

Global Insight

Weekly

Shock absorption?

Kelly Bogdanova – San Francisco

While stock markets remain on a road littered with potholes, a confluence of catalysts has facilitated a forceful rebound. We size up the bounce in global equities, but we caution that this is no time to be complacent as plenty of uncertainties and risks could shake markets.

Most equity markets have rallied substantially since Mar. 23, the day many country and global indexes hit a low point. Since then, the S&P 500 has jumped 25.1 percent, while Canada's S&P/TSX has climbed 23.8 percent and Europe's main benchmark has bounced 15.9 percent—all in less than a month.

These moves have mitigated the damage that has occurred since global benchmark indexes reached all-time highs in mid-February. For example, instead of the S&P 500 being down 33.8 percent from the global peak to its low point, it is now down “only” 17.2 percent. Other markets have improved as well, as the chart illustrates.

Equities have bounced sharply for a number of legitimate reasons, and this is not an unusual phenomenon during major bear market periods of the past 20 years. In fact, the S&P 500's move is roughly in line with recent history.

But this is no time to be complacent about market risks, of which there are many. We continue to believe it is appropriate to hold equities at the Underweight level in portfolios—this is below the long-term strategic recommended level. The strength in equity markets allows those who are not yet Underweight to reposition portfolios.

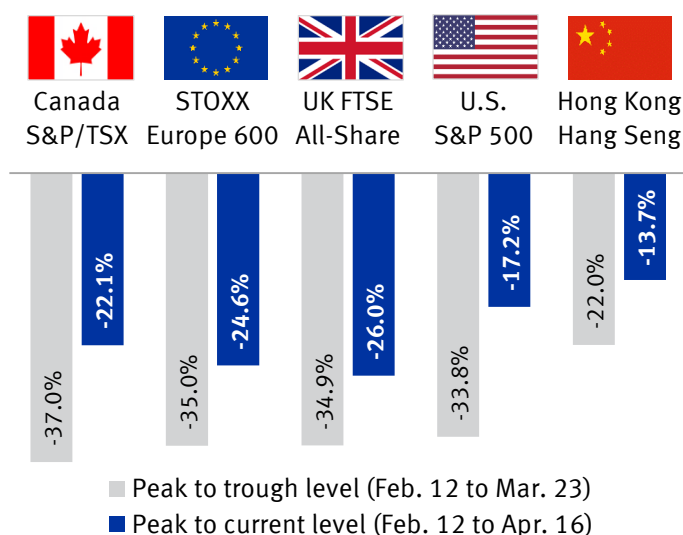
We outline the catalysts behind the recent rally, compare the moves to prior bear market periods, and discuss the lingering risks.

Morale boosters

The avalanche of negative COVID-19 news—that sometimes piled onto equity markets by the hour—has receded, and some

Equity indexes have recovered some of their lost ground

Index performance since the MSCI All-Country World Index peaked on Feb. 12, 2020



Source - RBC Wealth Management, Bloomberg

Market pulse

- 3 U.S. banks bracing for a recession
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- 4 Downgrading Japan equities to Market Weight

Click [here](#) for authors' contact information. Priced (in USD) as of 4/16/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see [page 6](#).**
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glimmers of light have started to shine through, boosting equity markets in the past few weeks:

- The spread of COVID-19 infections has eased in the U.S., Canada, and Western Europe. The daily number of deaths has declined in some of the hardest-hit areas, such as Italy, Spain, and New York.
- There are signs that some parts of major economies—whether it be in certain regions or a limited number of industries—could begin the process of opening up in weeks rather than months.
- The historic \$2.3 trillion in lending and bond purchase facilities recently announced by the Federal Reserve to shore up and support the credit market, including high-yield debt, was well received by equity markets. It removed the risk of an imminent credit crunch. Furthermore, market participants realize the Fed still has more arrows in its quiver.
- The OPEC+ deal to significantly cut oil production by 9.7 million barrels per day removed a potential negative from the crude oil and equity markets. Of course, the oil market remains quite weak due to the collapse in demand caused by COVID-19 shutdowns, but at least major oil-producing countries can begin the process of whittling down supply.

