GLOBAL Insight WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee March 31, 2022

Same shock, different effects

Kelly Bogdanova – San Francisco

The Russia-Ukraine conflict and related sanctions have added stress on the global economic recovery, intensifying inflationary and supply chain threats. We look at why the U.S. and Canadian economies are better equipped to handle these risks than European economies, and how that factors into equity portfolio construction.

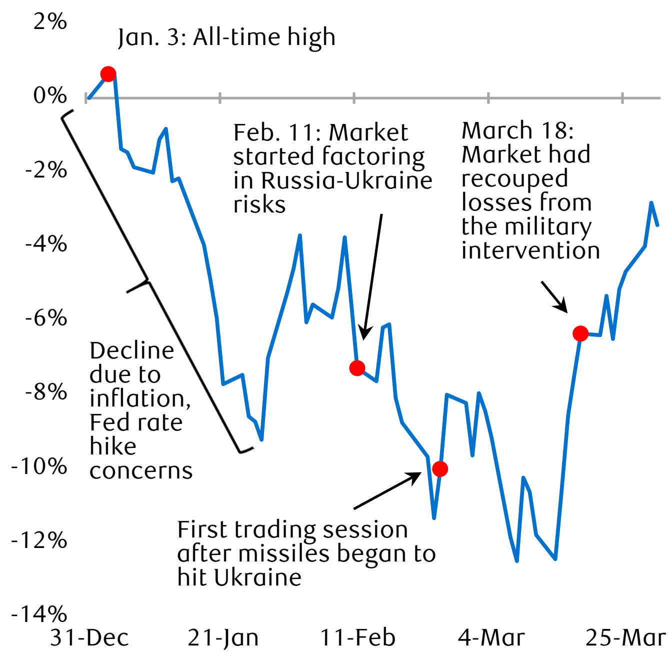
Equity markets have continued to stabilize of late, regaining the lost ground that occurred a few weeks ago just before and during the early phase of Russia's military intervention in Ukraine.

At the most acute point, the S&P 500 had retreated 12.5 percent year to date by March 8, and markets outside of the U.S. had fallen 13.1 percent, as measured by the MSCI ACWI ex US Index. As of the close of trading on Wednesday, these two indexes were down "only" 3.4 percent and 5.1 percent year to date, respectively. Canada's S&P/TSX is up 4.0 percent year to date.

Barring escalation that would involve NATO countries, markets seem to have largely absorbed the military phase of the Russia-Ukraine crisis, as the S&P 500's behavior has been similar to previous military conflicts and other geopolitical events (see chart).

The S&P 500 has rebounded off its lows (YTD % change)

The market retreated 5.6% surrounding Russia's initial military intervention in Ukraine, near the 6.2% average decline of 18 previous military and geopolitical events since WWII



Source - RBC Wealth Management, Bloomberg; daily data through 3/30/22

Mix encouragement with tempered expectations

Market participants are still reacting positively to headlines that signal progress in the Russia-Ukraine negotiations. The prevailing sentiment seems to be that if a deal is reached and military hostilities cease, it could spell further relief for equity markets and commodity prices. We think this sentiment is misplaced for two main reasons.

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

First, Russia and Ukraine are still very far apart on a number of fundamental issues, despite Ukraine indicating it will not seek NATO membership. The status of Crimea/Sevastopol and Donbass are two major sticking points (but not the only ones). Ukraine seems in no mood to cede what it considers to be its territory, and we don't think its main allies would support this either. In turn, Russia cannot and will not negotiate on Crimea/Sevastopol as evidenced by a strict provision in its constitution (and wouldn't regardless), and Russia will not backtrack on its recent recognition of the Donbass republics as independent. Meanwhile, the heads of the two Donbass regions just stated they intend to hold referendums to become part of Russia (like Crimea/Sevastopol did in 2014), after military hostilities end in their regions.

Second, even if Russia and Ukraine eventually agree to end military hostilities, we think most, if not all, of the anti-Russia sanctions that are impacting commodity prices would remain in place. UK Prime Minister Boris Johnson's spokesperson told reporters, "The prime minister said a ceasefire alone would not be cause for UK sanctions to be removed on Russia," according to Reuters. The prime minister of the Netherlands went further. During a state visit to Spain, he said a peace agreement with the loss of Ukraine's territory and sovereignty will not lead to the automatic termination of EU sanctions against Russia, Reuters reported. We think their sentiments are shared by other Western leaders. In the U.S., there is no broad-based political support for lifting anti-Russia sanctions, as they are enthusiastically backed by Democrats and Republicans in Congress, many of whom were advocating punitive sanctions before Russian missiles began to strike Ukraine.

