December 5, 2019

RBC WEALTH MANAGEMENT

Global Insight Weekly

20/20 vision

Frédérique Carrier – London & Kelly Bogdanova – San Francisco

With the curtain about to rise on 2020, we remain constructive on the setup for financial markets. But this bias runs parallel to a heightened need for vigilance, so we're keeping our eyes trained on the investment environment.

Our team of specialists and strategists in the U.S., Canada, Europe, and Asia recently published the *Global Insight 2020 Outlook*, which sets out RBC Wealth Management's views on the economy, equities, fixed income, currencies, and commodities.

The report also spotlights four key topics that we believe will frame investment strategy in the coming year:

- We survey the global economic environment and see higher ground for equities, but we are also more cautious than at any time in the past decade
- The wave of game-changing innovations transforming the outlook for the Industrials sector
- The persistence of negative interest rates and how they might change investor behaviour and distort financial markets
- Whether the solution to the last debt problem is sowing the seeds of the next dilemma for investors

Below are highlights from the *2020 Outlook* and links to each individual article.

2020 investment stance

We believe most developed economies should continue to grow, albeit slowly, through at least 2020. And with an environment of slow growth and low, stable inflation, major central banks have signaled a willingness to safeguard the expansion by easing monetary policy further if necessary.

Against this backdrop, we expect equities will advance in 2020. We think moderate revenue and earnings growth are attainable, and that valuations in North America are not outlandish while in Europe and Asia they are cheap. Yet while we maintain a Market Weight stance, we believe investors should not be complacent.

Fixed income markets largely expect central banks to remain on hold in 2020, though with a bias towards further easing. This should anchor yields across the global landscape near historical lows. On balance, we prefer interest rate risk to credit risk, where we would focus on quality as the yields on speculative-grade corporate bonds are not commensurate with the additional risks inherent in the late phase of the economic cycle.

For currencies, as long as economic growth persists, the U.S. dollar should continue to find support. The Canadian dollar will likely trend moderately lower in the absence of rate cuts, while the pound will remain hostage to Brexit developments.

Finally, regarding commodities, RBC Capital Markets sees the price of WTI crude oil between $50 and $60 over the next 12–18 months, while gold will be driven by the vagaries of the U.S.-China trade dispute and Brexit.

Market pulse

Click here for authors' contact information. Priced (in USD) as of 12/5/19 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6**
Disseminated: Dec 5, 2019 17:00ET; Produced: Dec 5, 2019 15:53ET

Wealth Management

Eyes wide open: Equities and the economy

As we look out to 2020, we see three reasons to bullish: (1) the start of the next U.S. recession looks to us to be a year or more away, with accommodative monetary conditions remaining the order of the day; (2) the dominant U.S. consumer can sustain spending as unemployment is at a 50-year low, the savings rate is high, and home prices are back to pre-financial crisis levels; and (3) the "internals" of the stock market look good to us; earnings estimates have stabilized at a reasonable level, the breadth readings of the market are healthy—i.e., indexes are moving higher on the back of a majority of stocks advancing, not a select few—and valuations are not overstretched in North America while they are inexpensive in Japan and Europe.

Nevertheless, there are also three reasons to be cautious: (1) the yield curve has inverted; (2) recession probabilities are increasing; and (3) slow growth makes for a challenging investment environment. Occasional very low or negative quarters of growth can't be ruled out. Importantly, bull markets usually peak before a recession starts—sometimes as much as a year before, so markets could conceivably peak in 2020.

All of this leaves us constructive but more vigilant than we have been in the last 10 years.

A new industrial revolution

Cutting-edge innovations, such as "lights out" manufacturing plants, smart water systems, and 3D printing, will completely transform the industrial landscape within the next 5–10 years. We believe now is an opportune time to seek out the companies likely to establish competitive advantages as these "change forces" take hold, given the heavily discounted valuations in the Industrials sector from tariff pressure and poor earnings results. The sector is less vulnerable to fears of a potential Democratic sweep in the 2020 U.S. elections than other cyclical sectors, and it could benefit from any trade war détente ahead of the November vote.

