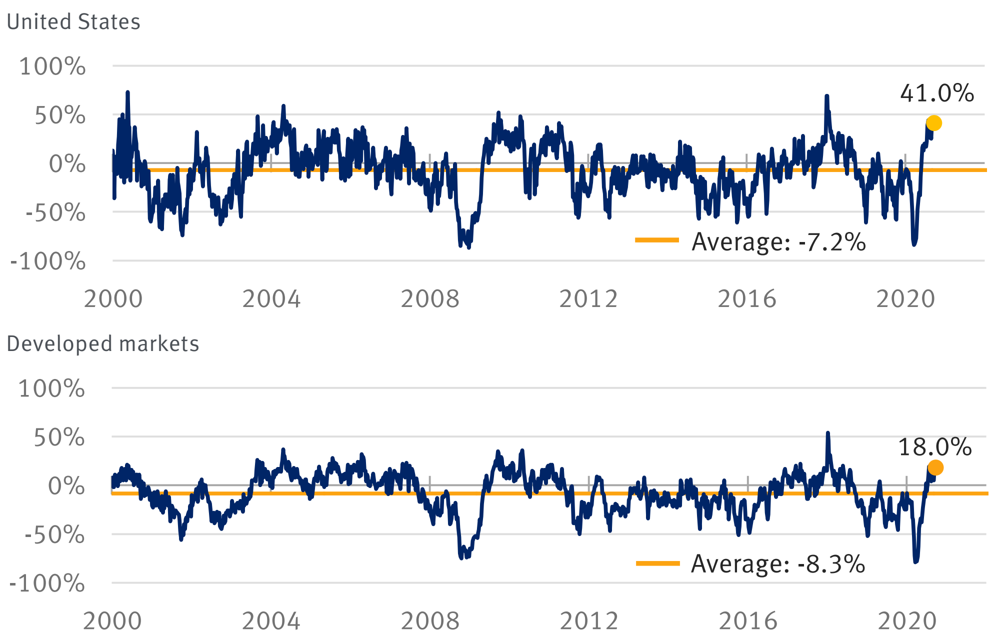
Reconciling valuations

However, there is a reconciling factor at play: corporate bond yields are about 15% lower than they were at the beginning of the year, making the discounted present value of future S&P 500 earnings that much more valuable, in our opinion. Overall stock market valuations are not scarily expensive, but they are certainly not cheap. In our view, they are likely to remain more richly valued for an extended time for several reasons:

- Central banks, led by the Fed, are committed to ultralow short-term interest rates through 2023—and probably much longer. The Fed likely would also act to prevent long-term rates from moving high enough to threaten the recovery. This commitment dramatically reduces the risk of widespread corporate insolvencies among public companies and correspondingly supports equity valuations.
- We do not expect a complete withdrawal of fiscal support as long as unemployment remains high and social distancing remains the order of the day, with its deeply constraining impact on some significant parts of the economy.
- A second wave spike of new COVID-19 cases notwithstanding, it is fair to say considerable progress has already been made in mitigating the most damaging physical effects of the virus. One doesn't have to be a wild-eyed optimist to expect more progress over the coming year, permitting further reductions in social and business constraints and adding to both normalcy and the certainty of growth.

We expect the rocket ride that the stock markets enjoyed off the depressed March lows is unlikely to be repeated in the

Percentage of companies with upward earnings revisions



Source - RBC Global Asset Management; weekly data through 9/25/20 coming months and quarters. The broad market averages, already correcting, could be in for a longer stretch of consolidation as conflicting economic forces play out.

Larger forces at work

Beyond the pandemic, economic growth in the developed economies is likely to be slower than even the subdued growth of the past decade. The nonpartisan Congressional Budget Office, which regularly prepares long-term forecasts for the U.S. economy—and has compiled an enviable track record—estimated in a September report that the annual potential growth rate for the U.S. economy for the coming decade is 1.8% versus the 2.3% achieved from 2010 to 2019, itself a notable slowdown from the prior decade.

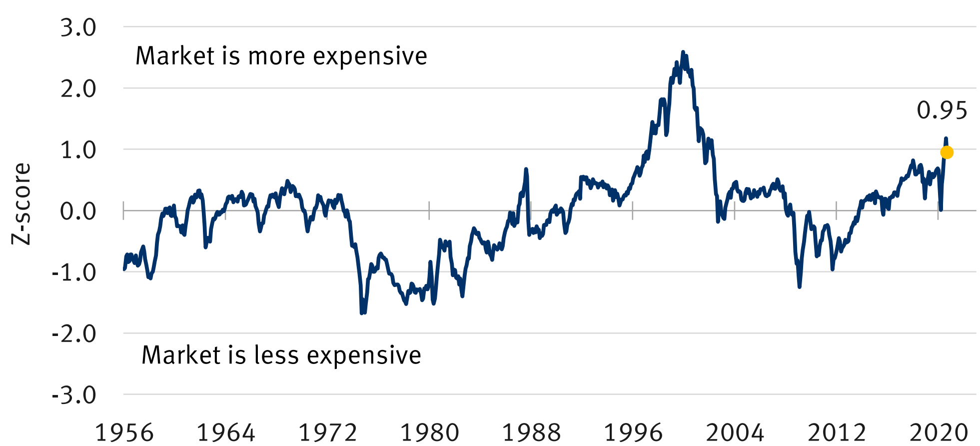
This further deceleration is the result of very slow growth in the working age population, which leaves all the heavy lifting to productivity increases—a notoriously difficult factor to forecast. Virtually all the developed economies, as well as China, are facing the same set of challenging circumstances.

