

Global Insight

Weekly

Global equity selloff: Autumn of discontent?

Kelly Bogdanova – San Francisco

Several forces have driven the surges of volatility that have ripped through global stock markets. While it could be a bumpy ride ahead, we think the greatest deteriorations in economic conditions and equity markets are likely in the rearview mirror.

Autumn has once again ushered in volatility and a swift global equity market selloff. The S&P 500 dropped 3.5% on Wednesday, dragging other markets down with it, and has declined 7.6% since its all-time high on September 2.

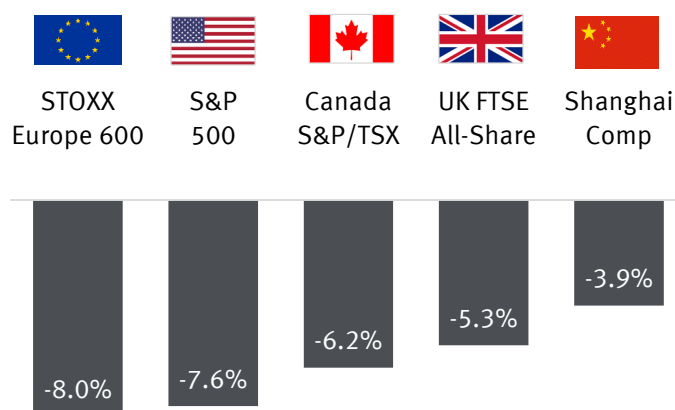
The discontent is primarily driven by:

- **Lack of progress on another U.S. fiscal stimulus package.** Some investors had been expecting a deal before the election on November 3, and now that seems off the table. There is scope for COVID-19 relief to pass later this year, during the “lame duck” session, or the legislation could be stalled until after the January 20 presidential inauguration.
- **The resumption of COVID-19 lockdowns due to the spike in infections.** France and Germany simultaneously announced national quarantines, although less harsh than last spring. By some measures, France’s second wave is feared to be more serious than the first. In the U.S. and Canada, infections continue to climb, sparking renewed concerns that restrictions on business activity may ramp back up in some regions of North America.

Considering equity markets’ rocket-like surges off the March lows, which pushed higher and lasted longer than most expected, the volatility shouldn’t be overly surprising or concerning. We view this as typical market behavior when uncertainties become amplified.

Autumn adjustment

Index returns since the September 2, 2020 high in the major global indexes (not including dividends)



Source - RBC Wealth Management, Bloomberg; data through 10/29/20 and is in local currencies

Market pulse

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Click [here](#) for authors’ contact information. Priced (in USD) as of 10/29/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6.**
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Wealth
Management

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How threatened is the fledgling recovery?

Clearly the concerns boil down to economic vulnerabilities. Will the renewed COVID-19 shutdowns and delayed U.S. fiscal support hamper the recovery or cause a double-dip recession?

We don't think the U.S. or global economies will fall back into a deep pit like they did when the first wave of COVID-19 hit earlier in the year.

First, health officials have a better handle on how to treat those who are sick. More effective treatment regimens are being implemented, new therapeutics are coming, and vaccine progress seems likely, according to medical experts. Even though COVID-19 infections have spiked, testing has also increased markedly. In many countries, daily death totals have not risen by the order of magnitude that infections have.

Second, many government leaders around the world are striking a balance: Protect people from virus risks, but also minimize the economic and psychological consequences that quarantines and shutdowns have on the population.

Third, we believe additional U.S. fiscal stimulus will ultimately pass, it's just a matter of when, the amount, and the composition of the relief. Such details shouldn't hinder markets over a long-term time frame, in our view. Overall, fiscal support in the U.S. and elsewhere will likely be maintained as long as unemployment remains high and physical distancing restrictions persist, with their constraining impact on key segments of the economy.

The election element

Of course, the elephant in the room (no pun intended) is the U.S. election. Its impact on equity markets at this stage is more difficult to gauge, and we think this issue has been a less important factor for the current pullback than the aforementioned catalysts.

Market participants have had a lot of time to consider the various potential election outcomes, including possible unorthodox developments related to delayed election results, a contested election, or even civil unrest. Election scenarios have been poured over inside and outside of the country.

However, in recent weeks there has been debate among some institutional investors about the degree to which large 2021 fiscal spending packages may already be priced into the market, and about whether the market would benefit most over the near term from a divided or unified government.

Perhaps the debate surrounding these issues, combined with the overall uncertainty about the election outcome, has prompted some short-term-oriented institutional investors to shift positions ahead of the election.

