



The Harbour Group of RBC Dominion Securities

Investing in the Age of Trump

February, 2017



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Trump Has Been Dominating the Narrative

- Trump's presidency has been the #1 topic of conversation among clients and with all the headlines it is little wonder.
- The early days of the administration have been dominated by mixed signals on everything from taxes, immigration and the U.S. dollar.
- This is a far cry from the days after the election when investors clamored onto the idea of tax cuts all around, a boom in infrastructure spending and slashed regulations.
- Lower regulations seem like the easiest to achieve, but there is significant work to chop on taxes and stimulus via infrastructure.
- Trump is a “known unknown” in that we know he will be unpredictable but don't know what he is going to say or do.
- In the face of that uncertainty we focus on quantitative data such as GDP growth and earnings growth which can be measured objectively.
- Our main focus from a political perspective is on the “big three” of tax reform, infrastructure spending, and deregulation.



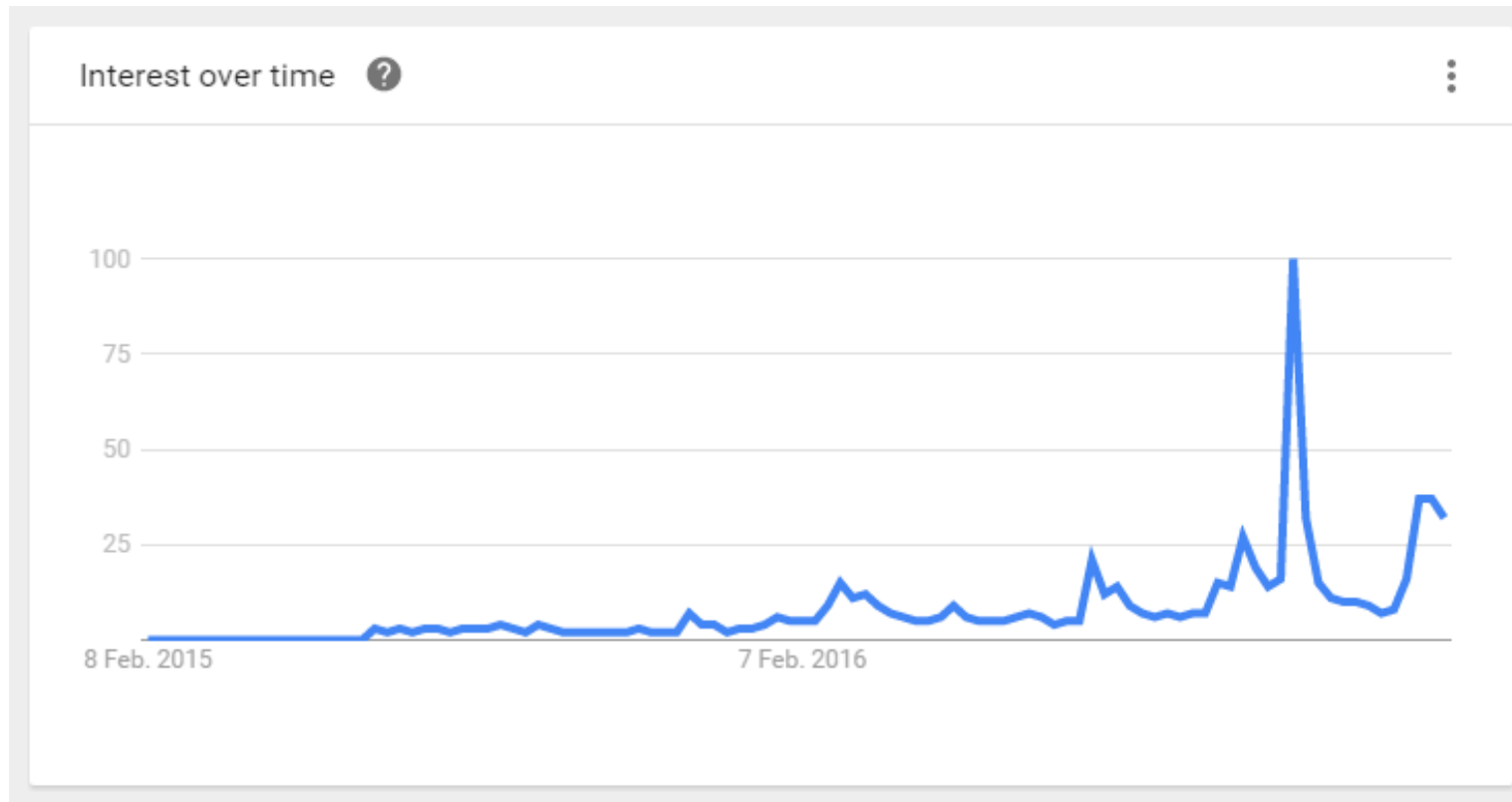
RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Could Interest In All Things Trump Be Peaking?

Google Searches for "Trump"



Source: Google Trends



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Markets Have Priced In A Lot Of “Good Trump”

- The capital markets have been quick to price in nearly all of the positives of Trump’s proposed policies.
- Significant corporate and personal tax cuts, a repatriation holiday and infrastructure spending are all growth positive, and the pricing of the stock and bond markets currently reflects that.
- We believe this has been exacerbated by U.S. investors resisting the urge to take profits on the view they will face a lower tax bill if they wait until this year.
- There are also potential negatives in his platform surrounding trade and geopolitical uncertainty, neither of which are currently reflected in equity market multiples.
- The new year could bring some volatility if Trump’s policies get a cool reception in congress and investors waiting for the calendar to turn decide to take some gains.
- So long as recession probabilities don’t change (and they look pretty low right now) we continue to look to volatility for opportunities.



