GLOBAL
Insight
WEEKLY

Perspectives from the Global Portfolio Advisory Committee

July 29, 2021

Long story long

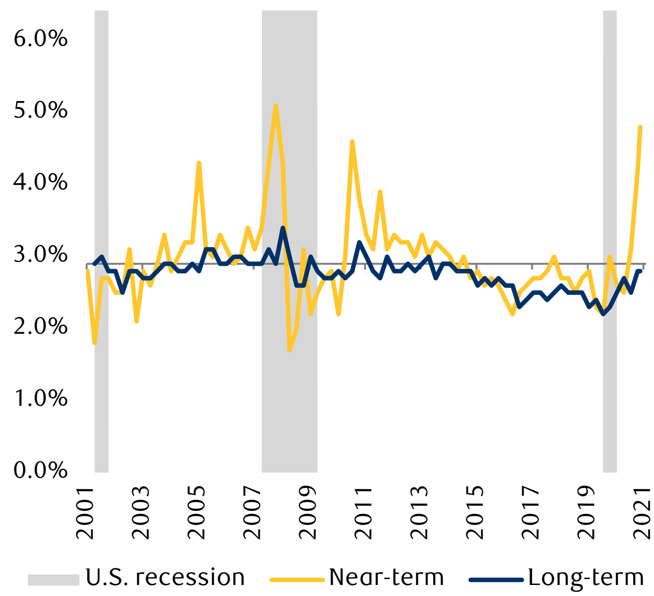
Thomas Garretson, CFA – Minneapolis

Global markets weathered two key events in the U.S. this week: the latest Fed meeting and the highly anticipated first estimate of Q2 U.S. GDP. While each highlighted near-term uncertainty, both serve as a reminder that what actually matters is the long term.

This week's Federal Reserve meeting was never expected to deliver much in the way of fireworks, but it did start the clock ticking on the next phase of monetary policy: tapering asset purchases. Much has been made about the Fed's need to see "substantial further progress" on inflation and employment as it nears a decision on that front, especially as policymakers have been less than forthcoming about what "substantial" actually means. But for the first time, the Fed's official statement was updated to acknowledge that progress has indeed been made toward those goals. Perhaps stating the obvious, but a sign nonetheless that the Fed is one step closer to making the call that economic conditions warrant a slowdown in bond buying.

We now enter a key two-month stretch for the Fed that will feature the Aug. 26–28 Jackson Hole Economic Symposium—where Fed Chair Jerome Powell is scheduled to speak and which has historically served as a forum for major central bank policy shifts—followed by the September Fed meeting. With markets focused on one or both to provide the first concrete details on how the Fed plans to approach tapering, our view largely remains the same: it doesn't really matter. It's clear the Fed will follow the same playbook from 2013 and 2014: announce, start, and proceed gradually. We think the market understands this.

Consumer inflation expectations: Near-term pressures still far outweigh long-term concerns



Source - RBC Wealth Management, Bloomberg, University of Michigan Surveys of Consumers; shows inflation expectations relative to historical averages, 2.8% for long-term, 3.0% for near-term; data through July 2021

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

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For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

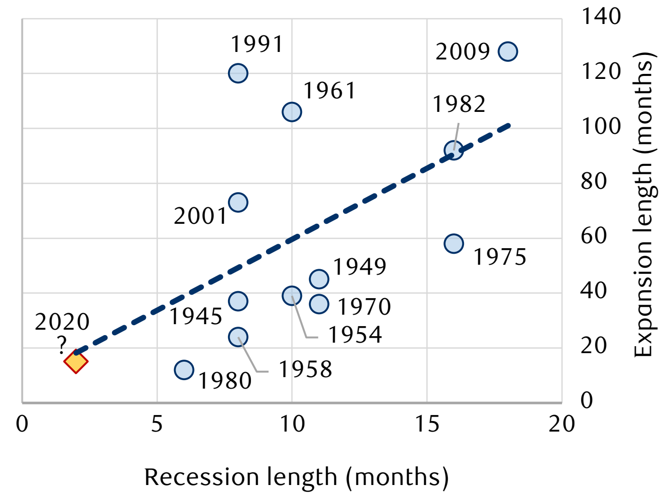
Inflation fears subside as inflation ramps up

Of course, inflation once again featured heavily during Powell's press conference, but the narrative was largely the same: near-term pressures have been driven by specific sectors of the economy, and are expected to fade. The Fed is still focused on longer-term inflation expectations, and the fear that they could become unhinged from the policy goal of price stability. But as highlighted once again, "Indicators of longer-term inflation expectations appear broadly consistent with our longer-run inflation goal of two percent."