Sanctions stress

Commodity and equity markets will likely have to contend with a longer period of uncertainty about inflationary and supply chain shocks associated with anti-Russia sanctions.

In addition, keep in mind that Russia has barely begun to roll out its counter-sanctions. "No rubles, no gas" was its first major announcement in this regard. If EU countries refuse to pay for Russian natural gas supplies in rubles (or gold) rather than in euros or dollars, Russia could halt gas supplies sooner rather than later. This policy is primarily in response to EU countries freezing billions of Russia's euro and dollar exchange reserves. Thus far, EU countries have refused to pay for gas in rubles. Russia is considering other "rubles for commodities" mechanisms on crude oil, industrial and precious metals, agriculture, fertilizers, and timber against countries that have implemented anti-Russia sanctions. Moscow is also studying whether to impose restrictions on uranium supplies to the U.S., which are used for nuclear power plants. These are just a few potential counter-sanction examples.

Furthermore, we don't rule out that a new sanctions front could develop, albeit much less in magnitude. Western sanctions could be imposed on countries that are choosing to remain "neutral" in the Russia-Ukraine conflict and not implementing anti-Russia sanctions of their own. The U.S. State Department has already hinted as much. China and India seem like the biggest targets. If such actions take place, China's Foreign Ministry indicated there would be a tit-for-tat response.

We think energy, metal, and agriculture commodities will continue to be priced with a "sanctions premium" (also called a "geopolitical risk premium")—higher than they would have been had the Ukraine crisis not occurred—and this will exert pressure on global inflation, supply chains, and economic growth for at least the time being.

When will such pressure lift? It will take time for Europe to shift away from Russian commodities. Likewise, it will take time for Russia to re-route its commodities further toward Asia, including to China and India, and to other countries that have not imposed sanctions (currently 140 of the 190+ countries in the United Nations, by China's count). We have not yet seen credible estimates as to how long these processes could take.

What makes the U.S. and Canada more resilient?

Given the lingering inflation, supply chain, and growth risks, there is a wider range of potential outcomes for the global economy and corporate earnings in 2022 than there was just a few months ago.

The silver lining is that the U.S. and Canadian economies are better equipped to handle these risks than European economies. The U.S. and Canada, especially in combination, are much more self-sufficient due to natural resource abundance, and they have fewer direct and indirect ties to the Russian economy. While Russia is the world's largest commodity producer, the U.S. and Canada are either at the top or near the top of the ranks in a wide variety of energy, industrial and precious metal, and agriculture commodities.

The U.S. and Canada both have the benefit of primarily selling their commodities and other goods and services to the largest market in the world—the U.S. Even the S&P 500, which includes many of the largest and highest-earning multinational companies in the world, derives roughly 70 percent of its revenue domestically; less than 12 percent typically comes from Europe.

For these reasons, and importantly because U.S. recession risks are currently rather low according to our leading economic indicators, we remain moderately Overweight U.S. equities and have a constructive Market Weight stance on Canadian equities. For long-term investors who have money to put to work and have a dollar-cost averaging plan—and would rather not be sitting on a lot of cash in an inflationary environment—we would stick with the plan.