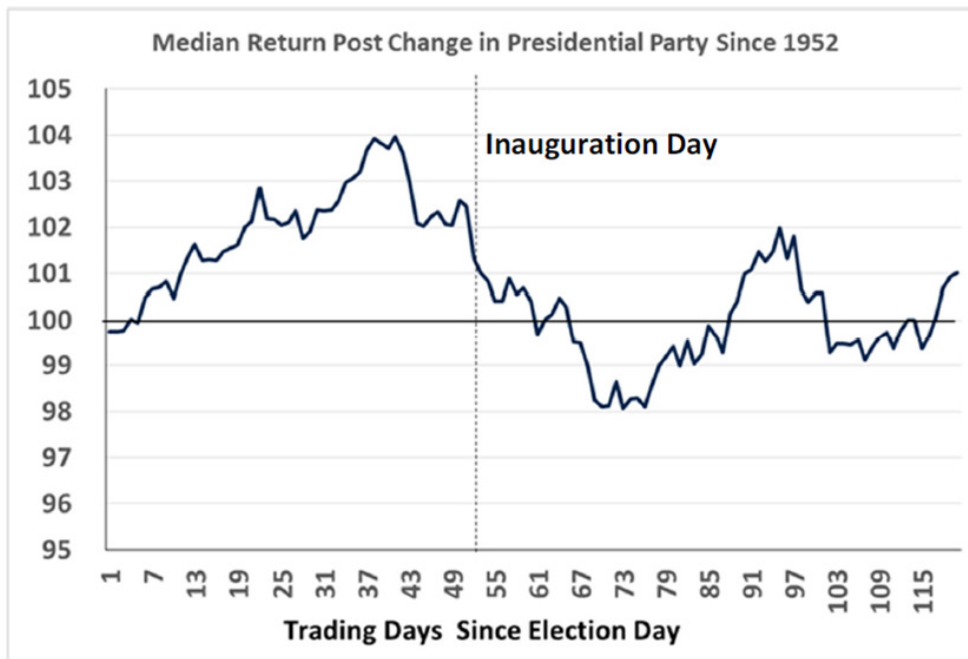
RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

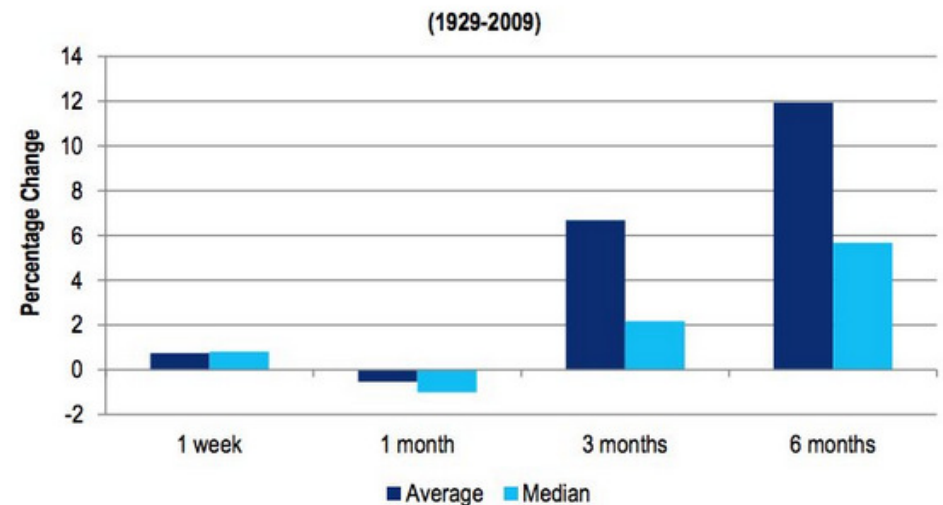
Post-Election Hangover Coming?

- Historically stocks do well after a new president is elected, but fatigue often sets in post-inauguration.
- Given the strong performance post-Trump, this risk is heightened and could be triggered by congressional resistance to his budget plans.



Source: DoubleLine Capital, Bloomberg

Figure 15. S&P 500 Performance Following First Inauguration



Source: FactSet, Citi Research – US Equity Strategy



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

This Brings Us Back To The Subject Of Volatility

- 2016 was unique in that equity markets showed a remarkable ability to shake off huge political surprises and then rally to new highs.
- Will this happen in 2017? It is much too early to tell.
- It is absolutely normal for markets to be volatile, and almost each and every year we get a 5 - 10% correction that shakes out marginal investors.

How Corrections Play Out (Since 1945)			
	Type (% Decline)		
	Mild Corrections (5% to 10%)	Intermediate Corrections (10% to 20%)	Bear Markets (20%+)
Number of occurrences	56	19	10
Average decline	-7%	-14%	-35%
Peak to trough (in months)	1	4	18
Recovery (in months)	2	4	26

Source: RBC Wealth Management



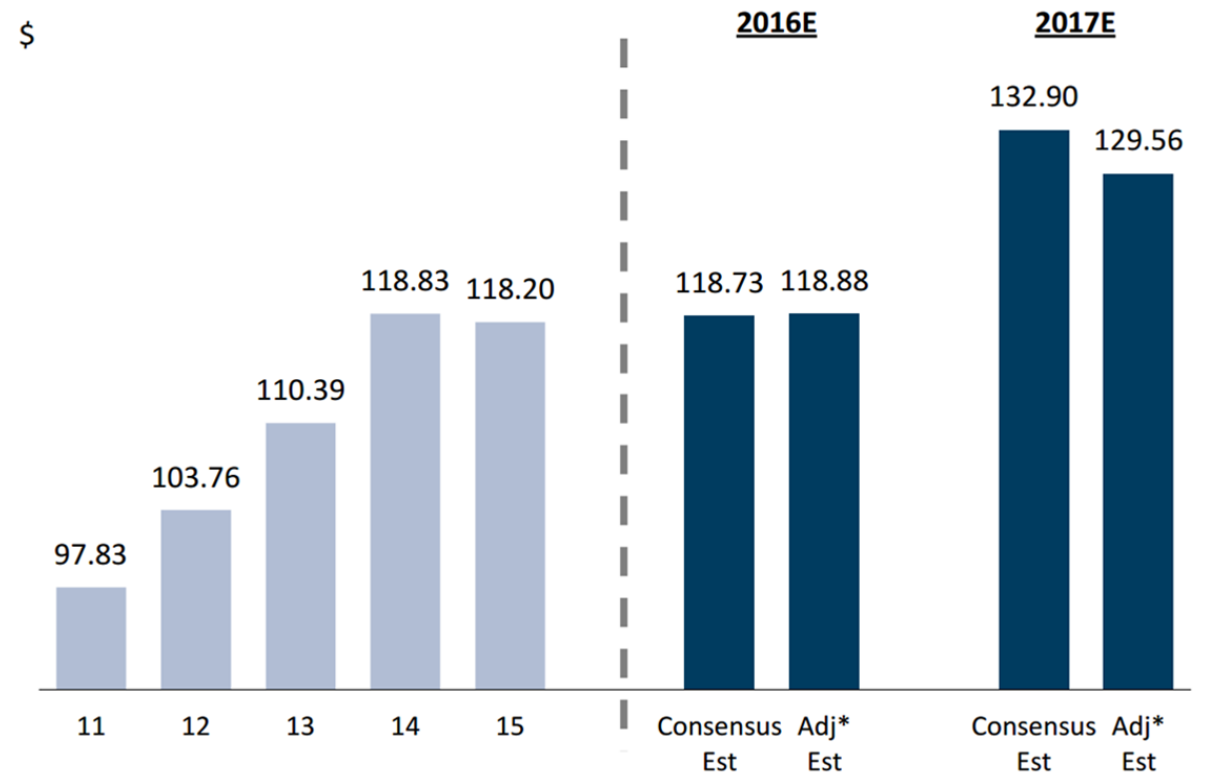
RBC Wealth Management
Dominion Securities