And that dynamic can be seen in the chart on the previous page, as the July University of Michigan Surveys of Consumers reveal that consumers still see inflation as only being temporary, whereas long-term inflation expectations remain essentially in line with historically average levels. The same dynamic persists in market-based pricing of the inflation outlook as well, which has actually declined in recent weeks.

Does a short recession mean a shorter expansion?

Postwar business cycles



Source - RBC Wealth Management, Bloomberg, National Bureau of Economic Research; shows business cycles since 1945

Two distinct timelines

Also notable from this meeting was Powell's attempt to decouple the Fed's tapering plans from the future rate hike process. While current economic conditions may in fact warrant a reduction in bond purchases, it does not necessarily mean that they too will warrant rate hikes when that time comes.

The market has traded with some trepidation because of the idea that tapering asset purchases comes first, followed then by rate hikes. In our view, the Fed will likely hit the reset button if and when the tapering process is completed, potentially in late 2022, and will then take a fresh look at the inflationary and labor market environments. Put another way, starting the clock on tapering in no way starts the clock ticking on the next rate hike cycle.

If you can't build it, they won't come

Next up was the first look at Q2 GDP, which significantly missed consensus forecasts, printing at just 6.4 percent on an annualized basis against expectations of 8.4 percent. However, the details of the report were perhaps more encouraging than the headline shortfall would suggest for a number of reasons.

What's interesting is what contributed to growth, and what did not. Consumption data on goods and services was well ahead of expectations, a sign that demand remains robust as the economy continues to reopen, particularly for services as demand shifts away from pandemic-driven goods spending. But the drag on growth came from negative readings on residential investment (on a lack of housing supply, a decline in inventories), yet another sign of supply chain constraints, and from a pullback in federal government spending compared to past quarters—which could reverse with an infrastructure bill.

That's where the bright side comes in. Those kinds of factors typically mean that spending and growth have simply been delayed to future quarters, which could be key as investors increasingly ponder what this business cycle—and its durability—is going to look like. There have been some fears that a too-rapid recovery might actually risk shortening this expansion after a short recession, which the National Bureau of Economic Research recently dated at just two months long in 2020.

As the chart above shows, there is at least some correlation between the length of recessions, and the length of the subsequent economic expansion. Where demand remains robust, perhaps the supply-side constraints will act as a natural speed limiter, adding longevity to this expansion which has already entered its 15th month.

Rolling with it

As we have so often said over the past year, just as the pandemic was unprecedented for the global economy, so too will be the recovery. The recent volatility in certain economic data has only confirmed that, while the Fed has worked to finesse its near-term messaging in an environment of persistent and heightened uncertainty. Markets largely took these events in stride this week, with Treasury yields holding steady and U.S. stocks setting fresh record highs, perhaps taking the long view: the Fed will likely remain accommodative for years to come, and even amid fits and starts, the economy remains on the right trajectory.

UNITED STATES

Alan Robinson – Seattle

- **U.S. stock indexes posted fresh highs as Q2 2021 earnings season hit high gear** with 40% of the market capitalization of the S&P 500 Index reporting during the week. Fund flows suggested that retail investors were driving the rally with institutions sitting it out, as daily U.S. equity volumes barely averaged 10 billion shares during the week. Supportive economic data and dovish Fed comments helped equities, while turmoil in Chinese markets briefly dampened bullish sentiment.

