August 29, 2019

RBC WEALTH MANAGEMENT

Global Insight Weekly

Prelude to the main event?

Kelly Bogdanova – San Francisco

While the U.S. and China circle each other and jab over trade, we believe the trade war is the undercard to a much broader geopolitical faceoff. Whether or not a trade deal is consummated we doubt the rivalry will let up. It could drift on and off the market's radar and is something investors will have to get used to dealing with.

Lately the market's attention on the U.S.-China trade dispute has centered on rapidly evolving, sometimes contradictory events—from President Trump's biting tweet about President Xi's newfound status as an "enemy"; to the tariff increase on $550B in Chinese goods; and then to Trump's abrupt change in tone as he characterized the trade negotiations constructively.

China's retorts have garnered attention as well, with the latest coming in the form of an olive branch. China will hold off on retaliating against Trump's newly planned tariff hikes to "prevent escalation of the trade war."

The exchanges left many questions unanswered as market participants searched for clues about whether a trade deal is feasible, and if so, when.

It's important for investors to stay tuned into the bigger picture. There is much more to the story than this sparring match or the current state of negotiations. To us, the trade dispute is merely a symptom of a simmering geopolitical rivalry between the U.S. and China that has the potential to intensify over the long term.

Rather than an all-encompassing agreement, we think the best-case scenario is a cosmetic trade deal sometime before the 2020 U.S. presidential election—meaning, a deal that would initially generate some buzz and excitement but would prove to be light on substance in the end, similar to NAFTA 2.0.

This is about more than the trade deficit

The U.S. seeks to change China's development plans, economic structure, laws, regulations, and ideology. There are key reasons we don't think this will happen.

Source - RBC Wealth Management

Market pulse

Click here for authors' contact information. Priced (in USD) as of 8/29/19 market close, EST (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6**

Disseminated: Aug 29, 2019 16:44ET; Produced: Aug 29, 2019 16:28ET

Trade deal or not, we doubt the competition between the U.S. and China will let up.

Words matter

As the trade dispute has worn on, it has become clearer in government policy documents and statements by officials that the U.S. does not view China as a potential partner, but sees it as a competitor, at best, or a rival or enemy, depending on who is doing the talking.

A hawkish view on China is uniquely bipartisan and nonpartisan, as there are critics of the Middle Kingdom on each side of the political aisle and within key agencies.

A consequential shift occurred in early 2018, for example, when the Pentagon changed its nearly 20-year focus on terrorism as the greatest threat facing the country and instead put China and Russia atop the list.

The *National Defense Strategy* summary report stated, "China is a strategic competitor using predatory economics to intimidate its neighbors while militarizing features in the South China Sea." It argued that China's goal is "displacement of the United States to achieve global preeminence."

Other assessments of China by U.S. government entities and elected officials are even more aggressive.

How does a country forge a comprehensive trade deal if it views its trading "partner" as a serious threat to its hegemony? When push comes to shove, we don't think it would, even if Trump reverts back to calling Xi his "good friend."

Full-court press

The other roadblock to a comprehensive deal is that, from China's perspective, the Trump administration is asking for the moon. The U.S. seeks to change China's development plans, economic structure, laws, regulations, and ideology.

It aims to thwart China's long-term strategic economic programs, Made in China 2025 and the Belt and Road Initiative. The U.S. views these initiatives as security threats and expansions of China's state-controlled industrial and technology policies.

The U.S. also wants China to further reform and reduce support for its state-owned enterprise (SOE) system—never mind that China has significantly curtailed this sector over the past 20 years. The Trump administration is asking China to tighten its intellectual property laws, stop so-called forced technology transfers, and relax barriers for joint ventures with foreign companies, among other requests.

Even though some of the U.S. demands have merit and could be addressed at least in part in a "cosmetic" trade deal, why would China give up the long-term strategic goals of Made in China 2025 and the Belt and Road Initiative? We don't think it will, and this is another reason a groundbreaking, comprehensive trade agreement seems unlikely.