This argues for a more intensely competitive corporate and business environment. From a portfolio management standpoint, it puts a premium on seeking out those businesses that are able to sustainably grow their sales, earnings, and dividends faster than the GDP of the major economies. Those companies' shares may become available at more attractive prices during a period of market correction/consolidation like the one we may be entering.

For a global portfolio we are boosting our recommended equity exposure to a full benchmark weighting from a modest Underweight. While near-term risks are very much in evidence, we expect the economy's progression from here will be shaped by these aforementioned factors:

- A multi-year commitment to low rates and accommodative monetary conditions on the part of major central banks, particularly the Fed
- A reluctance by governments to withdraw stimulus too abruptly or too soon
- Reasonable expectations that the effects of the COVID-19 virus will be tamed further over the coming year by policy, science, and the passage of time.

S&P 500 Index: Average of normalized valuation metrics



Based on historical data since January 1956 for 12-month trailing P/E, 12-month forward P/E, equity risk premium, Shiller P/E, Tobin's Q, and Federal Reserve model; historical data since March 1956 for market capitalization divided by U.S. GDP; and historical data since January 1960 for RBC Global Asset Management fair value.

Source - RBC Wealth Management, FactSet; monthly data through September 2020

Regional highlights

United States

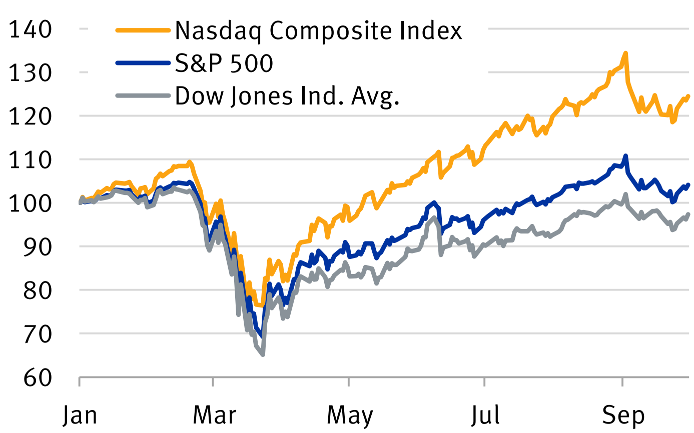
- Following a torrid advance off of the March low, the U.S. equity market took a long overdue break in September. The S&P 500 pulled back 9.6% at its worst point, while an index of Tech and related stocks known as the NYSE FANG+ retreated 13.6%. We view this as a healthy, normal correction. It began in the frothiest part of the market (Tech) and has spread to other areas, albeit to a lesser extent. We are using the pullback as an opportunity to bring our U.S. equity weighting back up to Market Weight from moderately Underweight.
- The possibility of resumed COVID-19 shutdowns and/or election-associated turbulence could bring about more choppy and volatile market conditions in coming months. But if economic and earnings progress continues, even at a modest pace, we don't think the market will revisit the March lows. At this stage we can make a case for at least moderate earnings growth and equity gains in the next 12 months. Earnings trends are moving in the right direction. Lately, annual profit estimates have pushed higher rather than lower. We're comfortable with the S&P 500 consensus forecast of $130 per share for 2020. We believe 2021 earnings could end up within a range of $155–$166, with the high end of that range representing the consensus estimate. Much will depend on whether additional COVID-19 shutdowns are implemented next year.

Canada

- We maintain a modest Underweight recommendation on Canadian equities. The domestic benchmark extended its rally in recent months, but its valuation has remained stable at approximately 15.5x the consensus 2021 earnings estimate. This represents a modest premium to the benchmark's long-term average but a sizeable discount relative to the S&P 500's multiple of above 20x. We believe the Canadian equity market requires evidence of a sustained economic recovery and enhanced clarity for key sectors before it can shrink that valuation gap.
- At a little over 10x the consensus 2021 earnings estimate, the Canadian bank sub-industry remains discounted relative to its long-term average of roughly 11.5x. This discount reflects ongoing uncertainty with respect to

The U.S. equity market takes a breather

Year-to-date performance indexed to 100



We view the September correction as part of a normal market move after the torrid gains from the March lows.

Source - RBC Wealth Management, FactSet; data through 9/30/20 credit losses as well as muted growth expectations beyond next year's post-pandemic recovery. The Big Six banks amassed nearly CA$18 billion in credit provisions over their past two fiscal quarters in anticipation of recession-induced loan losses. We believe we'll have a better sense of whether provisions prove sufficiently conservative as loan deferral programs run their course through October and borrowers are compelled to resume payments.

- Following an incredibly volatile spring when the North American futures contract briefly ventured into negative territory, crude oil prices have traded in a narrow range around $40 per barrel. This is roughly the cash flow break-even level required for major Canadian producers to cover operating costs, capital spending, and dividends. Our conviction level with respect to the direction of crude oil prices is low given the outsized influence of the COVID-19 pandemic on demand and the elevated level of supply intervention chartered by OPEC and its partners.