UNITED STATES

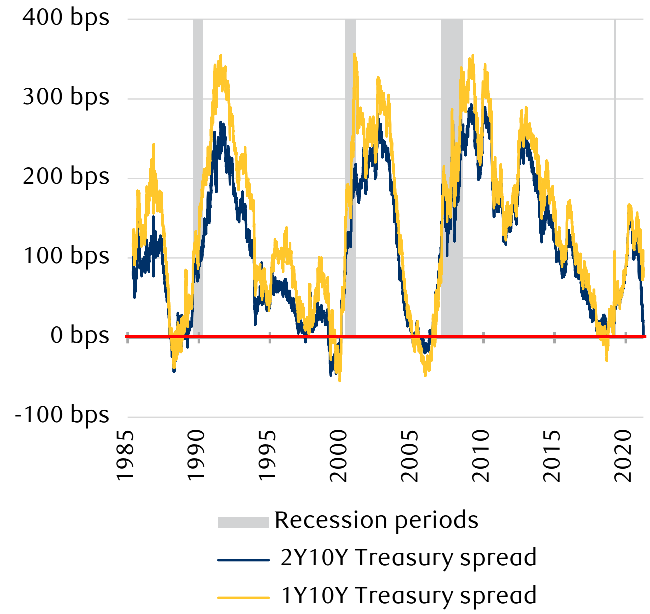
Tyler Frawley, CFA – Minneapolis

- **U.S. equities look to be on track for weekly gains**, as geopolitical concerns have eased due to optimism surrounding Russia-Ukraine peace talks. All of the major indices are higher on the week as of intraday trading on Thursday; the Nasdaq Composite leads the way with a return of 1.29%. **The S&P 500 has outperformed the Dow Jones Industrial Average but both are higher**, having risen 0.84% and 0.47%, respectively. Sector leadership is evident in Real Estate, which has returned 3.88%, and Utilities, which has returned 3.13%. Energy has been the worst performer, falling 1.51%, as the price of WTI crude oil has fallen 9.69% since last Friday.

- **The U.S. Treasury yield curve has continued to flatten, with parts of it inverting as investors price in an aggressive rate-hiking plan by the Federal Reserve** as it attempts to bring inflation down from 40-year highs. On Tuesday, we saw the spread between the yields on the 2-year and 10-year U.S. Treasury bills briefly invert for the first time since 2019. This came on the heels of a similar inversion in the less-closely-watched spread between the 5-year and 30-year Treasury yields on Monday. These inversions have investors trying to understand whether or not the Treasury market is signaling a potential upcoming recession. While we believe the flattening yield curve is worth keeping an eye on, we note that the spread between the 1-year and 10-year yields, which the Global Portfolio Advisory Committee monitors as part of its U.S. recession scorecard, has not inverted. **This leads us to believe recession speculation is likely premature**, and we would take a wait-and-see approach before writing off the current expansion.

- **Economic activity data this week has been largely in line with expectations, with initial jobless claims numbers from the Department of Labor coming in slightly higher than expected** at 202,000 versus the consensus expectation of 196,000. This represents a modest increase after reaching a 50-year low as employers continue to show reluctance to reduce their workforces in the current competitive labor market.

2Y10Y U.S. Treasury yield curve briefly inverts



Note: 2Y10Y measures the difference between the 2-year and 10-year Treasury rate, with an inversion defined as the 2-year rate exceeding the 10-year rate. This also applies to the 1-year and 10-year (1Y10Y) spread.

Source - RBC Wealth Management, FactSet, data through 3/30/22

CANADA

Simon Jones & Luis Castillo – Toronto

- Government of Canada bonds have been under pressure in recent weeks, as the market prepares for the Bank of Canada (BoC) to further tighten monetary policy in response to mounting inflationary pressures. Last week was particularly volatile, with short-term government bond yields, which are most sensitive to the market's expectation of future central bank policy, experiencing their largest daily increase since the Global Financial Crisis. Contributing to this most recent rise was a speech by BoC Deputy Governor Sharon Kozicki, who indicated that the central bank is prepared to act "forcefully" in order to return inflation to target levels, with the pace and magnitude of future hikes likely to be a focus of deliberations by the BoC's Governing Council when it convenes ahead of April's meeting. **Having priced in almost two percentage points of additional rate increases over the balance of this year, the bond market is expecting the BoC to deliver one of the most aggressive tightening cycles in recent decades**.

- Throughout H1 2021, the Canadian dollar steadily gained against the U.S. dollar with the support of very favorable short-term rate differentials as Canadian rates rose significantly above their U.S. counterparts. Rate differentials have historically played a role in currency fluctuations, promoting flows into the currency of the country with higher yields. But this support has waned in 2022 as the U.S. Federal Reserve has intensified its rate hike guidance, enabling U.S. short-term rates to catch up to—and eventually exceed—Canadian rates. That being said, interest-rate differentials are but one in a multitude of factors that influence currencies. Another important historical driver has quickly regained dominance—oil prices. Canada's is a commodity-based economy, which means rising commodity prices benefit its currency. **While the influence of interest rates has decreased in recent months, the surge in oil prices has allowed the loonie to maintain its lofty exchange rate against the USD**.