Get used to it

To us, the trade dispute is part of a broader geopolitical struggle between the U.S.-led unipolar framework that has existed since the end of the Cold War, and what China and other nations see as an inevitable shift toward a multipolar world order in which various powers exert authority.

The U.S.-China rivalry could play out over many years and drift on and off the market's radar screen, sometimes impacting equity performance when trade, tariff, and economic growth issues surface. At other times, the rivalry will likely stay in the background, not driving equities in either direction, as is often the case with geopolitical struggles. Trade deal or not, we think the tensions between the two nations are something investors need to get used to.

China trade war/tariff risk by industry

How RBC Capital Markets industry analysts assess the risk to demand for the U.S. stocks they cover

Very negative

- Chemicals
- Coatings
- Department Stores
- Specialty Softline Retailers
- Railroads

Negative

- Autos & Auto Parts
- Beverages
- Building Products
- Oil Exploration & Production
- Forest Products
- Hardline/Broadline Retailers
- Household & Personal Care
- Integrated Oil & Gas
- Internet Retail/Travel
- Machinery/Cap Goods
- Medical Supplies & Devices
- Multi-Industry & Electrical Equipment
- Oil Services
- P&C Insurance; Insurance Brokers
- Packaging
- Semis & Semi Equipment
- Tobacco

Neutral

- Banks (Large)
- Banks (Small & Midcap)
- Biotechnology
- Business Services
- Cable & Telecom
- Communications Infrastructure
- HC Payors (Managed Care)
- HC Service Providers
- Homebuilding
- Internet Media
- IT Services
- Life Insurance
- MLPs (Midstream)
- Payments, Processors
- Refiners
- REITs
- Software
- Spec. Pharma (Branded)
- Spec. Pharma (Generics)
- Specialty/Consumer Finance
- Asset Managers
- Utilities

Note: Scale used in survey: +2 = very positive, +1 = positive, 0 = neutral, -1 = negative, -2 = very negative; no industries were viewed as positive or very positive in this question.

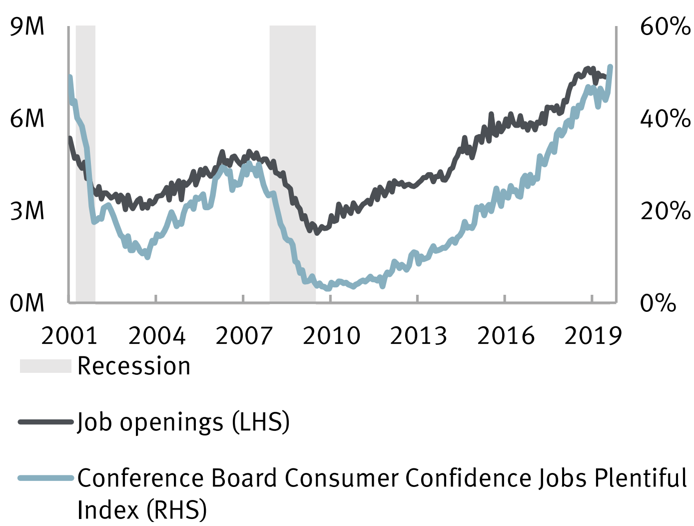
Source - RBC Capital Markets U.S. Equity Strategy, RBC Capital Markets estimates; table published in the August *RBC Macroscope*, survey from May 2019.