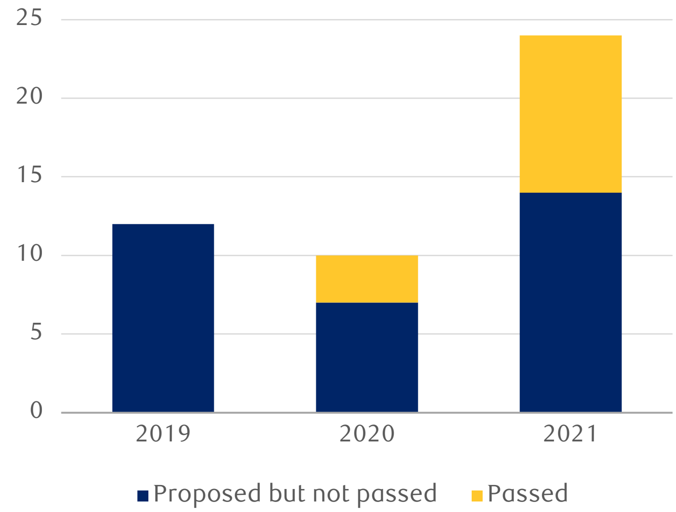
- **The Technology bellwethers led the earnings charge**, with Microsoft Corp. (MSFT), Alphabet Inc. (GOOGL), Apple Inc. (AAPL), and Facebook Inc. (FB) all beating lofty consensus estimates. However, investors generally took profits on these prints, highlighting the rich valuations in the Tech sector and cautious management guidance for the rest of the year. **"Old-economy" companies also reported solid results**, highlighting the strength of the U.S. consumer. However, **management teams frequently warned of increasing costs hurting profit margins**.

- With large areas of North America facing extreme seasonal temperatures this year, **the heat has also been rising in corporate annual shareholder meetings** typically held during the summer. Activist hedge funds were successful in forcing board changes at Exxon Mobil Corp. (XOM), while proxy voting groups pushed Chevron Corp. (CVX) to commit to further reducing emissions. This builds on recent trends of investors focusing on environmental, social, and governance (ESG) factors as a tool to effect societal change *and* to improve investment returns. Climate-related proxy votes have increased in frequency over recent years, and an increasing number of these proposals have been approved (see chart).

- On July 28, **the U.S. Senate voted 67-32 to debate a long-heralded infrastructure measure**, marking the first bipartisan agreement on this topic in years. While there is likely plenty of arguing ahead regarding the amount of spending, **a signed deal would provide additional long-term stimulus to the economy** across a range of industries. Some senators have suggested cryptocurrency taxes to help fund the spending.

Shareholders increasingly vocal on climate issues

Number of climate-related proxy proposals at U.S. annual general meetings



Source - RBC Wealth Management, Institutional Shareholder Services (ISS)

CANADA

Luis Castillo & Simon Jones – Toronto

- Market participants attentively awaited the release of Canada's June Consumer Price Index (CPI) results following the release of strong (5.4% y/y increase) U.S. inflation numbers earlier this month. However, **Canada's CPI rose at a much lower 3.1% y/y**, slightly below economists' expectations, as **Canadian inflation took a step back from May's multiyear highs**. Still, the Bank of Canada's (BoC) most recent Monetary Policy Report suggests policymakers expect inflation will climb to 3.9% in Q3 (significantly above the BoC's control range) before easing back towards the 2% target by 2022, as "transitory" supply constraints eventually ease. **This recent divergence between Canadian and U.S. CPI is also being reflected in the market's expectations of future inflation**. We have recently seen the gap between U.S. and Canadian inflation breakevens (a measure of market-implied inflation expectations) once again approach one of the widest levels in over a decade.

- **Retail sales continued their downward trajectory,** falling 2.1% in May according to Statistics Canada. The decline coincides with the closure of nonessential retailers across several provinces as provincial governments worked to slow the spread of the virus during the pandemic's third wave. These closures led to a decrease in sales in eight of the 11 segments that comprise retail sales, and the restrictions resulted in 23.5% of Apparel retailers closing for an average of six days during the period. However, Building Material retailers experienced the most significant sales decline of 11.3% during the period. Sales in this segment have declined nearly 20% from the record highs attained in March of this year. On the positive side, early indications are that retail sales rebounded firmly in June as provinces began the process of reopening their economies. Statistics Canada's preliminary estimate for June retail sales is a 4.4% increase.

EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- **The European Commission Economic Sentiment Indicator for the eurozone increased further in July**, reaching an all-time high, suggesting Q3 is off to a strong start. Services are bouncing back as economies have reopened and manufacturing continues to be strong, notwithstanding supply chain constraints that are affecting the car industry in particular. We think such shortages and the COVID-19 delta variant remain the two primary risks to watch for the rest of the year.