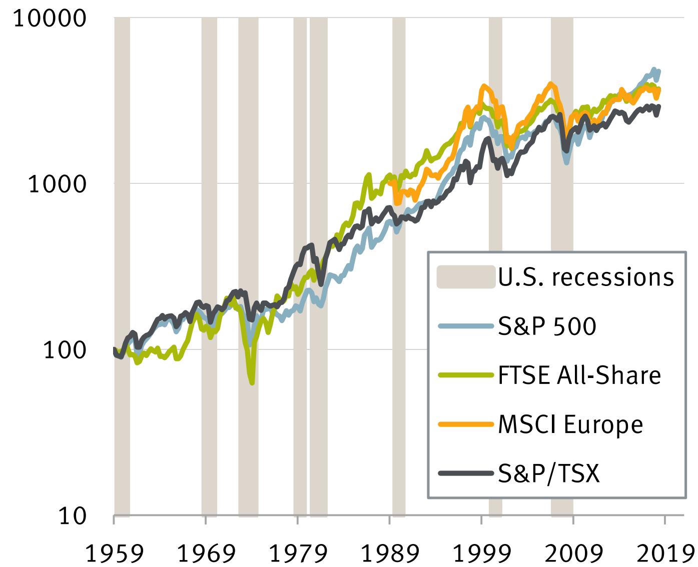
Upside down: The impact of negative yields

Very low and negative interest rates reflect a slow real growth environment, and low, relatively stable inflation. Moreover, greater demand from emerging market countries for the scarce "safe" debt in developed world debt markets is adding pressure.

This climate can nudge investors in search of yield out of their comfort zones and into higher-risk assets, making them more vulnerable to market corrections. Companies may be enticed to borrow money for low-return investments that may hinder a country's long-term productivity. The environment also squeezes bank margins, weakening the banking system, and deprives central banks of a precious tool to rescue economies entering recession as interest rates are already at such a low level.

Beware of U.S. recessions

Bull markets don't die of old age, they are killed off by U.S. recessions



Source - RBC Wealth Management, U.S. Department of Commerce, Federal Reserve; monthly data through April 2019, indexed to Jan. 1960 = 100 (S&P 500, S&P/TSX, FTSE All-Share), Jan. 1970 = 1000 (MSCI Europe)

So while central banks may have extended the business cycle by loosening monetary policy, paradoxically, they may have also contributed to making it marginally more fragile. This is all the more reason for investors to be vigilant.

The low rates puzzle

As central banks have once again turned to the ultralow interest rate playbook, it's fair to ask if they are sowing the seeds of future problems in the credit market and placing a strain on savers. In business cycles, the solution for one problem often becomes the source of the next.

The low rates solution for the debt problems of the last decade has created a new set of challenges for savers today, and fixed income investors have rarely been paid less to take on more risks. We urge investors not to let a low yield environment push them out of their comfort zones and into making decisions that could put portfolios and long-term investment objectives in jeopardy.

Despite lower returns, the appeal of a fixed income allocation remains the lower volatility and the preservation of capital this asset class provides.