Volatility has jumped but remains well below the March extremes

Volatility Index (VIX) for the S&P 500



Source - RBC Wealth Management, Bloomberg, Chicago Board Options Exchange; data through 10/29/20

Stumbles are not surprising

Even with the lingering COVID-19 and related challenges, we think the greatest deteriorations in economic conditions and equity markets are in the rearview mirror.

As we have stated previously, the economy's path back to pre-COVID-19 output levels will take time and will include bumps along the way. What we're experiencing now is one of those bumps.

While near-term risks are very much in evidence, looking ahead we expect the largest economies, corporate earnings, and major equity markets to gain more ground over the next 12 months. The U.S. economy should reach its pre-pandemic level by 2022 and return to its prior growth trajectory in 2023—a much shorter time frame than it took following the global financial crisis.

This should be fueled by progress taming the COVID-19 virus, the ongoing normalization of economies, and especially central banks' entrenched commitment to accommodative, ultralow interest rate policies.



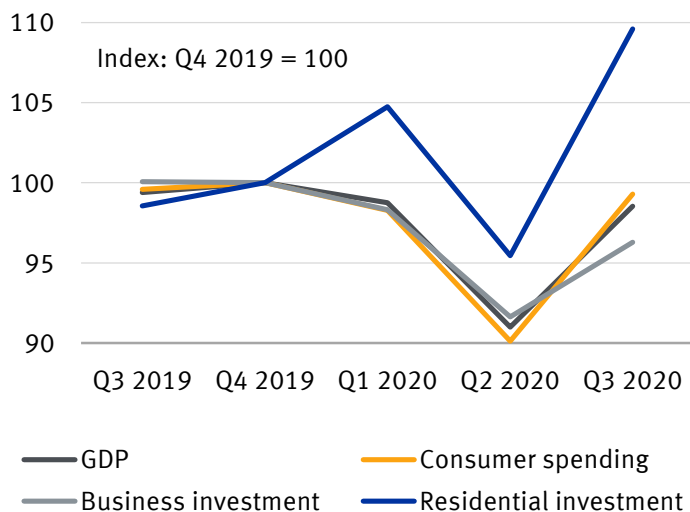
United States

Alan Robinson – Seattle

- **U.S. stocks endured a tough week as rising COVID-19 cases sparked fears of a renewed economic slowdown** due to consumer behavioral changes and fresh mitigation measures. The seven-day average of new daily cases through Oct. 28 hit an all-time high of 72,000, and infectious disease expert Dr. Anthony Fauci warned that a vaccine may not be available until January at the earliest.
- The CBOE Volatility Index (VIX), a measure of investor bearishness, spiked above 41 to reach a four-month high during the week. While this is clearly a negative short-term data point, we note that **when the VIX is above 35, stock market returns over the next 12 and 24 months have a 93% and 96% chance, respectively, of being positive**, and over those time periods, returns are slightly more than 2x better than average.
- The midpoint of Q3 2020 earnings season was crossed during the week. By Oct. 28, half the S&P 500's constituents by market cap had reported. At this stage, **earnings have beaten lowered estimates by +18% in aggregate**, with 83% of companies beating consensus forecasts.
- Some sectors fared worse than others. **The U.S. airline industry was badly impacted in Q3, posting aggregate losses above \$11 billion**, and revenues near one-fourth of year-ago levels. While trends turned up at the start of Q4, renewed COVID-19 concerns have the potential to ground airlines' recoveries if travelers forgo their usual Thanksgiving and holiday season travel plans.

Economy retraced some losses in Q3, home spending shines

U.S. GDP, with selected components



Source - Bureau of Economic Analysis, RBC Wealth Management

- Q3 economic growth figures were released during the week that showed the **U.S. economy grew by 33.1%** on an annualized basis compared to the depressed level experienced in Q2. This was broadly in line with consensus expectations, and **only partially retraces the 31.4% and 5.0% declines in Q2 and Q1**, respectively, leaving activity running 3.5% below its pre-shock level (see chart). Some areas fared better than others, with residential investment surging above last year's highs.