Continental Europe & UK

- Much of Europe is battling a resurgence of COVID-19 infection rates. For now, as fatality rates remain very subdued throughout the region, the hope is that widely available testing and tracing systems that have proven effective combined with localised social distancing measures should be sufficient for the region to avoid national lockdowns.
- Recent economic activity levels point to the recovery decelerating as the resurgence of infection cases weighs on business activity. It is too early to worry about a double-dip recession, in our view, particularly as most countries are prolonging their temporary unemployment schemes. National authorities and the European Central Bank will continue to be on the alert.
- We would hold a Market Weight position in European equities. We continue to favour Health Care, a sector underpinned by aging demographics and rising global health care expenditures; renewables-focused Utilities as governments target green and sustainable investments; select companies benefitting from secular trends in the Industrials sector; as well as the luxury and sporting goods categories within the Consumer Discretionary sector where long-term fundamentals appear structurally attractive.
- We remain Underweight UK equities given the many uncertainties around both the economic recovery as the country seems inexplicably ill-prepared for its second wave of COVID-19 infections and the outcome of tumultuous Brexit negotiations. Even if a bare-bones free trade agreement with the EU is achieved, trade is very likely to be disrupted when the transition period ends on Dec. 31, 2020. While prospects appear grim in the short term, valuations have fallen to very depressed levels. We would focus on UK companies well positioned to benefit from long-term structural growth tailwinds or that possess internal levers to grow.

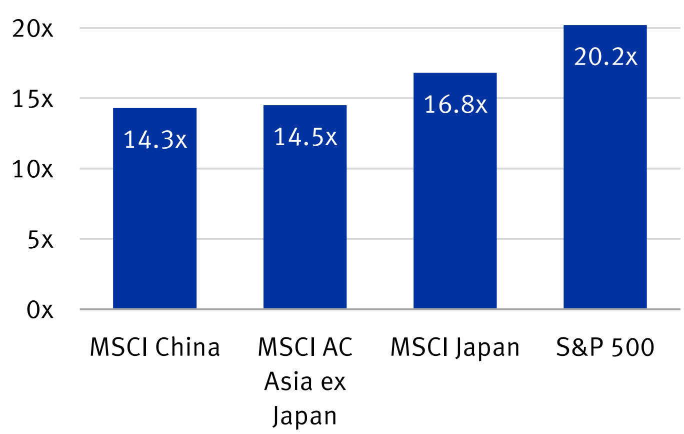
Asia

- Recently, the Chinese economy has featured accelerating retail consumption and manufacturing investment, combined with a slowdown in infrastructure spending and stabilizing real estate. In August, China retail sales expanded for the first time since the COVID-19 pandemic took hold, rising 0.5% y/y. Within retail sales, online retail sales growth decelerated and its share of overall retail sales edged down, which suggests that offline consumption has picked up. September through October is traditionally a high consumption season. With the October National Day holiday week underway, the country has been hosting many events to boost offline consumption.

- Escalating U.S.-China tensions have led to broadly range-bound Chinese equity market activity in the past two months. The momentum of previously leading sectors, e.g., Information Technology, e-commerce, Consumer Staples, and Health Care, also weakened. We think the consumption recovery story and normalization in consumption patterns may benefit traditional retail players through year end.
- Japan remains on a two-speed economic recovery, currently led by manufacturing. We expect the gradual lifting of business restrictions, along with the recent decline in the number of new COVID-19 infections, to support the services sector. We believe August marked the start of a period of sustained deflation that may continue into H1 2021. We anticipate the Bank of Japan will maintain its accommodative monetary policies for the rest of the year. Japan has elected its first new prime minister in eight years. Yoshihide Suga has emphasized that he will promote economic growth while containing COVID-19, and proceed with regulatory reform. Most political observers believe Suga will call a snap election soon, in an attempt to win a convincing mandate from the voters.

The U.S.-China valuation gap widens

Estimated 2021 price-to-earnings ratios

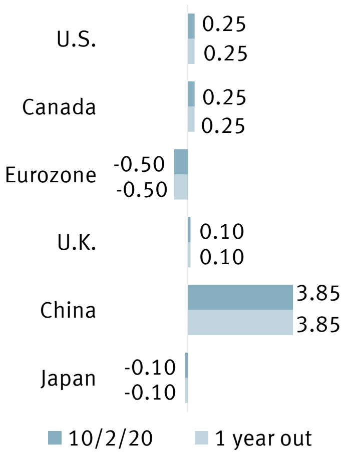


In tandem with the recovery and escalating trade tensions, the valuation gap between U.S. and Chinese equities has widened in 2020.

Source - RBC Wealth Management, FactSet; data through 9/30/20

Calm before the political storm

Central bank rate (%)



Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

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The Federal Reserve and the Bank of England (BoE) both have the month of October off, but will next meet in early November when political issues could just be heating up.

For the Fed, the result of the November 3 U.S. presidential election should be known by the time of the Fed's November 4–5 meeting, though there remains the chance it won't be. Regardless of the outcome, we believe Fed policy remains well positioned to deal with potential volatility, with all of the facilities put in place since March still operational.

With respect to the BoE, Brexit remains an ongoing issue that has only escalated of late ahead of looming deadlines later in the year. Up first though, is the expiry of the UK's current job retention scheme that ends on October 31 and will be replaced by a less generous scheme running until March. While some harbor expectations that the BoE will need to take policy rates into negative territory early next year in response to both Brexit and pandemic risks, we continue to believe that the most likely path forward is an extension to quantitative easing, a potential rate cut to 0%, and possibly a form of yield curve control. The latter would be more likely should the job retention scheme be extended further. The BoE would likely want to moderate any upward pressure to yields such an extension may cause.