Earnings Momentum Troughed in Q1 2016

- Earnings growth in the U.S. is getting “less bad” as investors price in a return to growth in 2017.

S&P 500 EPS – Annual



Note: *Assumes historical degradation 2011–15

Source: S&P, Thomson Financial, FactSet, and RBC Capital Markets



RBC Wealth Management
Dominion Securities

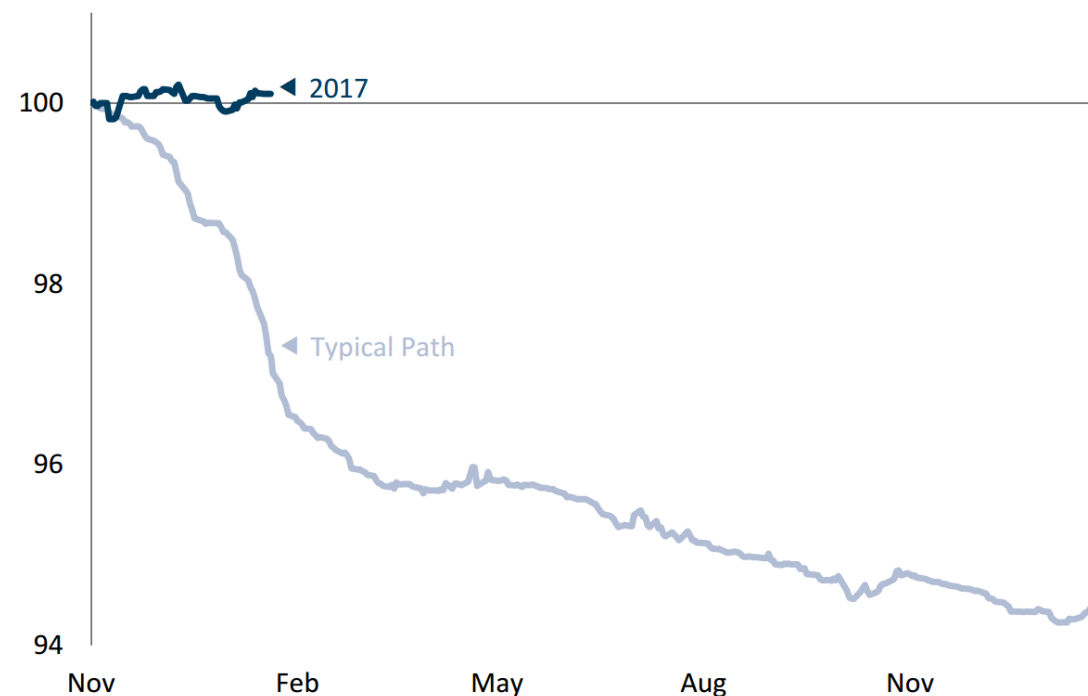


THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

S&P 500 Estimates Holding Firm

- Typically analyst estimates for earnings prove to be overly optimistic, which causes them to cut back their projections as the year goes on.
- That is not the case this year, with estimates holding firm as investors expect tax and regulatory relief under Trump, and economic growth data has been solid.