EUROPE

Rufaro Chiriseri, CFA, Thomas McGarrity, CFA & Frédérique Carrier – London

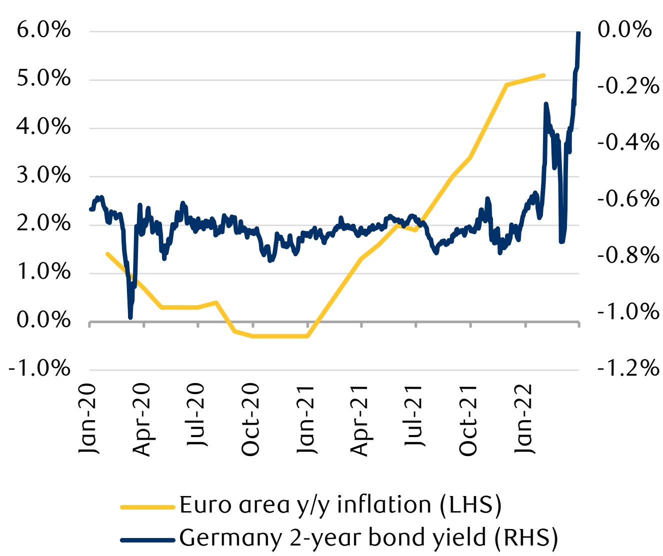
- **Eurozone economic sentiment retreated in March**, with consumer confidence suffering the largest drop. Manufacturing business sentiment also declined, though to a lesser extent, and mostly due to supply chain disruption. By contrast, services sentiment improved, benefiting from the relaxation of COVID-19 restrictions. These indicators may well deteriorate in the coming months due to the impact of the Russia-Ukraine war and its proximity.

- **Four key countries registered large inflation increases in March**. Headline inflation was up 9.8% y/y in Spain and 7.6% y/y in Germany. Italy's inflation increased 7% y/y while France's inflation rose to a lesser 5.1% y/y thanks to government measures to cap oil prices. **Core inflation, which excludes energy and food prices, was much more modest**, at low single digits in all countries. Still, the high headline inflation numbers will likely eat into consumers' disposable income.

- **Euro area bonds continued their selloff into this week** in tandem with other developed markets. Yields on German 2-year bonds soared from -0.20% and briefly touched above 0%—a level last seen in June 2014. Yields have been on the rise as market expectations for the year-end policy rate have shifted higher and also due to increased inflation expectations.

- **Unemployment in the euro area is lower than it has been in 40 years**. European Central Bank President Christine Lagarde recently cited concerns around a tight labour market and potential wage growth effects. Wage growth has remained relatively stable; however, surveys indicate pressure is building and this will be a concern for the central bank.

European bond yields rising as inflation intensifies



Source - RBC Wealth Management, Bloomberg; inflation data through 1/31/22; bond yield through 3/31/22

- **European equities rose to their highest point in five weeks** as optimism grew around the prospect of a possible de-escalation of the Russia-Ukraine war. Officials from the two countries met in Turkey for talks, though nothing was agreed upon.

- **The STOXX Europe 600 ex UK Index now sits around 1% above its level before the invasion**. However, it remains down 3.5% since tensions meaningfully escalated on Feb. 11 and is down 8% year to date (in EUR terms). The focus will soon shift to Q1 earnings season, where we think the market will be laser-focused on company commentary and guidance around the outlook for demand and margins given the intensifying inflationary pressures for consumers and corporates.

ASIA PACIFIC

Emily Li & Jasmine Duan – Hong Kong

- **Concerns regarding China's growth outlook and a U.S. securities regulator's tough stance on a potential delisting of Chinese firms added volatility to Asian equities this week**. Shanghai, home to the Chinese headquarters of many international companies and the country's largest port, has imposed a two-phase lockdown to conduct a mass COVID-19 testing blitz. China's zero-tolerance approach to COVID-19 is putting pressure on growth, even though authorities pledged strong support for the economy and markets via a slew of initiatives earlier this month. China's latest Composite Purchasing Managers' Index (PMI), which tracks manufacturing and services activity, has shown the impact of lockdowns, slipping to 48.8 in March from 51.2 in February, below consensus estimates.

- **The U.S. Securities and Exchange Commission on Wednesday added Baidu (9888 HK/BIDU), Futu (FUTU), Nocera (NCRA), iQIYI (IQ), and CASI Pharmaceuticals (CASI) to its provisional list for possible delisting**. The number of Chinese firms identified by the regulator now stands at 11 and should continue grow, in our opinion. Regulators for the two countries are trying to work out plans that would meet the legal and regulatory requirements of both sides. But we think this could take some time as statements by the Chinese regulator appear more optimistic compared to those from its U.S. counterpart.