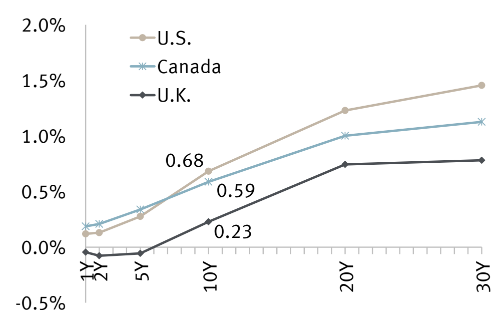
All that said, fixed income markets around the globe have been extraordinarily steady in recent months as central bank policy has kept markets in check amid a steadily progressing economic reopening and recovery. We stay with our bias toward corporate credit over government debt as the powerful fiscal and monetary tailwinds should continue to support risk assets, allowing investors to pick up yield in the process. However, volatility may begin to increase into the winter months should challenges to the economic recovery appear. This may bring opportunities for fixed income investors starved of yield.

Fixed income views

Region	Gov't Bonds	Corp. Credit	Duration
Global	=	+	5–7 yr
United States	=	+	7–10 yr
Canada	=	+	3–5 yr
Continental Europe	=	+	5–7 yr
United Kingdom	–	=	3–5 yr

+ Overweight = Market Weight – Underweight
Source - RBC Wealth Management

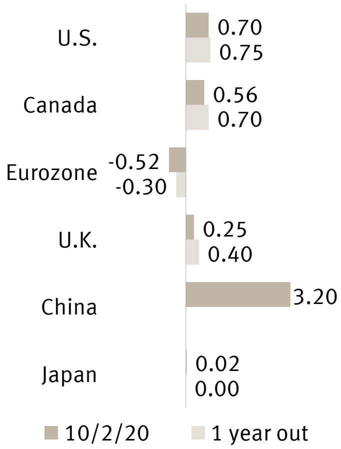
Sovereign yield curves



Source - Bloomberg; data through 9/30/20

Global fixed income

10-year rate (%)



Note: Eurozone utilizes German Bunds.

Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

Regional highlights

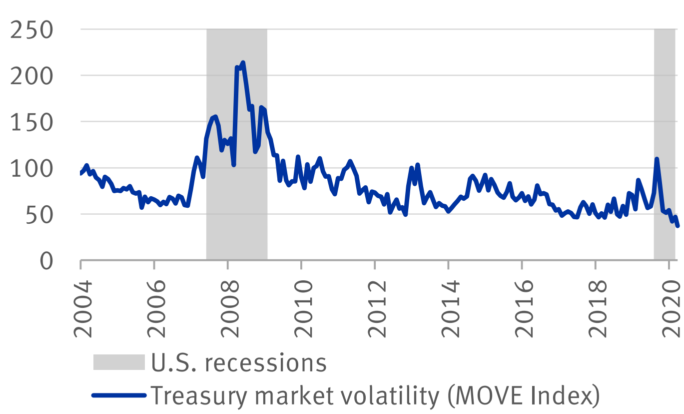
United States

- Following its September meeting, the Fed now forecasts policy rates at 0% through 2023, even as it expects labor markets to fully recover to an unemployment rate of 4%, and for inflation to rise to the 2% target. The Fed's new average inflation targeting regime means that policymakers will let the economy and inflation run hot for a period of time, so we expect rates at 0% beyond the current 2023 horizon. Treasury yields remain well-anchored as policy expectations will exert a far greater influence on yields than higher growth and inflation, or even greater Treasury supply amid record government deficits. The catalyst for higher yields is fiscal support, the outlook for which depends greatly on the results of the November U.S. elections.
- It has been almost too quiet in credit markets as the Fed's efforts via corporate bond purchases, along with strong stock market performance, have reduced credit market volatility. Investment-grade credit spreads, or the yield compensation over Treasuries for credit risk, have traded in a very tight range of just 0.11% since July, and now yield 1.35% over Treasuries for an average index yield of 2.01%. That near-record low yield has us looking for better opportunities elsewhere including speculative-grade BB-rated credits and preferred shares.
- After the Bloomberg Barclays Municipal Bond Index fell to a record low of just 1.12% in August, yields through September have since drifted roughly 20 basis points higher as a result of increased new issue volume, while weekly muni fund inflows slowed somewhat. Our strategy targets the steepest part of yield curves, from 15–25 years, where muni-to-Treasury ratios present the most attractive value. While the pandemic imposes financial challenges for municipalities, for every Puerto Rico, there are thousands of municipalities that steadfastly honor their debt obligations. According to a Moody's Investors Service default study, investment-grade municipal general obligation bonds defaulted less than 0.05% over 10-year rolling periods since 1970.

Canada

- The yield curve has modestly resteepened as short-term yields remain anchored and nascent signs of a rebuild of inflation expectations have emerged. Three years of policy inaction from the Bank of Canada (BoC) is embedded in market pricing

Fresh lows in Treasury market volatility



Treasury market volatility plunges to fresh lows as Fed expectations remain well-anchored.

Source - RBC Wealth Management; monthly data through 9/24/20 and this has shifted the pivot-point for interest rates to longer-term maturities. Government bond issuance has increased considerably due to larger projected government deficits, but increased bond purchases from the BoC have offset much of the initial increase in issuance. We view inflation-protected bonds as attractively priced relative to conventional nominal bonds as long as inflation is slightly above 1% annually for the next decade.