United States

Bill Kuehn, CFA – Minneapolis

- **Investment-grade corporate bonds remain on track to have the best August in 37 years**. The rally in Treasuries has given the investment-grade bond market quite the tailwind, returning 3.4% month to date, which has pushed the year-to-date return to 14.2%. The August rally comes as **investor risk appetite has shied away from the riskiest assets** amid global economic growth concerns and the ongoing trade dispute between Washington and Beijing, while also seeking positive returns in a negative-yielding world. The average yield on **BBB-rated corporate debt** stands at 3.17%, according to Bloomberg Barclays data, the **lowest yield since May 2013**. We continue to recommend a Market Weight allocation to investment-grade corporate bonds and expect the market to continue to be supported as the $17T in negative-yielding debt worldwide makes the positive yield of U.S. corporate bonds attractive to foreign investors.
- The Conference Board's **Consumer Confidence Index eased slightly to 135.1 in August**, much better than the consensus expectation for a drop to 129, as the strength of the labor market continues to keep consumer optimism elevated despite the constant back and forth of the U.S. and China trade dispute and volatile equity markets. **The tight labor market continues to provide both income and employment gains,** and with over 7 million open jobs in the United States, the share of Consumer Confidence Survey respondents who say jobs are currently plentiful jumped to 51.2%, the highest since September 2000, while the share saying jobs are hard to get declined to 11.8%, the lowest in three months.
- **The second revision to Q2 GDP showed a slight drop to 2.0% q/q**; however, the revised data indicate **consumer spending continues to drive the U.S. economy** as business investment slows. **Personal consumption was revised to 4.7% q/q from 4.3% q/q**, and we anticipate the elevated consumer confidence will translate into continued personal consumption growth in the near term. The Baker, Bloom and Davis Economic Policy Uncertainty Index spiked to levels not seen since the 2016 election, and given the amount of policy uncertainty, **we do not anticipate business investment to be a large contributor to economic growth** until progress toward trade agreements begin to take shape.

Consumers remain optimistic about the labor market with over 7 million open jobs



Source - RBC Wealth Management, Bloomberg; data through 8/29/19

Canada

Carolyn Schroeder & Sayada Nabi – Toronto

- **The Canadian inflation rate hit the Bank of Canada's (BoC) target for a second straight month**, providing a stretch of price stability that is unlikely to weigh heavily on the central bank's interest rate decision in September. Headline inflation rose 0.5% m/m and 2.0% y/y in July as underlying inflation trends still look solidly anchored around the BoC's 2.0% target rate. Excluding food and energy products (whose prices are volatile), prices were up 2.2% from a year ago. According to RBC Economics, the central bank's preferred "core" measures averaged 2.0% once again, extending the tight 1.9%–2.1% range that began in February 2018 for another month. The prospects of the BoC following the Fed and other global peers with lower interest rates have increased as the U.S.-China trade dispute intensified. Nonetheless, **the Canadian economy has continued to perform well**, underscored by resilient near-term price and economic growth trends, **which may afford the BoC flexibility to remain patient on monetary policy moves**.
- Canadian manufacturing sales declined 1.2% m/m in June. Although the data was soft, Canadian investors feared the possibility of a much more significant drop amid a sharp decline of exports in June. RBC Economics attributes the fall in manufacturing sales to a decrease in prices, specifically a 5% drop for petroleum and coal. **Despite the drop in manufacturing sales in June, manufacturing sales volumes in Q2 increased 7.3% q/q and were up 2.9% y/y**. RBC Economics believes this **puts Canada on track for about a 3% increase in Q2 GDP**. One of the most visible headwinds for the Canadian manufacturing sector stems from the U.S.-China trade dispute. The ongoing

conflict between the world's two largest economies has adversely impacted U.S. manufacturing output, as well as sentiment in the sector, with negative spillover effects in Canada.

Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **U.K. Prime Minister Boris Johnson** added a new twist to the Brexit saga during the week as he **moved to suspend, or prorogue, Parliament** from September 11 to October 14. He thereby reduces the time the House of Commons might have to thwart a "no deal" Brexit before the October 31 deadline.
- Traditionally, Parliament takes a three-week pause in the autumn due to the political parties' annual conferences. While it may seem like a casual extension to the normal period of inactivity, **this hiatus is unusual in several respects**. Members of Parliament (MPs) usually get to vote on a recess and its length, it is not imposed on them. Moreover, some parliamentary business usually continues even as party conferences take place, whilst prorogation shuts down all parliamentary activity.
- **The prime minister's tactics are being contested and legal challenges are likely to take place**. As the Queen, adhering to constitutional tradition, has already given her assent, it is unclear whether the challenges will be successful.
- **Moderate MPs of all parties opposed to "no deal" will nevertheless continue to attempt to work together** to avoid a "no deal" outcome. This is a tall order, not only due to the even more limited time available if the parliamentary prorogation goes ahead, but also due to the various political factions with different aims and priorities.
- Some progress was made during the week, as Labour leader Jeremy Corbyn agreed with other opposition leaders that the first action when Parliament returns from summer recess on September 3 should be **to table legislation to force the prime minister to seek an extension to the October 31 deadline**. This legislation should have the support of the 30 or so moderate Conservatives MPs opposed to "no deal". Plan B is a **vote of no confidence** in the government, though here, votes from moderate Conservative MPs could prove more difficult to gather as many would likely hesitate to topple their own prime minister, perhaps risking an election and an opposition government.
- Those developments increase further the probability of a "no deal" Brexit and, as such, the pound retraced some of its gains made since mid-August. With Parliament reconvening in less than a week, **we expect headline risk to spike and volatility, particularly in the currency, to remain very high.**

Asia Pacific

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

- It's all about tariffs again. **Asian equities fell during the week** after U.S. President Donald Trump announced additional tariffs on Chinese imports and asked American corporations to pull out of China.
- To support the slowing economy and partially offset the impact from tariffs, **the Chinese government rolled out a series of guidelines to further encourage household consumption**. Measures include exploring ways to gradually loosen or remove car-purchase limits, and supporting new-energy vehicle (NEV) purchases in some areas. The government **also plans to stimulate sales of home appliances and incentivize tourism**, among other initiatives. We don't expect the measures to boost auto sales meaningfully. The impact of the slowing economy and the change in the national emission standard may continue to adversely affect auto sales during the year.
- In addition to local protests, **trade tensions and weakening global growth are clearly affecting Hong Kong's economy**, one of the key trade centers in Asia. Hong Kong's **exports contracted for the ninth straight month** in July, falling 5.7% y/y to HK$338.6B (US$43.2B). **Imports tumbled 8.7% y/y** to HK$370.8B, below the consensus estimate. Imports from Malaysia, Korea, and Singapore declined the most.
- **South Korea criticized Japan for downgrading Seoul's trade status and accused Prime Minister Shinzo Abe of treating it as an "adversary"**. Japan stated the decision was purely due to national security concerns. It downgraded the trade status after South Korea's Supreme Court ordered several Japanese companies to pay reparations for forced labor during World War II.
- **China Construction Bank** (CCB), the country's second-largest bank, **reported H1 2019 results with net profits up 5% y/y**, which largely met estimates. However, **net interest margins contracted**, falling short of the consensus estimate. In addition, deposit growth of 1% q/q in Q2 2019 was slower than industry growth of 2% q/q. Overall, **we think banking sector sentiment remains weak**. The market has been concerned that the slowing economy will affect loan growth. Also, **Chinese banks have been asked by the government to offer more loans to smaller businesses**. Investors worry such a policy would negatively affect asset quality.