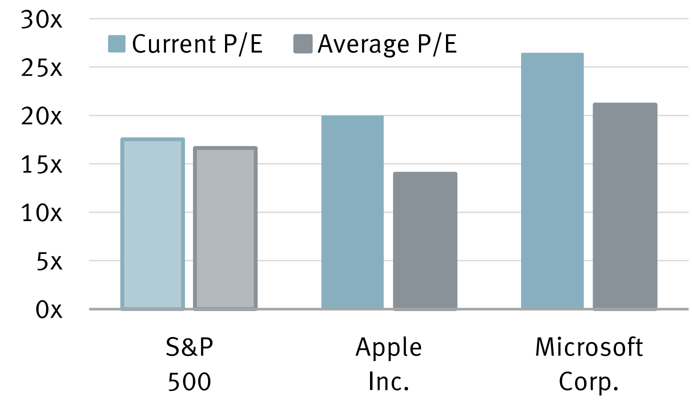
United States

Ben Graham, CFA – Minneapolis

- **Recent days have seen volatile U.S. equity markets** characterized by moderate declines on sharper-than-average moves in both directions. The first four trading days in December saw the VIX—a traditional fear index—end each day at higher levels than any single day in November. With the S&P 500 down 0.7% thus far in December, **small caps are leading large caps** on almost flat performance while the defensively oriented sectors of Utilities and Consumer Staples are the only sectors higher. The **hardest-hit sectors** for the month include economically sensitive ones and trade-heavy ones—Industrials, Information Technology, and Materials.
- With the S&P 500 up about 25% in 2019, **valuations ahead of 2020 have started to come into focus** as investors shift to the upcoming year. The S&P 500 resides at 17.6x next-twelve-month (NTM) EPS, after starting the year at 14.7x. Clearly, there has been a strong repricing in the markets over the course of 2019. However, the first of two key points to note is that the arbitrary starting point of the beginning of the year nearly perfectly coincides with the trough in December's selloff. That means **the returns and repricing experienced in 2019 are slightly distorted**. Here may be a better way to consider the path traveled in 2019: the S&P 500 is only up 6% from its September 2018 highs.
- The second key point is that **80% of the S&P 500 constituents are less expensive than the broader index** on a normalized valuation basis. This is only possible when the largest companies in the index have been among the best performing in a given year, which has been especially true in 2019. In fact, the world's two largest publicly traded companies (Apple Inc. and Microsoft Corporation) are up nearly 70% and 50%, respectively, for the year. The result is these **index heavyweights, which account for almost 10% of the market cap weighted index, have pushed index valuations higher and resulted in a more reasonable looking backdrop for the companies that fall behind the world's two largest publicly traded ones**, which supports our Market Weight recommendation for U.S. equities with a focus on quality.

S&P 500 valuations are influenced by the largest public companies in the world

Next-twelve-month P/E ratios



Source - RBC Wealth Management, FactSet; data through 12/4/19

Canada

Carolyn Schroeder & Callum Scott – Toronto

- **Canadian real GDP advanced by 1.3% (annualized) in Q3, led by higher business investment and increased household spending**, which boosted overall domestic demand by 0.8%. Meanwhile, a slowdown in the pace of inventory accumulation accounted for the largest drag in Q3, subtracting 1.5% from GDP growth. However, part of that was likely related to transitory shutdowns in commodities production. According to RBC Economics, net exports subtracted about half a percent from top-line GDP growth. All-in-all, the data should do little to change the narrative that, while concerns about the economic outlook remain, **current economic conditions still look relatively resilient in Canada**. The GDP reading was in line with the Bank of Canada's (BoC) forecast in October, and the central bank will likely take comfort in the increase in business investment as a sign that activity should continue to hold up relatively well in the near term.
- **The BoC held interest rates steady at 1.75% for the ninth consecutive meeting**, while the accompanying statement had a more neutral tone than the previous one. The central bank indicated that the global economy is stabilizing and the Canadian economy remains resilient. Domestically, **labour markets have been robust, wage growth has strengthened, and inflation has remained around the BoC's 2% target rate**, with growth headwinds and elevated household debt levels as points of concern. The BoC continues to note that "trade conflicts and related uncertainty are still weighing on global economic activity, and remain the biggest source of risk to the outlook." The BoC's prolonged pause has left Canada with the highest policy rate amongst the advanced economies, with little indication of a cut in the near future. The Canadian dollar rallied slightly against the U.S. dollar following the announcement.

Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **Signs that the worst may be over for euro area manufacturing continued to come through**, with the IHS Markit Spain Manufacturing Purchasing Managers' Index (PMI) for November improving to 47.5 from 46.8 in October thanks to new orders. The Germany Manufacturing PMI also edged higher to 44.1 from 43.8 for the same period. **Readings remain below 50 and in contraction mode, but we believe they are beginning to stabilize**. Meanwhile, the Eurozone Services flash PMI improved slightly in November, to 51.9 from 51.5 thanks to a rebound in Germany and despite weakness in Italy. **All in all, our base case of stabilization in the manufacturing sector and muted growth continues to play out**.
- Trade tensions between the U.S. and the EU resumed after the **Trump administration suggested it would seek to impose 100% tariffs on some $2.4 billion of French goods in retaliation for France's digital services tax**. The French administration introduced the tax in July to target Google, Apple, Amazon, and Facebook, which it views as avoiding paying taxes on many digital transactions. French goods such as Champagne, handbags, porcelain, and dairy products are being targeted, and tariffs could be imposed as early as January 2020. Intensifying trade tensions with the U.S. would be a headwind for the EU. The U.S. is an important trade partner of the EU, receiving just under 20% of its exports (excluding trade between EU member states).
- **Mergers and acquisitions (M&A) activity in luxury goods remains in focus** following the recently announced proposed acquisition by LVMH of U.S. jewellery firm Tiffany for over $16 billion, potentially the biggest deal ever in the sector. Shares in Moncler S.p.A., the Italian luxury outerwear group, rose sharply on December 5 following an unconfirmed Bloomberg report that Gucci owner Kering S.A. had held "exploratory talks" about a potential takeover. **We expect consolidation to remain an ongoing theme in this sector, given heavyweight players possess scale and diversification benefits**.

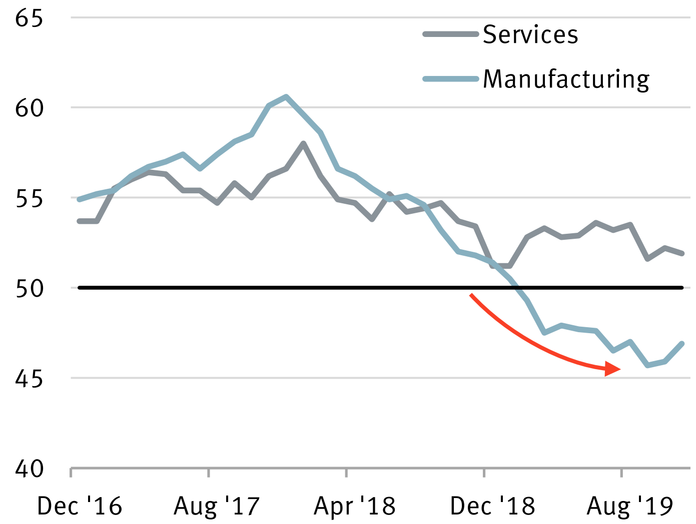
Asia Pacific

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

- **Asian equities continue to fluctuate** as investors are waiting to see if the U.S and China can reach a phase one trade deal. If there is no deal, we believe the U.S. will go ahead with its plan to implement more tariffs on Chinese goods on December 15.

Eurozone PMIs stabilizing

Markit Eurozone PMI data through November



Source - RBC Wealth Management, Bloomberg; data through 11/30/19

- After U.S. President Donald Trump signed the Hong Kong Human Rights and Democracy Act last week, **the U.S. House of Representatives passed the Xinjiang Bill**, which would impose sanctions on Chinese officials over human rights abuses against Muslim minorities. **China warned that it will soon release a list of "unreliable entities"** that could lead to sanctions against U.S. companies. The moves may add uncertainty to the U.S.-China relationship. We expect equity markets to be sensitive to any trade talk news in the next 10 days.
- Despite concern on trade tension and a slowing economy, **China's November economic data was largely intact**. The official manufacturing Purchasing Managers' Index (PMI) expanded in November for the first time in seven months to 50.2, higher than the 49.5 estimate. The Caixin Manufacturing PMI also expanded in November, coming in at 51.8 (vs. 51.5 estimate), which is stable compared to October. However, we aren't overly optimistic about the economic outlook for now as **the export sector may still face pressure from higher tariffs next year**.
- **Japan is trying hard to fend off its slowing economy**. The Abe government announced a **26 trillion yen stimulus package** to repair typhoon damage, upgrade infrastructure, and invest in new technologies. The amount is larger than the market's expectation and **targets to boost GDP by 1.4 percentage points**. Japan's economy has expanded as of Q3 2019, partially thanks to strong infrastructure demand due to the 2020 Olympics to be held in Tokyo. Growth remains subdued because of a global growth slowdown and U.S.-China trade tensions.