- Corporate bonds have been strong performers in recent months as low government bond yields have sent investors searching for yield. With compensation for credit risk receding to its historical average we are less broadly enthusiastic about corporate credit, but we continue to find opportunities in non-core fixed income. Credit fundamentals remain challenged by tough operating conditions, but the new issue market has reopened and afforded issuers the opportunity to refinance debt at lower coupons. This has eased both liquidity concerns and interest payment outlays.
- Preferred shares remain in a state of recovery and we see scope for this strength continuing. Relative valuations are supportive and a positive catalyst has recently emerged with the development of a new "institutional" market where banks can issue a preferred share-style of product and at a similar rate, but with a coupon that is tax-deductible. The traditional preferred share market could shrink by over 10% in the next 18 months as we expect to see less issuance and more redemptions. The issues that remain outstanding could be beneficiaries as there is a general shortage of high-yielding instruments outstanding, and this is one of the few markets where compensation for credit risk remains well above its historical average.

  Preferred shares broadly provide yields that are 3.5%–5% higher than government bonds and 2%–3.5% higher than corporate bonds sold by the same issuers.

Continental Europe & UK

- While sizeable support remains in place across Europe via the EU recovery fund and the European Central Bank's (ECB) extensive stimulus package, current leading economic indicators are pointing to divergence between individual countries' recoveries as well as certain sectors being impacted more by increasing rates of COVID-19 infections. This points to the possibility of further ECB action, either by extending the current emergency bond purchase program or providing further liquidity via the banking sector to support the real economy. We see the potential for this to be forthcoming as soon as the ECB's next policy meeting at the end of October.
- In the UK, as the country faces the challenge of local lockdowns from rising COVID-19 cases and challenging negotiations on a trade agreement with the EU, the Bank of England (BoE) has yet to further extend its monetary policy tools, with the base rate remaining at 0.1% and the quantitative easing (QE) program at £745 billion. However, the BoE continues to suggest that it is exploring the possibility of a negative interest rate policy, with a technical impact study expected to take some time. We anticipate a possible extension of the QE program before year end, with interest rates possibly being reduced to the zero bound. For now, we see forward guidance being maintained, with the idea of negative interest rates being discussed rather than acted upon.
- Overall, corporate credit in both regions has followed a similar path as other markets given ongoing strong investor

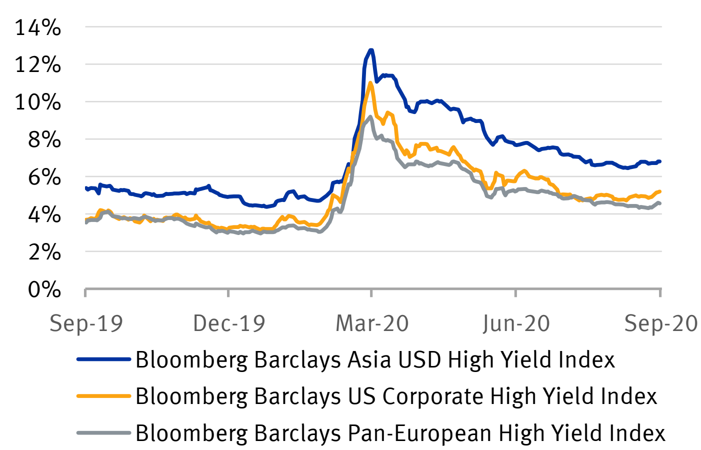
demand and continued central bank bond buying, with credit spreads at 1.2% in Europe and 1.5% in the UK. We maintain a preference for corporate credit over government bonds. We remain Market Weight on European government bonds and Overweight in European corporate credit, while being Underweight on UK government bonds and Market Weight on UK corporate credit.

Asia

- Asia investment-grade bonds (+6.0%) and Asia high-yield bonds (+1.6%) delivered positive returns in the first nine months of this year based on the Bloomberg Barclays Asia USD Investment Grade and High Yield Bond Indexes.
- After this strong performance, Asia investment-grade bonds now provide a historically low yield of 2.2%. This still delivers a yield pick-up over developed market bonds, but given the low all-in yield we expect future returns to come mainly from coupon clipping with lower price appreciation potential.
- We see a more attractive outlook for Asia high-yield bonds. While some short-term market pullbacks are possible, and actually welcomed, after such a strong rally, we remain constructive over a 6- to 12-month time horizon. Despite the strong rebound in Q2 and Q3, Asia high-yield bonds still provide a yield of 7.8%. This is very appealing in view of the current zero interest rate environment. Based on the latest Fed projections from September, the federal funds rate is not likely to be raised within the next three years. The search-for-yield demand is here to stay, in our view, and this is supportive for the Asia high-yield space.
- We have the most preference for the China property sector. The physical real estate market in China has shown a strong V-shaped recovery with demand staying solid. Prudent government policies have prevented the physical market from becoming either too hot or too cold. By contrast, we have turned very cautious on India. The country is one of the hardest-hit by COVID-19 and GDP in the April-June quarter fell a record 23.9% y/y. Both Moody's and Fitch have had a negative rating outlook on India since June, and we believe the risk of investment-grade issuers being downgraded to high-yield has increased for next year.

Asia high-yield returns lead the U.S. and EU

Bloomberg Barclays average high-yield indexes



In a zero-interest-rate environment, current yields on Asia high-yield bonds remain near 7.8%.