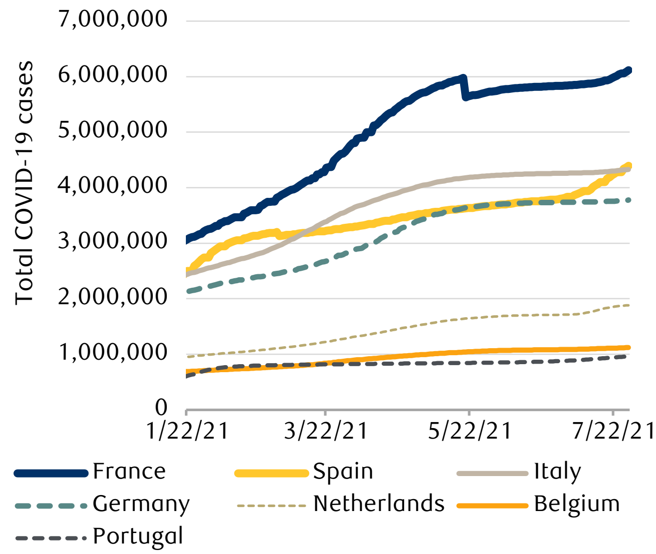
- On that front, **new COVID-19 daily infection cases seem to have started to abate in many affected countries**. This could suggest rapid vaccination progress is proving effective in fending off infections. Whether this is indeed the case will be key to gauging whether European countries can go through the current wave of infections without resorting to lockdowns. European countries have been more willing than the U.S. to use this economically damaging strategy to fend off the recent wave of the virus.

- **It has been a robust earnings season in Europe so far**, in our view. With over half of STOXX Europe 600 Index constituents having reported results, 62% have had earnings above consensus estimates, while 70% have had sales above expectations. **More companies beating expectations on the top line than on the bottom line reflects the recent inflationary forces at play within companies' cost bases**, especially higher raw materials and transport costs.

- **A sector that has been acutely affected is Consumer Staples**. Nestlé, Reckitt Benckiser, Unilever, and Anheuser-Busch InBev reported operating margins below consensus expectations, downgraded their full-year margin guidance, or both. This reflects the delay between the current input cost inflation and an increase in the prices of consumer staples products. The latter are set to rise more slowly so as to avoid denting volume growth.

- **Results from the region's luxury goods group generally came in ahead of consensus expectations**, as these companies showcased their pricing power to protect their margins amid inflationary cost pressures, as well as continuing to benefit from a very strong demand environment.

New COVID-19 cases abating in many countries?



Source - RBC Wealth Management, Bloomberg; data through 7/28/21

ASIA PACIFIC

Jasmine Duan – Hong Kong

- **A crackdown on China's private education sector led to massive equity selloffs in the China and Hong Kong markets earlier this week**. Investors were panic-selling due to concerns the crackdown could spread to other sectors, such as Internet, Health Care, and Real Estate.

- **The MSCI China Index was down more than 14% in only three trading days** starting July 23. The **Hang Seng TECH Index** (TECH Index), which represents the 30 largest technology companies listed in Hong Kong, **was down 17.5%** during the same period.

- **On July 28, China's securities regulator attempted to ease market fears**. In a call on Wednesday night, the regulator told executives of major investment banks that the education policies were targeted and not intended to hurt companies in other industries. Besides, the regulator is supportive of companies that seek foreign listings. Companies with variable interest entity structures can also seek cross-border listings. **The TECH Index rebounded by 8%** on July 29.

- **The market now has a divergent view on the outlook for Chinese equities**. We think it will take some time for investors, especially foreign investors, to rebuild confidence in the China market. **Investors may have to reassess the valuation and fundamentals of certain sectors**, e.g., China education, some Internet, and pharmaceuticals, which could lead to further volatility. However, **we also see opportunities emerging** as many sectors, such as tech hardware and Industrials, were dragged down by market sentiment, but are exposed to very low regulatory risk. We think the risk-reward for some new economy stocks appears reasonable after the regulator's clarification.

- According to Bloomberg, **ride-hailing giant Didi Global (DIDI) is considering privatization** in order to obey the requirements of the Chinese regulator and to compensate investors for losses incurred since the company listed in the U.S. in late June. Didi raised about US$4.4 billion in its initial public offering after selling American depositary shares at US$14 each.