Exhibit 1: S&P 500 EPS Estimate Revisions



Source: S&P, Thomson Financial, FactSet, and RBC Capital Markets

Note: Typical Path is 2012–16 average; indexed to 100 at 11/8/2016



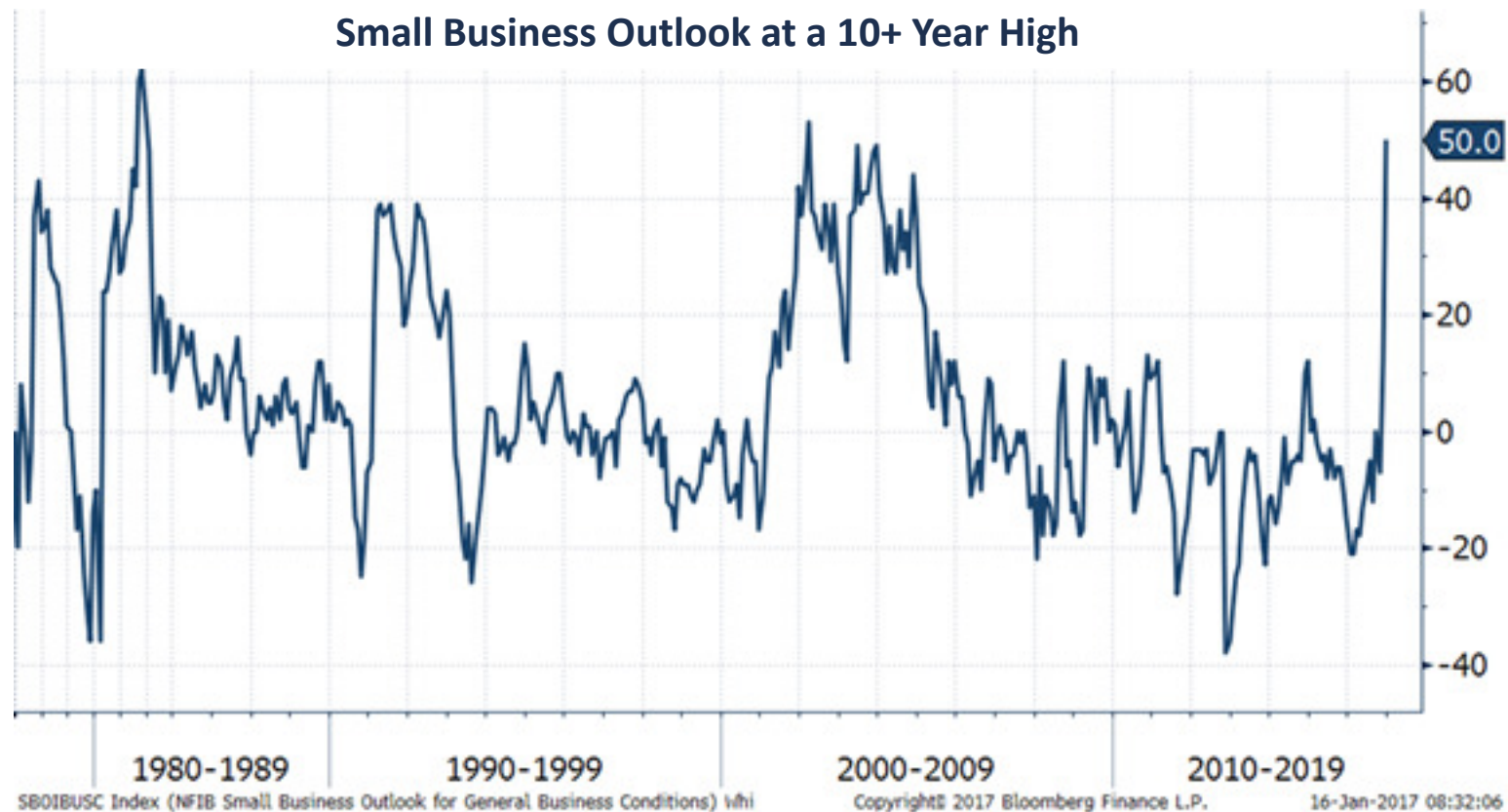
RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Small Business Confidence Has Spiked Since the Election

- Small businesses have reacted very favorably to the prospect of lower taxes and less regulation.
- While difficult to measure, perhaps this signals a re-igniting of “animal spirits” that drive corporate investment and markets.



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

U.S. Set to Outperform

- 2016 brought a substantial comeback for the TSX after many years of underperformance.
- 2017 is likely to see the U.S. take the lead once again.
- Higher economic growth expectations and a potential earnings tailwind from significant changes in the tax code bode well for U.S. earnings.
- Trump's election has also seemed to release some of the “animal spirits” that have laid dormant for some time.
- The U.S. has more opportunities to position for a stronger growth environment.
- RBC's U.S. Strategist sees double digit gains for the S&P 500, with a price target of 2500 in 2017, while RBC's Canadian strategist thinks it will take 18 months to derive similar returns from the TSX.
- RBC sees further USD strength, suggesting a boost to returns from U.S. securities when translated back into Canadian dollars.



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Potential Stimulus Coming as Full Employment Looms

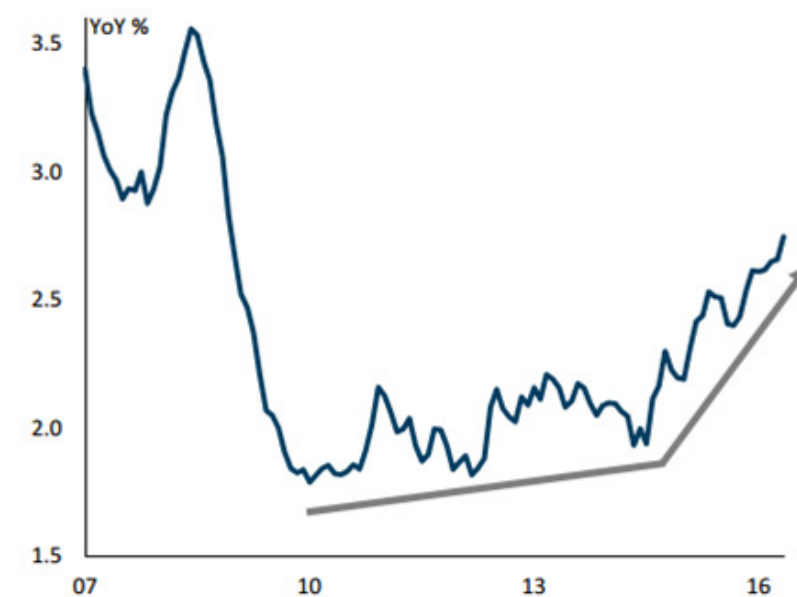
- Trump's pledge for fiscal stimulus comes just as wage growth is beginning to accelerate and the labour market tightens.
- It is yet to be seen what will make it through congress, but more stimulus is likely to push up inflation and accelerate the Fed's path to higher rates.

Wage Inflation vs. Unemployment Rate



Note: 3-Month Moving Average; Unemployment Rate Advanced 1-Year; as of 1/6/17
Source: BLS, Haver, and RBC Capital Markets

Wage Inflation



Note: 3-Month Moving Average; as of 1/6/17
Source: BLS, Haver, and RBC Capital Markets



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Winners and Losers From Higher Bond Yields

- Higher interest rates are being felt in sharply divergent sector performance, and just as there were sectors that outperformed as rates fell to new lows.
- The biggest winner from higher yields are the financials, as banks benefit from higher net interest margins and life insurance companies business models are leveraged to higher interest rates.
 - Life insurance companies in particular have been challenging investments as interest rates plumbed new lows.
- Commodity sectors ex-gold should also benefit from higher rates, as either stronger economic growth or accelerating inflation are typically positive for commodities.
 - Gold is more of a mixed bag, as higher rates increase the opportunity cost of holding gold, and over the long term gold has proven to be an inconsistent inflation hedge.
- Sectors most at risk from higher bond yields are those with higher yields which face rising competition from bond yields as an income generator. This has no implication for the ability of these companies to pay their dividends, but would likely inhibit valuations.
- History shows that sell offs in the income sectors often yield buying opportunities.