Source - RBC Wealth Management, Bloomberg; data through 9/23/20

Commodities

Commodity forecasts

	2020E	2021E
Oil (WTI $/bbl)	$38.43	$45.15
Natural Gas ($/mmBtu)	$1.99	$2.40
Gold ($/oz)	$1,774	$1,893
Copper ($/lb)	$2.67	$2.75
Soybean ($/bu)	$9.25	$9.99
Wheat ($/bu)	$5.34	$5.72

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (soybean and wheat)

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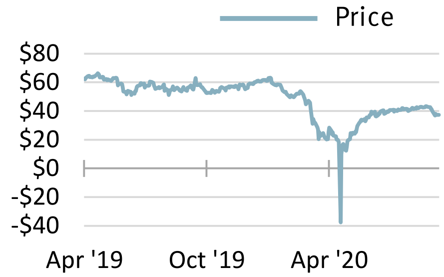
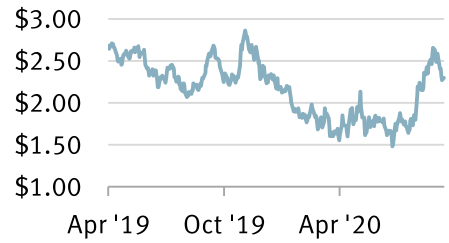
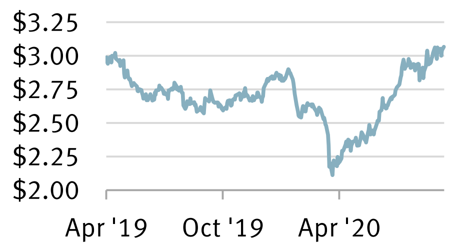
WTI – A multi-step process
Oil is well off the lows of negative pricing, but remains about 32% lower y/y. WTI traded in a tight range through Q3 before falling 8% in September due to softness in the physical market. RBC Capital Markets strategists suggest that rebalancing the global oil market is a multi-step process that requires improving demand, a drawdown in inventories, and an expansion in refining margins.



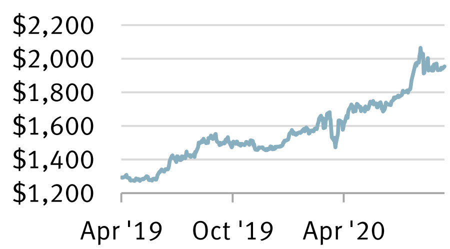
Natural gas – Gas-to-coal?
Natural gas prices are up about 5% year to date on stronger residential consumption and weaker supply due to COVID-19-related disruptions. RBC Capital Markets strategists believe a key theme going into 2021 could be an increase in coal demand driven by the rise in gas prices. That said, our strategists believe gas prices have more room to run.



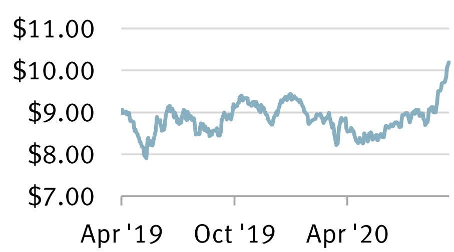
Copper – China's correlation
Copper prices rallied to two-year highs, driven by continued strength in Chinese demand and global supply disruptions. RBC Capital Markets equity analysts believe COVID-19 could keep the market tight through 2021, but also suggest new mine developments may ramp up on the back of stronger pricing. U.S.-China risks could also increase heading into the U.S. elections.



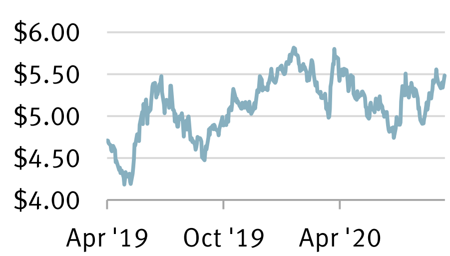
Gold – A COVID-19 winner
The historical negative correlation between equity markets and gold remains decoupled in the face of uncertainty and ultra-low bond yields. We maintain a constructive view premised on a sustained low-real-rate environment, the possibility of higher inflation down the road, and potential volatility heading into the U.S. elections. Gold is off its highs but remains above $1,900/oz.



Soybeans – A deal is a deal
Soybean prices are up about 8% year to date, driven by weak U.S. yields and continued demand from importing nations including China, which has stepped up its purchases of U.S. agricultural goods under the countries' Phase 1 trade agreement. China's agriculture ministry expects soybean imports to rise further this year.



Wheat – Growing production
Wheat also benefited from recent purchases by China, which in turn should set up the U.S. as the second-largest exporter, trailing only Russia, in the new marketing year. The USDA expects global wheat production for the 2020–21 season to exceed the previous year's record on stronger production from Australia, Canada, and the European Union. Wheat prices are down 2% year to date.



Source - RBC Wealth Management, Bloomberg; date range: 4/1/19–9/14/20

Currencies

Currency forecasts

Currency pair	Current rate	Forecast Sep 2021	Change*
Major currencies			
USD Index	94.01	93.32	-1%
CAD/USD	0.74	0.75	1%
USD/CAD	1.33	1.34	1%
EUR/USD	1.17	1.18	1%
GBP/USD	1.28	1.23	-4%
USD/CHF	0.92	0.91	-1%
USD/JPY	105.67	101.0	-4%
AUD/USD	0.71	0.69	-3%
NZD/USD	0.65	0.64	-2%
EUR/JPY	123.78	119.0	-4%
EUR/GBP	0.91	0.96	5%
EUR/CHF	1.07	1.07	0%
Emerging currencies**			
USD/CNY	6.80	6.60	-3%
USD/INR	73.76	73.50	0%
USD/SGD	1.36	1.34	-1%

* Defined as the implied appreciation or depreciation of the first currency in the pair quote. Examples of how to interpret data found in the Market Scorecard.
** Bloomberg Consensus forecasts
Source - RBC Capital Markets, Bloomberg

U.S. dollar: Mixed performance

The U.S. dollar broadly underperformed through July and August as the global economic outlook continued to improve and the Fed signaled low rates for longer. With Fed policy now priced in and growth forecasts stabilizing, we expect mixed performance into 2021. Key risks to monitor include the fiscal cliff and its impact on U.S. growth and the U.S. elections, particularly should the latter yield a contested result.