Canada

Ryan Harder & Sayada Nabi – Toronto

- **The Bank of Canada (BoC) kept its policy interest rate unchanged** this week, but reduced its overall quantitative easing (QE) purchases from a minimum of CA\$5 billion per week to CA\$4 billion per week. **It also shifted its QE focus away from short-dated government debt toward longer-dated maturities**, which coincidentally lines up with where the federal government has been disproportionately issuing new debt. With the BoC now owning about a third of all outstanding Canadian government debt, QE has become and will remain an important source of demand for surging federal issuance. This week's meeting was also accompanied by the quarterly Monetary Policy Report (MPR), where it was noted that **the BoC expects economic slack to remain until 2023**, an outlook that would keep rates near zero and downward pressure on inflation in the near-to-medium term. Despite this, the MPR's economic projections were modestly more optimistic than the July MPR, as Q3 economic data including GDP and retail sales recovered more strongly than expected. However, a resurgence of COVID-19 cases remains a significant source of risk and uncertainty, and the BoC noted that it sees the ongoing recovery to be slower and uneven.
- Around the globe, equity markets came under significant pandemic-related pressures this week and Canada was no exception. **The TSX closed 2.71% lower on Wednesday, the biggest one-day decline in the past four months**. This weakness was **primarily driven by resource sectors**, with Materials sagging 4.5% as mining and forestry names were red across the board. In a similar vein, the Canadian Energy sector was the other major cause of weakness as the sharp pullback in West Texas Intermediate this week pushed the sector down nearly 4%. While also in the red, the Consumer Staples and Real Estate sectors emerged as sources relative of outperformance.



Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **We are upgrading our stance on UK equities to Market Weight from Underweight.** The FTSE All-Share Index has been a perennial underperformer since the referendum to leave the EU in June 2016, and is now below the levels it reached at that time. By comparison, the MSCI World Index returns in GBP are up more than 55% over that time frame. UK equity valuations are extremely depressed, trading on 12.5x 2021 consensus earnings estimates.
- **Short-term prospects for the UK remain challenging.** COVID-19 infection rates will likely lead to further social distancing restrictions that will weigh on the nascent recovery. A free trade agreement with the EU seems more likely now, though it will probably be very rudimentary and an additional headwind to businesses which are already facing significant challenges due to the pandemic. Cabinet Office Minister Michael Gove stated in September that only 24% of businesses were prepared for the end of the Brexit transition period. **Still, a trade agreement with the EU will be a base to build on** in coming years, in our view. The Bank of England is on the alert and **more monetary policy support is likely coming this year and next.**
- **Yet on a one-year view,** as infection rates eventually subside and the uncertainty of “deal or no deal” with the EU dissipates, **we believe the UK economy should emerge from these challenging times.** Moreover, it’s likely the worst of dividend cuts have already happened. Listed companies, prompted by the regulators, slashed dividends by more than 55% y/y in Q2, with three-quarters of dividend payers either cancelling or cutting dividends. We expect a notable

UK equities marked underperformance

FTSE All-Share



Source - RBC Wealth Management, Bloomberg, data through 10/28/20

rebound in 2021 and note that **UK equities still have a more generous dividend yield than other markets**, with a prospective yield of 4% for 2021.

- We continue to prefer UK companies that are well positioned to benefit from long-term structural growth tailwinds or possess internal levers to grow, rather than those relying solely on an improving macroeconomic environment. **These opportunities can be found in the Consumer Staples, Health Care, and Industrials sectors** in particular.



Asia Pacific

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

- **China and Hong Kong equities have continued to trade in a narrow range** since July. This relative “tranquility” shows the market’s reluctance to take risks as investors are waiting for some major events in the coming week or two.
- The fifth plenary session of the 19th Central Committee of the Communist Party of China concluded on Oct. 29. **The market is waiting for China to roll out its 14th five-year economic and development plan** after the meeting. Detailed measures will likely focus on consumption upgrades, new infrastructure investment, and openness, among others.
- **Nearly 1,000 Chinese companies are releasing Q3 2020 results on Oct. 29.** Investors are waiting to see if the results can confirm if China’s recovery from COVID-19 is accelerating. Companies scheduled to report earnings in the next few days include the Chinese banks, which reported the worst Q2 earnings in a decade as regulators required them to forgo profits. **Bloomberg reported that regulators have relaxed guidance on profit growth for banks in Q3.** If this is the case, revenue growth could accelerate on the back of a solid macro recovery, rebounding investment yield, and robust loan growth.
- According to Reuters, **demand for Ant Group’s (6688 HK) IPO is strong and prompted the company to close the institutional order book of the Hong Kong portion one day earlier than scheduled.** Per the report, the company is seeking to raise about \$34.5 billion through IPOs in Shanghai and Hong Kong, a blockbuster listing that would be a record-setting IPO and make it one of the world’s most valuable financial companies. The securities will be listed on Nov. 5.
- **Samsung Electronics (0005930 KS),** the world’s largest maker of memory chips and personal electronics, **reported net income rose a better-than-expected 52%** to 9.27 trillion won (\$8.2 billion) in Q3 2020. **However, the company warned that demand from server customers will likely weaken** due to inventory correction. Management also forecast rising competition in mobile phones and consumer electronics and said it will have to boost marketing spending.