RBC Wealth Management
Dominion Securities

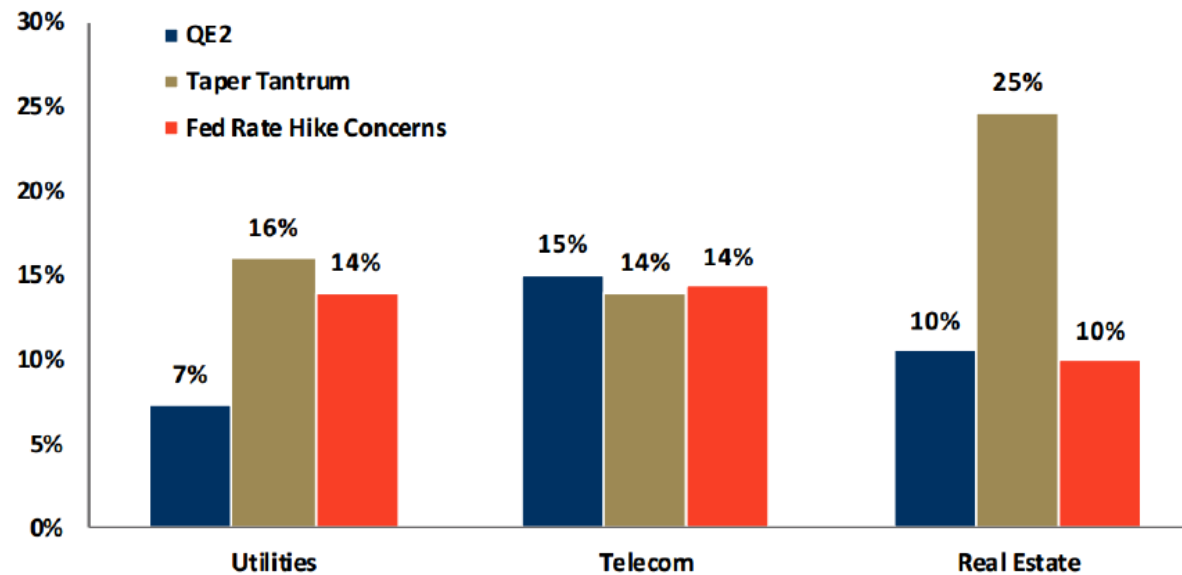


Higher Bond Yields Bring Buying Opportunities

- Naturally, a sell off in the bond market creates opportunities to lock in yield on high quality government and corporate bonds.
- Historically, we have also seen strong price performance from the “yield” sectors in the year following the peak in bond yields in addition to the income generated.

Sector returns one year from bond yield peaks

One-year % returns from rate peaks



Source: RBC Capital Markets



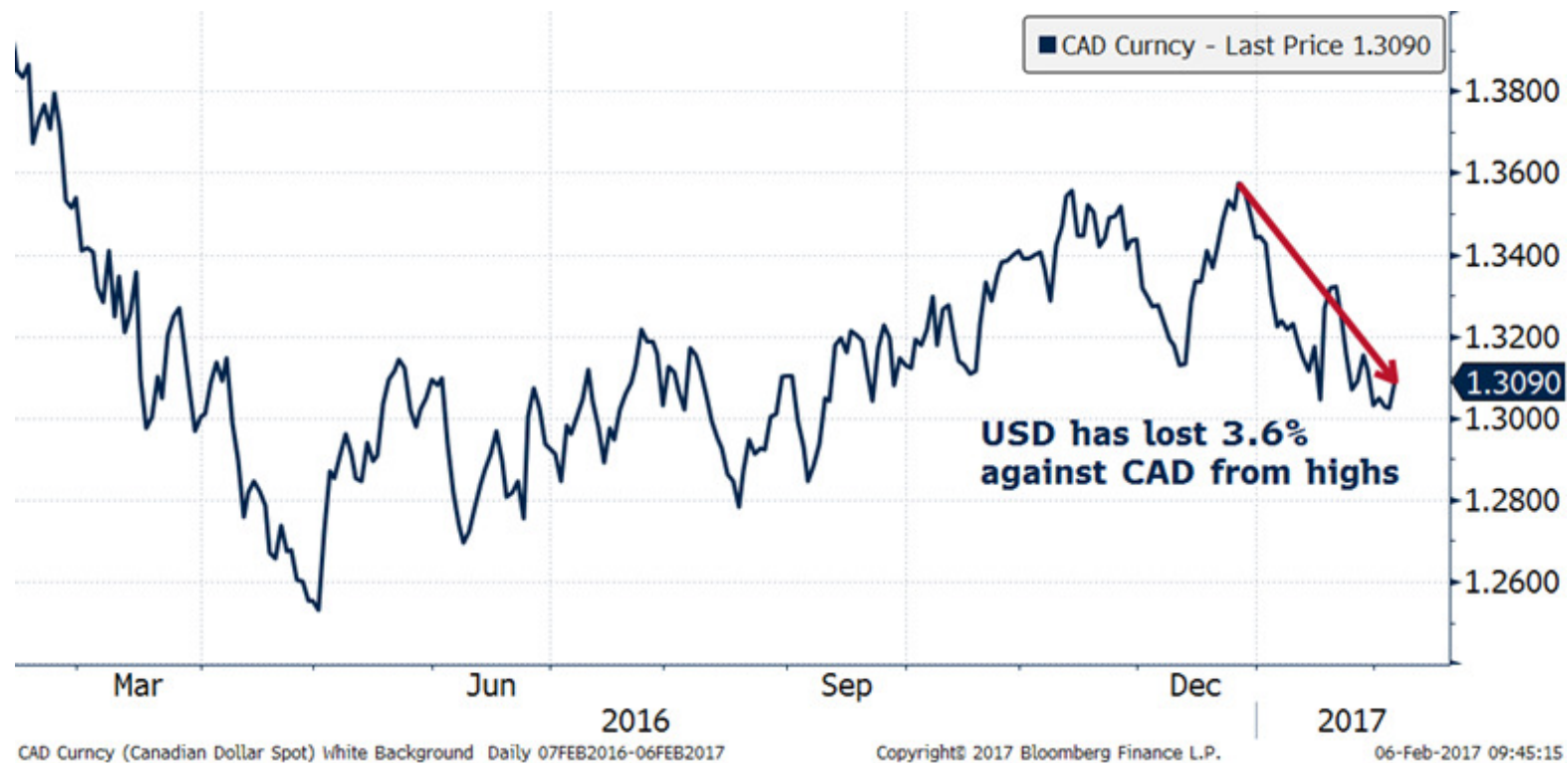
RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Canadian Dollar Has Been Unexpectedly Strong