MARKET SCORECARD

Data as of August 29, 2019

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,924.58	-1.9%	16.7%	0.4%	19.6%
Dow Industrials (DJIA)	26,362.25	-1.9%	13.0%	0.9%	20.6%
NASDAQ	7,973.39	-2.5%	20.2%	-1.7%	26.5%
Russell 2000	1,496.72	-4.9%	11.0%	-13.7%	8.2%
S&P/TSX Comp	16,384.49	-0.1%	14.4%	0.0%	8.6%
FTSE All-Share	3,939.37	-4.7%	7.2%	-5.5%	-2.0%
STOXX Europe 600	376.74	-2.3%	11.6%	-2.5%	2.3%
EURO STOXX 50	3,411.33	-1.6%	13.7%	-1.3%	0.7%
Hang Seng	25,703.50	-7.5%	-0.6%	-9.5%	-7.4%
Shanghai Comp	2,890.92	-1.4%	15.9%	4.4%	-14.1%
Nikkei 225	20,460.93	-4.9%	2.2%	-10.4%	5.7%
India Sensex	37,068.93	-1.1%	2.8%	-4.3%	18.1%
Singapore Straits Times	3,081.83	-6.6%	0.4%	-5.0%	-5.2%
Brazil Ibovespa	100,524.40	-1.3%	14.4%	28.2%	40.9%
Mexican Bolsa IPC	41,831.30	2.4%	0.5%	-16.6%	-18.5%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,527.23	8.0%	19.1%	26.6%	16.6%
Silver (spot $/oz)	18.24	12.2%	17.7%	23.6%	4.9%
Copper ($/metric ton)	5,673.00	-3.9%	-4.6%	-6.6%	-16.2%
Oil (WTI spot/bbl)	56.71	-3.2%	24.9%	-18.4%	22.1%
Oil (Brent spot/bbl)	60.98	-6.4%	13.3%	-20.9%	17.3%
Natural Gas ($/mmBtu)	2.29	2.4%	-22.2%	-21.0%	-22.8%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	1.496%	-51.8	-118.8	-138.8	-63.3
Canada 10-Yr	1.147%	-33.0	-82.0	-117.5	-69.2
U.K. 10-Yr	0.436%	-17.5	-84.1	-105.3	-56.4
Germany 10-Yr	-0.692%	-25.2	-93.4	-109.6	-103.4
Fixed Income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	2.12%	2.7%	9.2%	10.4%	9.2%
U.S. Invest Grade Corp	2.79%	3.4%	14.2%	13.7%	12.6%
U.S. High Yield Corp	5.77%	0.2%	10.8%	6.3%	10.3%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	98.4480	-0.1%	2.4%	4.1%	6.7%
CAD/USD	0.7522	-0.8%	2.6%	-2.9%	-5.9%
USD/CAD	1.3294	0.8%	-2.5%	3.0%	6.3%
EUR/USD	1.1058	-0.2%	-3.6%	-5.5%	-7.6%
GBP/USD	1.2182	0.2%	-4.5%	-6.5%	-5.7%
AUD/USD	0.6728	-1.7%	-4.6%	-8.0%	-15.4%
USD/JPY	106.5100	-2.1%	-2.9%	-4.6%	-2.9%
EUR/JPY	117.7800	-2.2%	-6.4%	-9.9%	-10.3%
EUR/GBP	0.9077	-0.4%	1.0%	1.0%	-2.1%
EUR/CHF	1.0910	-0.9%	-3.1%	-4.0%	-4.6%
USD/SGD	1.3876	1.0%	1.8%	1.6%	2.4%
USD/CNY	7.1445	3.8%	3.9%	4.7%	8.3%
USD/MXN	20.1364	5.2%	2.5%	6.2%	12.9%
USD/BRL	4.1691	9.3%	7.6%	1.5%	31.8%

Source - Bloomberg. Note: 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. Data as of 9:35 pm GMT 8/29/19.

Examples of how to interpret currency data: CAD/USD 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD 2.6% return means the Canadian dollar rose 2.6% vs. the U.S. dollar year to date. USD/JPY 106.51 means 1 U.S. dollar will buy 106.51 yen. USD/JPY -2.9% return means the U.S. dollar fell 2.9% vs. the yen year to date.

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Rating	Count	Percent	Investment Banking Services Provided During Past 12 Months Count	Investment Banking Services Provided During Past 12 Months Percent
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Hold [Sector Perform]	588	40.80	114	19.39
Sell [Underperform]	81	5.62	2	2.47

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