- **Sinopec (386 HK/600028 CH)**, China's largest producer of refined oil products, **plans to spend a record amount this year to increase oil and gas drilling as China aims to bolster its energy security and insulate itself from volatile global commodity markets**. The company announced that it will increase its capital expenditure 18% to RMB198 billion, including a 22% boost in drilling. The announced increase comes just weeks after China's leaders said the nation's top energy priority in 2022 is securing fuel supplies. The country is trying to prevent soaring costs of oil, gas, and coal from derailing efforts to keep its economy on a stable footing.

MARKET
Scorecard

Data as of March 30, 2022

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,602.45	5.2%	-3.4%	16.3%	75.2%
Dow Industrials (DJIA)	35,228.81	3.9%	-3.1%	6.5%	57.8%
Nasdaq	14,442.27	5.0%	-7.7%	10.7%	85.8%
Russell 2000	2,091.07	2.1%	-6.9%	-4.8%	80.5%
S&P/TSX Comp	22,075.96	4.5%	4.0%	18.0%	69.3%
FTSE All-Share	4,219.75	1.5%	0.3%	9.3%	38.8%
STOXX Europe 600	460.19	1.6%	-5.7%	6.9%	46.1%
EURO STOXX 50	3,959.14	0.9%	-7.9%	0.8%	43.2%
Hang Seng	22,232.03	-2.1%	-5.0%	-22.2%	-4.1%
Shanghai Comp	3,266.60	-5.7%	-10.3%	-5.5%	18.9%
Nikkei 225	28,027.25	5.7%	-2.7%	-4.8%	46.9%
India Sensex	58,683.99	4.3%	0.7%	17.0%	106.3%
Singapore Straits Times	3,442.61	6.2%	10.2%	7.9%	42.5%
Brazil Ibovespa	120,259.76	6.3%	14.7%	2.9%	61.1%
Mexican Bolsa IPC	55,814.99	4.5%	4.8%	16.5%	63.2%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	2.351%	52.6	84.1	64.8	162.4
Canada 10-Yr	2.436%	62.3	101.0	90.3	167.2
UK 10-Yr	1.666%	25.6	69.5	84.2	133.0
Germany 10-Yr	0.646%	51.1	82.3	93.2	113.6
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	2.97%	-3.1%	-6.3%	-4.5%	-3.9%
U.S. Investment-Grade Corp	3.65%	-3.0%	-8.1%	-4.5%	4.2%
U.S. High-Yield Corp	6.04%	-1.4%	-5.1%	-0.7%	23.3%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,933.43	1.3%	5.7%	14.7%	19.2%
Silver (spot $/oz)	24.86	1.7%	6.7%	3.5%	77.0%
Copper ($/metric ton)	10,314.50	4.0%	5.9%	17.6%	116.7%
Oil (WTI spot/bbl)	107.82	12.6%	40.0%	78.1%	436.7%
Oil (Brent spot/bbl)	112.60	11.5%	44.8%	75.6%	394.7%
Natural Gas ($/mmBtu)	5.56	26.3%	49.1%	112.0%	229.1%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	97.8120	1.1%	2.2%	4.8%	-1.4%
CAD/USD	0.8015	1.6%	1.3%	1.2%	13.5%
USD/CAD	1.2478	-1.6%	-1.3%	-1.2%	-11.9%
EUR/USD	1.1158	-0.5%	-1.9%	-4.8%	1.0%
GBP/USD	1.3136	-2.1%	-2.9%	-4.4%	5.8%
AUD/USD	0.7512	3.4%	3.4%	-1.1%	21.7%
USD/JPY	121.8100	5.9%	5.8%	10.4%	13.0%
EUR/JPY	135.9200	5.4%	3.8%	5.1%	14.1%
EUR/GBP	0.8495	1.6%	1.0%	-0.4%	-4.5%
EUR/CHF	1.0300	0.1%	-0.7%	-6.7%	-2.7%
USD/SGD	1.3527	-0.2%	0.3%	0.4%	-5.1%
USD/CNY	6.3477	0.6%	-0.1%	-3.4%	-10.6%
USD/MXN	19.8846	-2.9%	-3.1%	-3.4%	-16.5%
USD/BRL	4.7743	-7.3%	-14.4%	-17.3%	-8.1%

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 1.3% return means the Canadian dollar rose 1.3% vs. the U.S. dollar year to date. USD/JPY 121.81 means 1 U.S. dollar will buy 121.81 yen. USD/JPY 5.8% return means the U.S. dollar rose 5.8% vs. the yen year to date.

Source - Bloomberg; data as of 3/30/22 market close

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As of December 31, 2021

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Buy [Outperform]	831	57.59	365	43.92
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Sell [Underperform]	55	3.81	3	5.45

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