- The Canadian dollar has been stronger than expected so far this year.
- RBC is forecasting 1.35 in Q1, then 1.38 for the rest of 2017.



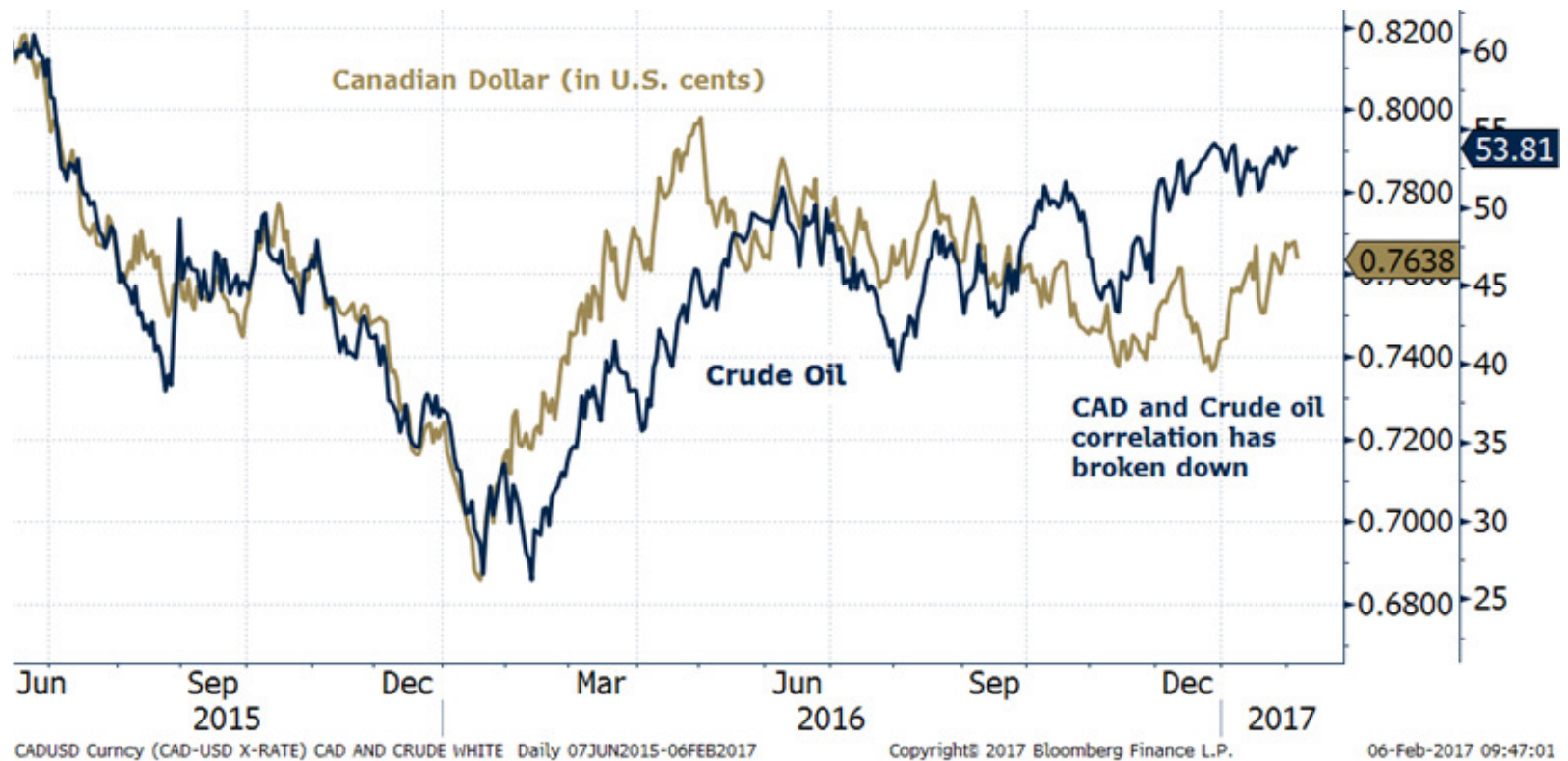
RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Oil's Impact on the CAD is Waning

- Despite a strong move in crude oil, the CAD has failed to keep pace.
- Barring a move significantly higher or lower (i.e. \$10+) we think the Bank of Canada and Federal Reserve outlooks will be the dominant drivers of the Canadian dollar.



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

CAD Strength Largely Due To Weaker USD

- Fundamentals such as interest rate expectations continue to argue for a weaker CAD.
- It appears the CAD strength seen year to date is mostly the result of a broadly weaker U.S. dollar.