Understanding what this rally is

While the catalysts that drive bear market rallies differ dramatically from one bear market to the next, it's interesting that the magnitudes of the rallies are similar.

For example, during this COVID-19 crisis, the S&P 500 climbed 27.2 percent from Mar. 23 through Apr. 14, its recent high point.

During the bear market associated with the bursting of the tech bubble and 9/11 attacks, the S&P 500 rallied between 19.0 percent and 21.4 percent on three separate occasions, according to Bloomberg.

During the global financial crisis bear market, the S&P 500 staged two big rallies less than one month apart in late 2008. The first was an 18.5 percent move, followed by a separate 24.2 percent run.

Such moves provided opportunities to reposition portfolios until the full bear market cycles were flushed out of the system.

Potholes await

Despite the glimmers of hope and the slower pace of negative news lately, there are still a number of risks facing this COVID-19 bear market:

- The stream of negative economic data has only just begun. We believe market participants are bracing for record-breaking or near-record-breaking declines in a host of data in a number of countries, and for deep (and brief) recessions

in major economies. A lot of bad news is already factored into markets. But it's not yet clear if market participants are underestimating (or overestimating) the magnitude and duration of the economic retrenchments. Perhaps even more importantly, it is not yet clear whether they are gauging the recovery trajectories properly.

- The process to open up major economies is not without complications and health risks. Increasingly, business groups and some elected officials are calling for mass “testing, testing, testing” as a key requirement to get things moving again, but COVID-19 and antibody testing are not yet widespread in the U.S. and many other countries.
- The start of Q1 earnings season so far has revealed what market participants know—there is a lot of uncertainty about what Q2 earnings and beyond will look like. The 2020 Refinitiv I/B/E/S consensus estimate for the S&P 500 of \$142 per share has fallen meaningfully, and we think it will continue to push lower. RBC Capital Markets recently cut its 2020 estimate to \$135 per share, but there are downside risks to this estimate if the presumed economic rebound in the second half of the year is muted or pushed back.
- There is anecdotal evidence that many institutional investors are looking past the earnings valley of 2020, and ahead to 2021. This makes sense given equities should be valued on a multiyear stream of profits, not just on earnings for a couple of quarters or one year. But the view of 2021 is cloudy at this stage given the lingering risks associated with the opening up of major economies and the spread of the virus. Will there be additional COVID-19 outbreaks in the months ahead or next year? RBC Capital Markets has penciled in \$153 per share for the S&P 500 for 2021, and this estimate is dependent on any changes in the economic landscape.

Biding our time

We think the lingering uncertainties argue for keeping some powder dry, and holding equities at the Underweight level in portfolios.

In the near term, markets have to contend with weak economic data, a difficult Q1 earnings season, and uncertainties associated with unwinding mass quarantines. Over the longer term, we expect major economies and corporate profits to bounce back.