MARKET Scorecard

Data as of July 29, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,419.15	2.8%	17.7%	35.6%	46.3%
Dow Industrials (DJIA)	35,084.53	1.7%	14.6%	32.2%	28.9%
Nasdaq	14,778.26	1.9%	14.7%	40.2%	78.2%
Russell 2000	2,240.03	-3.1%	13.4%	49.3%	42.8%
S&P/TSX Comp	20,311.78	0.7%	16.5%	24.7%	23.2%
FTSE All-Share	4,054.12	1.0%	10.4%	19.3%	-3.2%
STOXX Europe 600	463.84	2.4%	16.2%	26.2%	18.7%
EURO STOXX 50	4,116.77	1.3%	15.9%	24.7%	16.8%
Hang Seng	26,315.32	-8.7%	-3.4%	5.8%	-6.4%
Shanghai Comp	3,411.72	-5.0%	-1.8%	3.6%	16.0%
Nikkei 225	27,782.42	-3.5%	1.2%	24.0%	28.5%
India Sensex	52,653.07	0.3%	10.3%	38.3%	39.7%
Singapore Straits Times	3,180.61	1.6%	11.8%	23.6%	-5.0%
Brazil Ibovespa	125,675.30	-0.9%	5.6%	19.0%	21.4%
Mexican Bolsa IPC	51,634.60	2.7%	17.2%	36.9%	25.1%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.263%	-20.5	34.9	68.9	-80.2
Canada 10-Yr	1.203%	-18.6	52.6	72.3	-27.3
UK 10-Yr	0.573%	-14.3	37.6	45.5	-8.1
Germany 10-Yr	-0.450%	-24.3	11.9	4.8	-5.9
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.36%	1.1%	-0.5%	-0.5%	19.3%
U.S. Investment-Grade Corp	1.93%	1.4%	0.1%	1.8%	27.1%
U.S. High-Yield Corp	3.89%	0.3%	3.9%	11.0%	22.0%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,828.23	3.3%	-3.7%	-7.2%	28.1%
Silver (spot $/oz)	25.54	-2.3%	-3.3%	5.1%	55.2%
Copper ($/metric ton)	9,664.00	3.3%	24.7%	49.1%	61.1%
Oil (WTI spot/bbl)	73.62	0.2%	51.7%	78.4%	29.5%
Oil (Brent spot/bbl)	76.01	1.2%	46.7%	73.7%	19.3%
Natural Gas ($/mmBtu)	4.05	10.9%	59.4%	118.3%	89.0%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	91.9020	-0.6%	2.2%	-1.7%	-6.3%
CAD/USD	0.8033	-0.4%	2.3%	7.1%	5.7%
USD/CAD	1.2449	0.4%	-2.2%	-6.7%	-5.4%
EUR/USD	1.1887	0.2%	-2.7%	0.8%	6.7%
GBP/USD	1.3965	1.0%	2.2%	7.4%	14.3%
AUD/USD	0.7395	-1.4%	-3.9%	2.9%	7.1%
USD/JPY	109.4600	-1.5%	6.0%	4.3%	0.6%
EUR/JPY	130.1200	-1.2%	3.1%	5.2%	7.4%
EUR/GBP	0.8512	-0.7%	-4.8%	-6.2%	-6.7%
EUR/CHF	1.0771	-1.8%	-0.4%	0.1%	-2.5%
USD/SGD	1.3527	0.5%	2.3%	-1.5%	-1.3%
USD/CNY	6.4564	0.0%	-1.1%	-7.0%	-6.3%
USD/MXN	19.8588	-0.4%	-0.3%	-9.6%	4.2%
USD/BRL	5.0738	2.1%	-2.4%	34.3%	34.2%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.80 means 1 Canadian dollar will buy 0.80 U.S. dollar. CAD/USD 2.3% return means the Canadian dollar rose 2.3% vs. the U.S. dollar year to date. USD/JPY 109.46 means 1 U.S. dollar will buy 109.46 yen. USD/JPY 6.0% return means the U.S. dollar rose 6.0% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 7/29/21

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Hold [Sector Perform]	575	40.69	173	30.09
Sell [Underperform]	51	3.61	4	7.84

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