MARKET SCORECARD

Data as of December 5, 2019

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,117.43	-0.7%	24.4%	15.5%	18.6%
Dow Industrials (DJIA)	27,677.79	-1.3%	18.6%	10.6%	14.5%
NASDAQ	8,570.70	-1.1%	29.2%	19.7%	26.7%
Russell 2000	1,614.83	-0.6%	19.7%	9.1%	6.5%
S&P/TSX Comp	16,854.92	-1.1%	17.7%	11.0%	5.9%
FTSE All-Share	3,969.84	-2.4%	8.0%	4.7%	-1.5%
STOXX Europe 600	402.66	-1.2%	19.3%	13.7%	4.1%
EURO STOXX 50	3,648.13	-1.5%	21.5%	15.8%	2.2%
Hang Seng	26,217.04	-0.5%	1.4%	-2.2%	-9.1%
Shanghai Comp	2,899.47	1.0%	16.3%	9.4%	-12.2%
Nikkei 225	23,300.09	0.0%	16.4%	6.3%	3.0%
India Sensex	40,779.59	0.0%	13.1%	13.6%	24.3%
Singapore Straits Times	3,174.19	-0.6%	3.4%	0.6%	-7.7%
Brazil Ibovespa	110,622.30	2.2%	25.9%	24.2%	52.5%
Mexican Bolsa IPC	42,216.03	-1.4%	1.4%	0.8%	-11.1%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,475.59	0.8%	15.1%	19.3%	16.6%
Silver (spot $/oz)	16.96	-0.4%	9.4%	17.0%	5.3%
Copper ($/metric ton)	5,857.50	0.2%	-1.5%	-5.1%	-10.1%
Oil (WTI spot/bbl)	58.43	5.9%	28.7%	10.5%	1.4%
Oil (Brent spot/bbl)	63.42	1.6%	17.9%	3.0%	0.9%
Natural Gas ($/mmBtu)	2.42	6.0%	-17.8%	-45.9%	-17.0%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	1.807%	3.1	-87.7	-110.7	-54.4
Canada 10-Yr	1.612%	14.9	-35.5	-52.1	-28.3
U.K. 10-Yr	0.773%	7.6	-50.4	-54.2	-48.4
Germany 10-Yr	-0.294%	6.6	-53.6	-57.1	-61.4
Fixed Income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	2.30%	0.0%	8.8%	10.2%	8.9%
U.S. Invest Grade Corp	2.87%	0.0%	14.1%	15.1%	11.6%
U.S. High Yield Corp	5.63%	0.0%	12.1%	9.4%	10.0%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	97.3880	-0.9%	1.3%	0.3%	4.3%
CAD/USD	0.7589	0.8%	3.5%	1.4%	-3.7%
USD/CAD	1.3178	-0.8%	-3.4%	-1.3%	3.8%
EUR/USD	1.1105	0.8%	-3.2%	-2.1%	-6.1%
GBP/USD	1.3162	1.8%	3.2%	3.4%	-2.1%
AUD/USD	0.6833	1.0%	-3.1%	-6.0%	-10.2%
USD/JPY	108.7700	-0.7%	-0.8%	-3.9%	-3.4%
EUR/JPY	120.7900	0.1%	-4.0%	-5.9%	-9.3%
EUR/GBP	0.8437	-1.0%	-6.1%	-5.3%	-4.1%
EUR/CHF	1.0963	-0.5%	-2.6%	-3.1%	-6.1%
USD/SGD	1.3605	-0.5%	-0.2%	-0.5%	1.0%
USD/CNY	7.0448	0.2%	2.4%	2.7%	6.4%
USD/MXN	19.3631	-0.9%	-1.5%	-5.6%	3.2%
USD/BRL	4.1873	-1.2%	8.1%	8.3%	29.1%

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 8:35 pm GMT 12/5/19.

Examples of how to interpret currency data: CAD/USD 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD 3.5% return means the Canadian dollar rose 3.5% vs. the U.S. dollar year to date. USD/JPY 108.77 means 1 U.S. dollar will buy 108.77 yen. USD/JPY -0.8% return means the U.S. dollar fell 0.8% vs. the yen year to date.

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As of September 30, 2019

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Hold [Sector Perform]	618	42.74	126	20.39
Sell [Underperform]	80	5.53	3	3.75

Ratings:

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