MARKET SCORECARD

Data as of October 29, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,310.11	-1.6%	2.5%	9.0%	25.3%
Dow Industrials (DJIA)	26,659.11	-4.0%	-6.6%	-1.5%	9.1%
Nasdaq	11,185.59	0.2%	24.7%	35.1%	58.7%
Russell 2000	1,561.58	3.6%	-6.4%	-1.0%	5.7%
S&P/TSX Comp	15,670.70	-2.8%	-8.2%	-4.6%	6.4%
FTSE All-Share	3,152.13	-4.0%	-24.9%	-21.7%	-18.1%
STOXX Europe 600	341.76	-5.4%	-17.8%	-14.2%	-3.9%
EURO STOXX 50	2,960.03	-7.3%	-21.0%	-18.3%	-6.2%
Hang Seng	24,586.60	4.8%	-12.8%	-8.2%	-0.9%
Shanghai Comp	3,272.73	1.7%	7.3%	10.8%	28.7%
Nikkei 225	23,331.94	0.6%	-1.4%	1.6%	10.3%
India Sensex	39,749.85	4.4%	-3.6%	-0.2%	16.7%
Singapore Straits Times	2,450.68	-0.6%	-24.0%	-23.3%	-17.8%
Brazil Ibovespa	96,582.20	2.1%	-16.5%	-10.2%	15.3%
Mexican Bolsa IPC	36,801.37	-1.8%	-15.5%	-16.1%	-16.1%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	1,867.81	-1.0%	23.1%	25.5%	51.9%
Silver (spot \$/oz)	23.28	0.2%	30.4%	30.7%	61.0%
Copper (\$/metric ton)	6,730.00	0.9%	9.4%	13.9%	8.9%
Oil (WTI spot/bbl)	36.17	-10.1%	-40.8%	-34.9%	-46.0%
Oil (Brent spot/bbl)	37.76	-7.8%	-42.8%	-38.7%	-51.2%
Natural Gas (\$/mmBtu)	3.31	31.1%	51.3%	27.5%	4.0%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.830%	14.6	-108.8	-100.9	-225.5
Canada 10-Yr	0.630%	6.9	-107.2	-97.1	-176.6
U.K. 10-Yr	0.221%	-0.8	-60.1	-49.0	-117.8
Germany 10-Yr	-0.636%	-11.4	-45.1	-28.5	-101.3
Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.20%	-0.1%	6.6%	7.3%	19.0%
U.S. Invest Grade Corp	1.98%	0.4%	7.0%	8.6%	23.7%
U.S. High Yield Corp	5.76%	0.6%	1.2%	3.3%	11.0%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	93.9170	0.0%	-2.6%	-3.9%	-2.8%
CAD/USD	0.7506	0.0%	-2.5%	-1.8%	-1.4%
USD/CAD	1.3323	0.0%	2.6%	1.8%	1.4%
EUR/USD	1.1673	-0.4%	4.1%	5.0%	2.6%
GBP/USD	1.2926	0.0%	-2.5%	0.5%	1.0%
AUD/USD	0.7028	-1.9%	0.1%	2.4%	-0.4%
USD/JPY	104.6300	-0.8%	-3.7%	-3.9%	-6.9%
EUR/JPY	122.1300	-1.2%	0.3%	0.9%	-4.4%
EUR/GBP	0.9031	-0.5%	6.8%	4.6%	1.6%
EUR/CHF	1.0691	-1.0%	-1.5%	-3.2%	-6.2%
USD/SGD	1.3668	0.1%	1.6%	0.3%	-1.2%
USD/CNY	6.7150	-1.1%	-3.6%	-5.0%	-3.6%
USD/MXN	21.3834	-3.3%	13.0%	11.9%	6.6%
USD/BRL	5.7776	3.0%	43.4%	52.9%	55.3%

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 10/29/20.

Examples of how to interpret currency data: CAD/USD 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD -2.5% return means the Canadian dollar fell 2.5% vs. the U.S. dollar year to date. USD/JPY 104.63 means 1 U.S. dollar will buy 104.63 yen. USD/JPY -3.7% return means the U.S. dollar fell 3.7% vs. the yen year to date.

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Hold [Sector Perform]	619	41.60	135	21.81
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