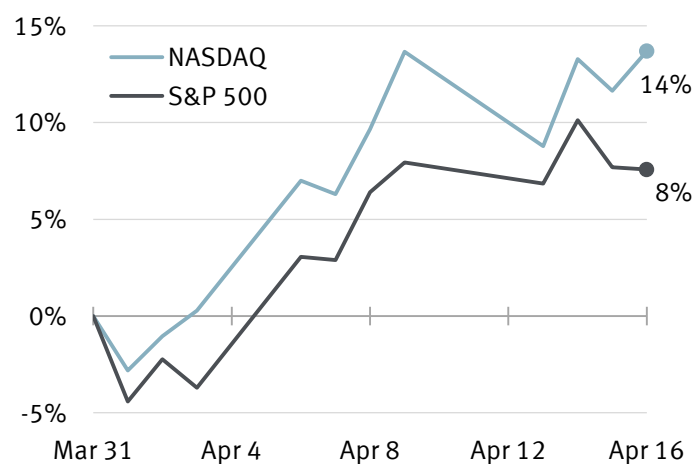
United States

Ben Graham, CFA – Minneapolis

- U.S. equity markets have shown a wide divergence in performance thus far this week with the **NASDAQ easily outpacing all other indexes** with its 4.6% gain. Both the S&P 500 and Dow Jones are within 1% of last week's closing levels, and small caps continue to sharply underperform given their decline of more than 5.5%. **Sector strength was most evident in Consumer Discretionary, greatly assisted by Amazon.com's near 20% weekly gain.** Health Care and Tech stocks also showed relative strength against the major indexes. Sector weakness was clear in the most cyclical sectors, as Energy, Financials, and Materials all declined at least 5%, as did Real Estate.
- A much anticipated earnings season kicked off this week with JPMorgan and UnitedHealth headlining the banking and Health Care releases. **A common theme so far, particularly for the banks, has been to deliver revenues at or above the levels seen in Q1 2019 with bottom-line earnings per share well below those reported a year ago.** In the Financials sector, this is related to banks increasing their loan loss reserves—money put away now and earmarked for possible losses later—in advance of a likely 2020 recession. **The 10 S&P 500 banks that have reported results thus far have increased reserves by \$23.5 billion in aggregate this quarter alone.** Specifically as it relates to JPMorgan, the company increased its reserves by \$6.8 billion and has positioned itself for an approximate 25% GDP contraction in Q2 with 10%-plus unemployment. JPMorgan is not alone in this reserve-building trend, but it is the only

NASDAQ outperforms S&P 500 as value lags growth

Month-to-date performance



Source - RBC Wealth Management, FactSet; data through 4/16/20 at 12:00 PM CST

company to highlight specific GDP and unemployment levels that it is currently prepared for.

- Economically speaking, **unemployment claims continue their rapid climb despite a modest deceleration in the pace.** After last week's increase of 6.6 million new unemployment claims, this week saw an increase of 5.2 million, bringing the total number of new claims since March began to 22.5 million. The very slender silver lining in the data is that unemployment is now in the second consecutive week of declining new claims after the 6.9 million mark two weeks ago and this week's report was actually better than consensus forecasts of 5.8 million.



Canada

Arete Zafiriou & Ryan Harder – Toronto

- COVID-19 and efforts to contain it disrupted Canadian business operations last month, and **the March jobs report showed employment falling by 1.01 million.** Notably, this includes 644,000 people who left the labor force—those who are not employed, but who are also not actively searching for a job. Accommodation and food services industries were hit the hardest, followed by the information, culture, and recreation industries. For reference, **since 1976, the largest previous decrease in nonfarm payrolls month-over-month was 125,000 in January 2009.** RBC Economics expects the April jobs report to show even greater losses, given another 3 million people reportedly applied for jobless benefits after the March survey period.
- The Bank of Canada (BoC) significantly increased its stimulus to the Canadian economy this week by launching a new Corporate Bond Purchase Program (CBPP) and Provincial Bond Purchase Program (PBPP).** Most provinces, which are seeing increased strains on healthcare spending while enduring substantial tax revenue declines, have seen their borrowing costs increase as the spread on provincial bonds relative to federal bonds had roughly doubled in the weeks leading up to Wednesday's BoC meeting. With stated maximums of CA\$50 billion (provincial) and CA\$10 billion (corporate), the programs follow similar initiatives from the U.S. Federal Reserve, which has been purchasing corporate bonds, ETFs, and even some high-yield bonds for weeks. **Provinces and corporations have already seen conditions improve on the back of the news,** with provincial and corporate credit spreads tightening by 20 basis points or more by the end of day Wednesday. Because banks are already receiving unique consideration from the BoC, their bonds are excluded from the CBPP, as are any securities rated below BBB.



Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- While lockdown conditions are widely expected to be extended in the UK, **a number of continental European countries (Germany, Spain, Austria, and Denmark) are starting to roll out the relaxation of containment measures.** More easing will require reliable testing and monitoring so as to manage a potential second and third wave of infections. Full easing will likely only come when vaccines are available, in the spring of 2021 at the earliest according to health experts.
- **In an attempt to quantify the impact of COVID-19 on the European economy, RBC Capital Markets has modeled five scenarios** with varying durations of full lockdowns and post-lockdown social distancing measures. The most likely scenario (40% probability), in its view, has lockdowns in place until the end of May, with social distancing continuing from June to September, after which the economy would return to 97% of potential. Its base-case scenario is the weighted average of the five scenarios, which range from the above to two that take into account the possibility of a second wave of the epidemic. **This base case points to euro area GDP contracting by 13.6% y/y in 2020** and then bouncing back by 15.1% in 2021.
- **The consensus currently expects continental European earnings to decline by 13.5% y/y in 2020. We believe this is much too optimistic** given the high proportion of cyclical companies in the MSCI Europe ex UK Index—the actual earnings contraction is likely to be a multiple of that. As Q1 earnings season starts in earnest, few companies have felt bold enough to issue guidance for full-year 2020. But more than earnings themselves, we believe investors should focus on balance sheet quality, as well as the ability of companies to generate cash flow or have enough liquidity to survive the upcoming months of subdued economic activity.



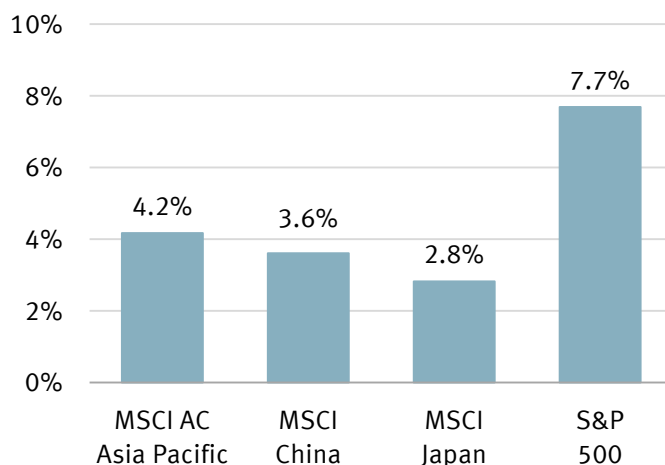
Asia Pacific

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

- **Asia Pacific equity markets have traded mostly higher during the week, led by New Zealand and Taiwan.** New Zealand has seen a slowdown in the spread of COVID-19 and there are signs that the government may partially lift the country's lockdown as early as next week. **Taiwan reported no new cases of COVID-19 for the first time in more than a month on Apr. 14**, in the latest sign that the island's early and effective prevention methods have paid off.

Asian equities rally in April, but lag the U.S.

Month-to-date performance



Source - RBC Wealth Management, FactSet; data through 4/15/20

- **The People's Bank of China stepped up its accommodative monetary policy** by lowering one-year medium-term lending facility loans to financial institutions to a record-low rate of 2.95% and reducing the amount banks must hold as reserves by around \$28 billion. Observers believe the easing moves were in preparation for a series of **potentially very weak economic data due to be released soon.** Elsewhere, **new home prices in China rose 0.13% m/m in March** as pent-up demand after a period of restrictions during the height of the country's COVID-19 epidemic supported sales. Despite the uptick, we believe it remains to be seen if there will be a full rebound in home prices, as the Chinese leadership continues to discourage home speculation and risks remain that some provinces may have to shut down again should there be a second surge in virus cases.
- **The Global Portfolio Advisory Committee has downgraded Japan equities from Overweight to Market Weight.** The Committee is of the view that Japan equities will likely trade in ranges in the short-to-medium term. While the Abe administration and the Bank of Japan have weighed in with unprecedented measures to support the economy and the financial market, sustainable upside is unlikely at least until COVID-19 is contained in Japan. As highlighted in the previous [Global Insight Weekly](#), **we expect the state of emergency (which has since been extended to the entire country) to drag Japan into a deeper recession in 2020.**