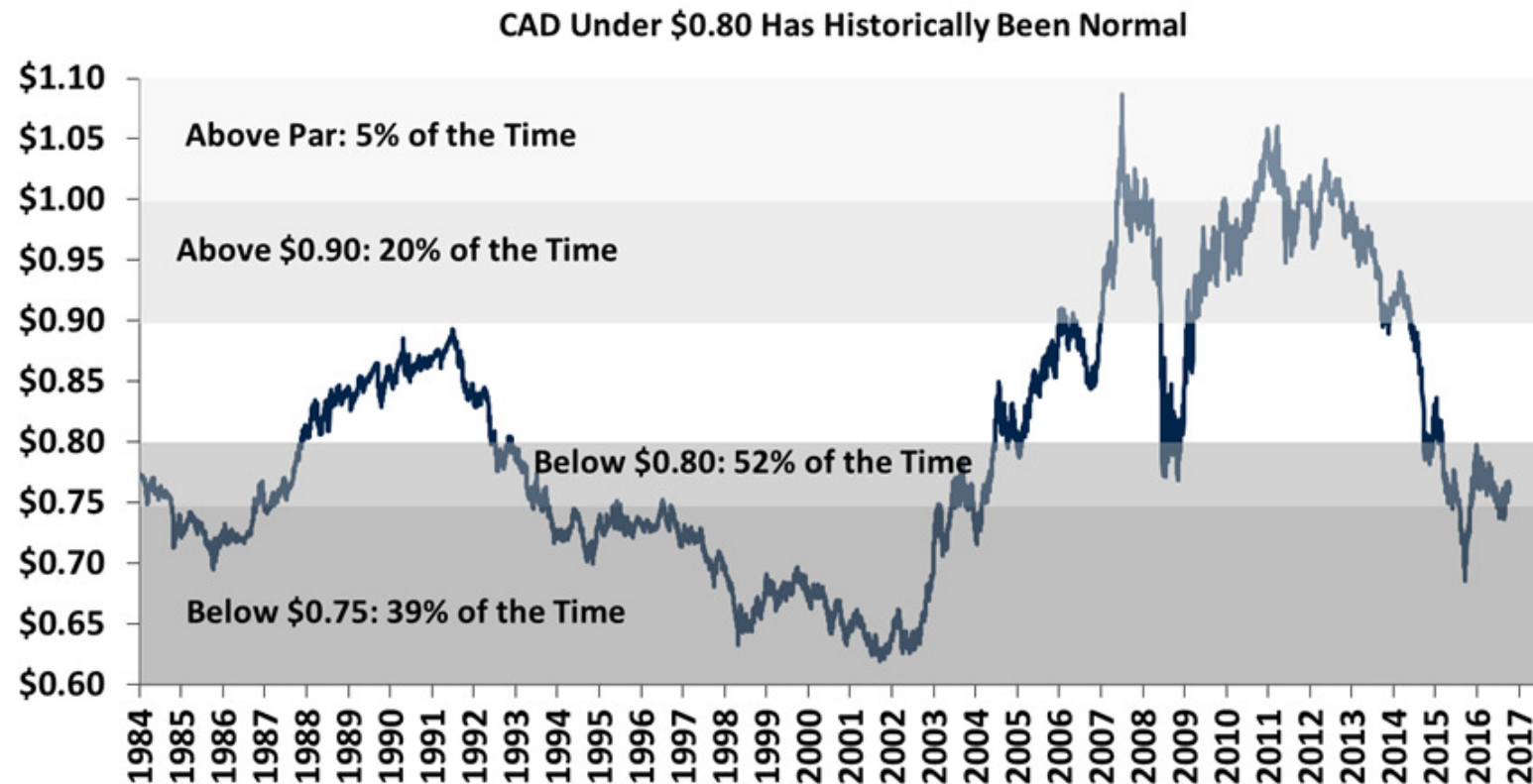
RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

CAD Valuation – Parity Is The Exception

- While the “recency effect” makes us feel like the Canadian dollar at or near parity is the norm, in fact it has only been above par 5% of the time since 1984.