Japanese yen: Status quo

The Japanese yen eked out small gains through Q3 and likely has further upside in Q4. Although the resignation of Prime Minister Shinzo Abe sparked a brief sell-off, his successor is unlikely to alter the policy backdrop and should be neutral for the yen. Alongside “safe-haven” demand, Japanese investor behavior will keep the yen supported as low rates encourage hedging foreign holdings by buying the yen.

British pound: Remaining cautious

After strong gains early in Q3, the British pound has reverted to underperforming as the risk of an exit from the EU without a trade deal is increasing leading into the October deadline. Trade negotiation headlines will be the prominent driver of sterling in coming weeks, and risks are asymmetric to the downside. A recent resurgence of UK COVID-19 infections and the prospect of negative rates from the Bank of England further support a cautious outlook.

Canadian dollar: External factors

Equity market strength and broad U.S. dollar weakness helped push the Canadian dollar higher through the summer months. Although we are optimistic on the growth outlook in Canada in Q3 and Q4, there are risks on the horizon including the end of payment deferral programs, high unemployment forecasts, and a possible second wave of COVID-19 infections. These risks point to potential Canadian dollar weakness into year’s end.

Euro: Modest upside

The euro has stayed largely range-bound since August as the positive sentiment towards the EU Recovery Fund and fiscal/monetary response has been largely digested by markets. The removal of key risks warrants a more constructive outlook on the euro. However, with evidence the growth recovery could be stalling in the region, absent an external catalyst we expect only modest gains through Q4.

External factors drove USD/CAD to a seven-month low

Source - Bloomberg, RBC Wealth Management; data through 9/21/20

High unemployment and stretched consumers could point to moderate Canadian dollar weakness towards the end of the year.

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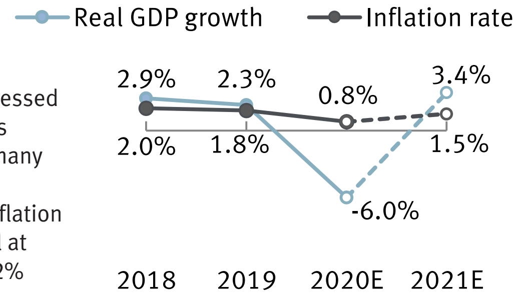
Key forecasts

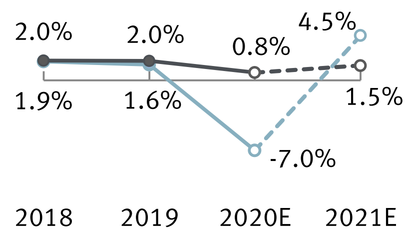
United States – A new normal

Q3 GDP looks to be surging higher off the deeply depressed Q2 low. Jobless claims have trended lower, new orders higher but the renewed surge in COVID-19 cases has many waiting for further stimulus. Housing and autos have showed surprising strength. The Fed's new average inflation targeting regime will not trigger a policy rate hike until at least 2025, inflation will be allowed to run above the 2% target for some time.



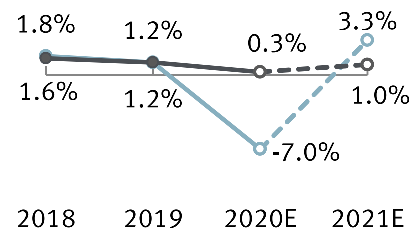
Canada – Strong recovery

A strong initial recovery from lockdowns has seen housing starts and sales surpass pre-pandemic levels amid strong demand. Manufacturing rebounded over the summer months as did business confidence. Household optimism neared its Feb. 2020 high. GDP is recovering but has some way to go to reach pre-COVID-19 levels. We expect a booming Q3 followed by more subdued growth thereafter with the virus a wildcard.



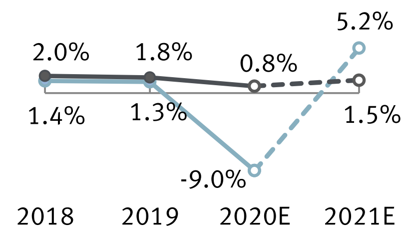
Eurozone – Recovery slowing down

After a sharp three-month rebound, economic activity has slowed as increases in COVID-19 infection rates have spurred stricter social distancing measures. Manufacturing data has plateaued as reinstated lockdowns have kept a cap on production. The aggregate unemployment rate sits at a historically low 7.9%. Business confidence has improved steadily since March, consumer confidence less so.



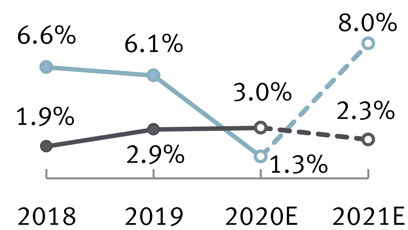
UK – Does not plan to implement negative rates

The Bank of England has no immediate plans to implement negative interest rates, choosing to study the matter further. The stance to avoid negative rates could be further supported by UK mortgage approvals hitting a 13-year high on the back of a bill passed in July waiving the stamp duty on the first £500,000 of any property purchased until next March. Difficult Brexit negotiations are weighing on confidence.