MARKET SCORECARD

Data as of April 16, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,799.55	8.3%	-13.3%	-3.7%	4.5%
Dow Industrials (DJIA)	23,537.68	7.4%	-17.5%	-11.0%	-4.2%
NASDAQ	8,532.36	10.8%	-4.9%	6.7%	19.2%
Russell 2000	1,178.09	2.2%	-29.4%	-25.6%	-24.6%
S&P/TSX Comp	13,899.32	3.9%	-18.5%	-15.8%	-9.2%
FTSE All-Share	3,102.13	-0.2%	-26.1%	-24.2%	-21.9%
STOXX Europe 600	324.92	1.5%	-21.9%	-16.5%	-14.0%
EURO STOXX 50	2,812.35	0.9%	-24.9%	-18.8%	-18.3%
Hang Seng	24,006.45	1.7%	-14.8%	-20.3%	-20.8%
Shanghai Comp	2,819.94	2.5%	-7.5%	-13.3%	-9.3%
Nikkei 225	19,290.20	2.0%	-18.5%	-13.2%	-11.7%
India Sensex	30,602.61	3.8%	-25.8%	-22.1%	-10.8%
Singapore Straits Times	2,612.25	5.3%	-18.9%	-21.6%	-25.3%
Brazil Ibovespa	77,811.90	6.6%	-32.7%	-17.5%	-6.1%
Mexican Bolsa IPC	33,759.75	-2.3%	-22.5%	-25.0%	-30.3%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	1,717.90	8.9%	13.2%	34.5%	27.6%
Silver (spot \$/oz)	15.46	10.6%	-13.4%	3.0%	-7.3%
Copper (\$/metric ton)	5,082.00	2.9%	-17.4%	-21.4%	-26.1%
Oil (WTI spot/bbl)	19.87	-3.0%	-67.5%	-69.0%	-70.0%
Oil (Brent spot/bbl)	28.17	23.9%	-57.3%	-60.7%	-60.6%
Natural Gas (\$/mmBtu)	1.69	3.0%	-22.8%	-34.3%	-38.6%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.617%	-5.2	-130.0	-197.3	-220.9
Canada 10-Yr	0.610%	-8.7	-109.2	-117.3	-166.4
U.K. 10-Yr	0.302%	-5.4	-52.0	-91.7	-116.1
Germany 10-Yr	-0.474%	-0.3	-28.9	-54.0	-99.9
Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.41%	1.6%	4.8%	11.3%	15.9%
U.S. Invest Grade Corp	2.74%	4.9%	1.1%	10.2%	15.5%
U.S. High Yield Corp	8.02%	5.2%	-8.1%	-3.2%	2.5%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	100.0960	1.1%	3.8%	3.1%	11.9%
CAD/USD	0.7080	-0.4%	-8.0%	-5.5%	-11.0%
USD/CAD	1.4123	0.4%	8.7%	5.8%	12.4%
EUR/USD	1.0831	-1.8%	-3.4%	-4.0%	-12.5%
GBP/USD	1.2446	0.2%	-6.1%	-4.6%	-13.2%
AUD/USD	0.6305	2.8%	-10.2%	-12.1%	-19.0%
USD/JPY	107.8200	0.3%	-0.7%	-3.7%	0.7%
EUR/JPY	116.7800	-1.6%	-4.1%	-7.6%	-11.9%
EUR/GBP	0.8703	-2.0%	2.9%	0.7%	0.8%
EUR/CHF	1.0509	-0.9%	-3.2%	-7.6%	-11.6%
USD/SGD	1.4285	0.5%	6.1%	5.5%	9.0%
USD/CNY	7.0814	0.0%	1.7%	5.5%	12.8%
USD/MXN	24.1626	2.1%	27.7%	28.0%	34.2%
USD/BRL	5.2530	0.9%	30.3%	39.0%	53.6%

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 9:35 pm GMT 4/16/20.

Examples of how to interpret currency data: CAD/USD 0.70 means 1 Canadian dollar will buy 0.70 U.S. dollar. CAD/USD -8.0% return means the Canadian dollar fell 8.0% vs. the U.S. dollar year to date. USD/JPY 107.82 means 1 U.S. dollar will buy 107.82 yen. USD/JPY -0.7% return means the U.S. dollar fell 0.7% vs. the yen year to date.

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			Count	Percent
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Hold [Sector Perform]	619	42.34	126	20.36
Sell [Underperform]	88	6.02	11	12.50

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