Source: RBC CM; The Harbour Group; Bloomberg

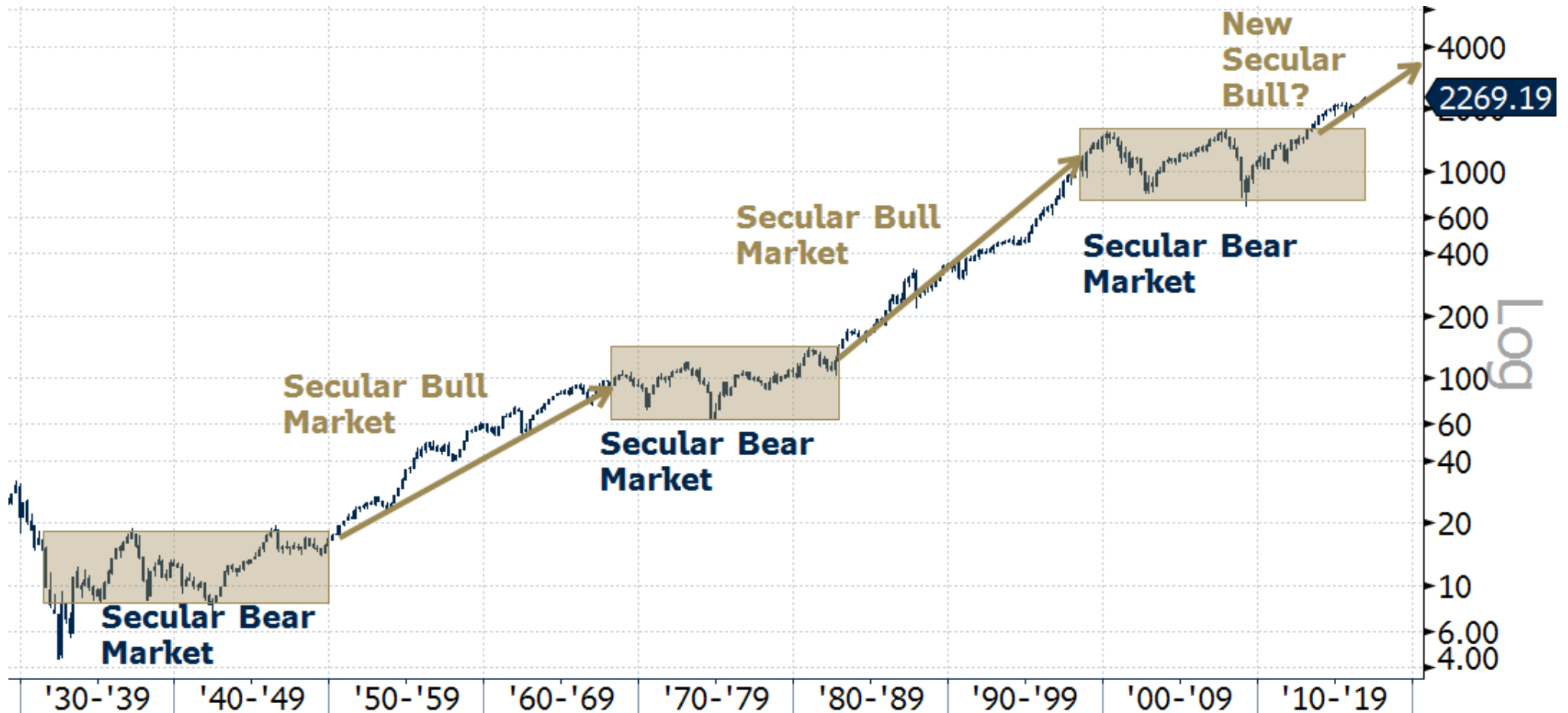


RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Still In A Firmly Entrenched Bull Market



SPX Index (S&P 500 Index) Secular Bull/Bear SPX Quarterly 01JAN1926-17JAN2017

Copyright © 2017 Bloomberg Finance L.P.

17-Jan-2017 11:28:20



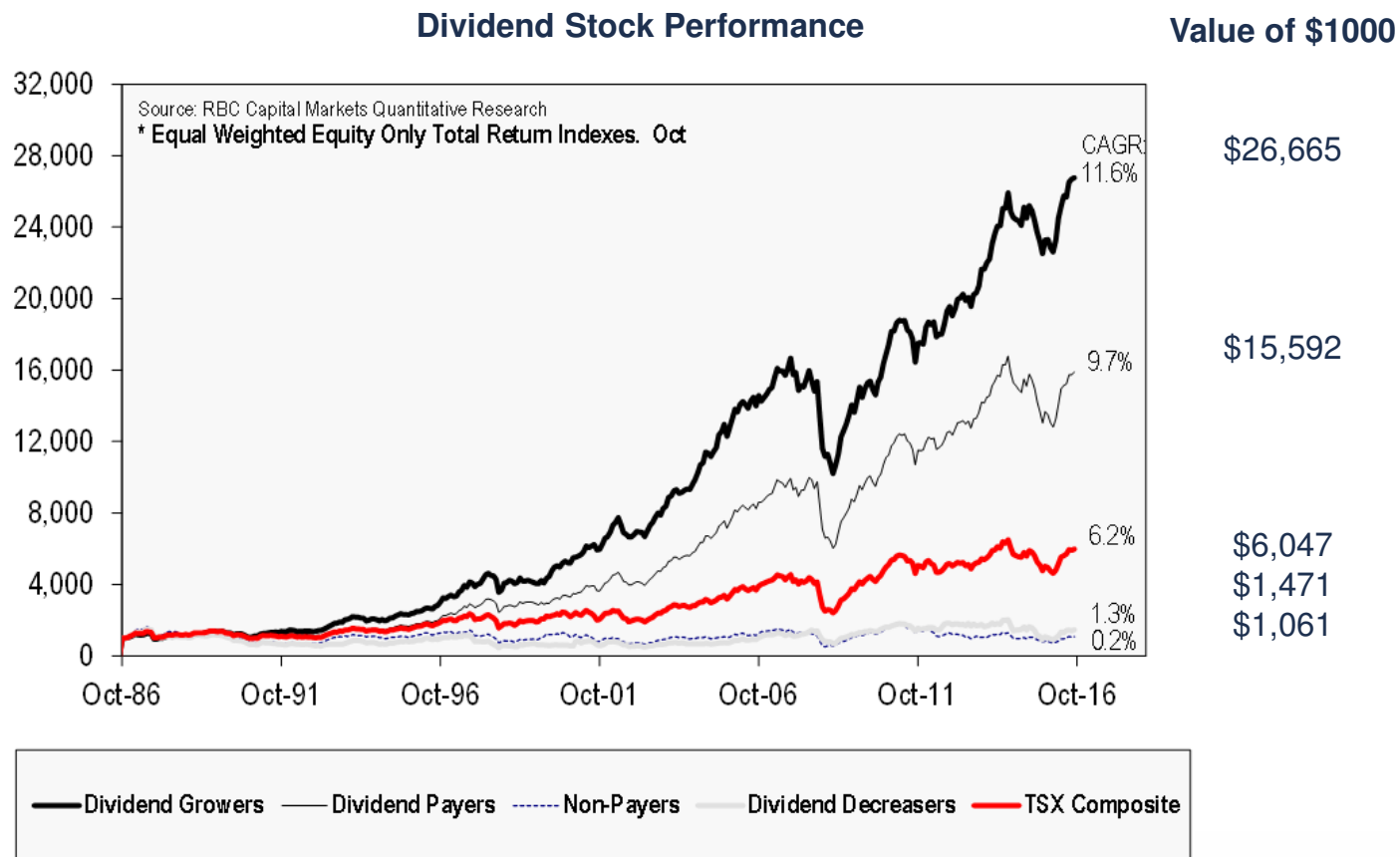
RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

A Focus on Dividend Growth Remains Appropriate

- Dividend growth has outperformed in Canada over the long term, as demonstrated below.
- Note that companies that cut or don't pay a dividend have actually provided a negative real return in aggregate going back to 1986!



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES

Disclaimer

There are many opportunities and solutions available to assist you in meeting your investment and estate planning goals. However, because of the complexity of integrating your corporate and personal goals, considering the different tax systems, it is essential that you involve the appropriate professionals in order to maximize these opportunities and accomplish your goals in the most tax-effective manner.

The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein.

RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. RBC Dominion Securities Inc. is a member company of RBC Wealth Management, a business segment of Royal Bank of Canada. ® Registered trademarks of Royal Bank of Canada. Used under licence. © 2016 Royal Bank of Canada. All rights reserved.



RBC Wealth Management
Dominion Securities



THE HARBOUR GROUP
OF RBC DOMINION SECURITIES