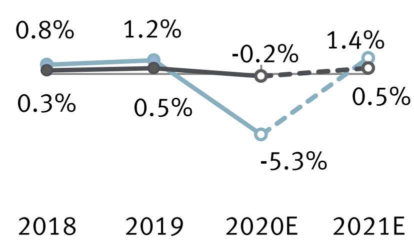
China – Recovery broadening

After ticking lower in August, China's official manufacturing PMI rose to 51.5 in September. The gradual reopening of global economies is expected to support continued external demand. Government investment in infrastructure is providing additional support. China's recent relaxing of COVID-19-related restrictions is expected to support a rebound in economic consumption.



Japan – Industrial production improving

August industrial production rose at a slower 1.7% pace m/m compared to July's booming 8.7% rise. Higher production was driven by a recovery in auto exports and information-related goods. A rise in COVID-19 cases is a headwind for domestic business activity. Consumer confidence improving, business sentiment less so. Q3 growth has been dampened by natural events including heavy rainfall and typhoons.



Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management (RBC GAM), Bloomberg consensus estimates

Market scorecard

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	3,335.47	-3.9%	4.1%	13.0%
Dow Industrials (DJIA)	27,452.66	-2.3%	-2.7%	3.2%
Nasdaq	11,085.25	-5.2%	24.5%	39.6%
Russell 2000	1,504.73	-3.5%	-9.6%	-1.0%
S&P/TSX Comp	16,211.52	-2.4%	-5.5%	-3.2%
FTSE All-Share	3,297.63	-1.8%	-21.8%	-19.2%
STOXX Europe 600	361.64	-1.5%	-13.2%	-8.2%
EURO STOXX 50	3,205.60	-2.4%	-14.7%	-10.5%
Hang Seng	23,459.05	-6.8%	-16.8%	-10.1%
Shanghai Comp	3,218.05	-5.2%	5.5%	10.8%
Nikkei 225	23,185.12	0.2%	-2.0%	6.6%
India Sensex	38,067.93	-1.5%	-7.7%	-1.6%
Singapore Straits Times	2,466.62	-2.6%	-23.5%	-20.9%
Brazil Ibovespa	93,580.40	-4.8%	-18.2%	-9.7%
Mexican Bolsa IPC	37,134.92	1.7%	-14.0%	-12.9%
Bond yields	**9/30/20**	**8/31/20**	**9/30/19**	**12 mo. chg**
US 2-Yr Tsy	0.121%	0.131%	1.622%	-1.50%
US 10-Yr Tsy	0.651%	0.705%	1.665%	-1.01%
Canada 2-Yr	0.244%	0.275%	1.580%	-1.34%
Canada 10-Yr	0.541%	0.622%	1.361%	-0.82%
UK 2-Yr	-0.042%	-0.057%	0.369%	-0.41%
UK 10-Yr	0.197%	0.311%	0.488%	-0.29%
Germany 2-Yr	-0.708%	-0.601%	-0.766%	0.06%
Germany 10-Yr	-0.542%	-0.185%	-0.571%	0.03%
Commodities (USD)	**Price**	**1 month**	**YTD**	**12 month**
Gold (spot $/oz)	1,897.98	-4.2%	24.3%	28.1%
Silver (spot $/oz)	24.02	-17.4%	30.2%	36.7%
Copper ($/metric ton)	6,486.50	-0.4%	8.4%	17.1%
Uranium ($/lb)	20.90	-0.5%	-12.6%	-7.7%
Oil (WTI spot/bbl)	39.24	-5.6%	-34.1%	-25.6%
Oil (Brent spot/bbl)	40.58	-9.6%	-38.0%	-32.6%
Natural Gas ($/mmBtu)	2.47	-3.9%	15.4%	8.5%
Agriculture Index	273.20	4.6%	0.8%	8.3%
Currencies	**Rate**	**1 month**	**YTD**	**12 month**
US Dollar Index	94.0190	1.9%	-2.6%	-5.5%
CAD/USD	0.7476	-2.0%	-2.5%	-0.6%
USD/CAD	1.3377	2.1%	2.5%	0.6%
EUR/USD	1.1713	-1.8%	4.5%	7.5%
GBP/USD	1.2846	-3.4%	-2.5%	5.1%
AUD/USD	0.7137	-2.9%	2.0%	6.1%
USD/JPY	105.6700	-0.4%	-2.9%	-2.4%
EUR/JPY	123.7800	-2.2%	1.5%	5.0%
EUR/GBP	0.9119	1.6%	7.2%	2.3%
EUR/CHF	1.0799	0.1%	-0.6%	-0.7%
USD/SGD	1.3680	0.4%	1.4%	-1.2%
USD/CNY	6.8084	-0.8%	-2.5%	-5.0%
USD/MXN	22.2661	1.0%	16.8%	12.1%
USD/BRL	5.6511	2.1%	39.2%	35.0%

September was a challenging month for global markets, most of which turned negative.

10-year global bond markets firmed following a month of global equity market weakness.

A stronger U.S. dollar contributed to weaker commodity performance across the board.

After losing ground in August, the U.S. dollar rallied in September and firmed against the CAD, EUR, AUD, and JPY.

Equity returns do not include dividends, except for the Brazilian Ibovespa. Equity performance and bond yields in local currencies. U.S. 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 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD -0.6% return means the Canadian dollar has fallen 0.6% vs. the U.S. dollar during the past 12 months. USD/JPY 105.67 means 1 U.S. dollar will buy 105.67 yen. USD/JPY -2.4% return means the U.S. dollar has fallen 2.4% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 9/30/20.

Research resources

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