July 30, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

Post-traumatic economic stress

Kelly Bogdanova – San Francisco

After the shock of a sharp Q2 contraction in U.S. GDP, signs point to a prolonged COVID-19 convalescence for the world's largest economy. Meanwhile, prospects for other economies appear mixed. We take a look at RBC Global Asset Management's revised GDP forecasts, and discuss how to position portfolios.

The U.S. economy's Q2 COVID-19 crash was about as bad as economists had expected—but that doesn't make it feel any better. GDP plunged 32.9 percent (q/q annualized) based on preliminary data, by far the worst decline since the Bureau of Economic Analysis (BEA) began collecting comparable quarterly data in mid-1947. The previous low was -10 percent in early 1958.

This plunge, combined with the five percent retrenchment in Q1 of this year, wiped out three years of economic growth. The size of the economy is back to what it was in Q2 2017.

Now that we know what we already thought we knew about Q2, the bigger questions are: How long will it take to climb out of the pit, and how does the U.S. stack up against other major economies?

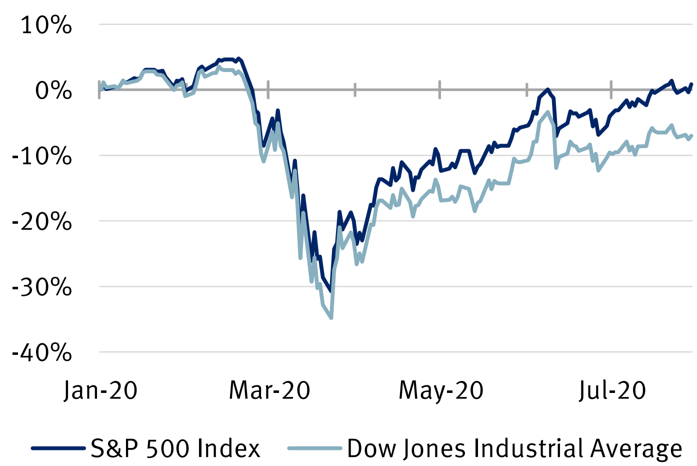
U.S. recovery prospects pushed back

Despite the equity market's swift and impressive V-shaped rally following an unprecedented torrent of monetary and fiscal stimulus, RBC Global Asset Management (RBC GAM) sees a full economic recovery taking longer than previously thought.

The real-time indicators RBC GAM tracks show renewed COVID-19 shutdowns have caused U.S. economic activity to retreat slightly in July. There is uncertainty about the remaining months of Q3 given the trajectory of infections and the possibility state and local leaders could extend restrictions or tighten them further. The ongoing outbreak has also inspired additional caution among the public.

U.S. stocks have climbed a wall of worry

Year-to-date U.S. equity performance (%)



Source - RBC Wealth Management, Bloomberg; data through 7/29/20

Market pulse

Click here for authors' contact information. Priced (in USD) as of 7/30/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6.**
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At this stage, RBC GAM Chief Economist Eric Lascelles forecasts U.S. GDP will decline 8.0 percent y/y in 2020, down from his previous forecast of -7.1 percent. This would be the biggest hit to annual GDP since the 11.6 percent slide in 1946.

Lascelles recently wrote, "We assume the economy begins to stabilize in August and then starts to edge forward thereafter, but remains behind schedule relative to most other countries. Instead of half of the economic decline being recovered in July, it takes until November to reach that point."

It will take much longer to claw back the rest of the lost ground. By mid-2022, U.S. GDP should be back up to where it was before the COVID-19 crisis began, according to RBC GAM. Previously, it had anticipated this would occur by December 2021.

The return to "normal" activity—the point at which all remaining economic slack is wrung out of the system—wouldn't occur until the start of 2024, according to Lascelles. He had previously targeted mid-2022.

Lascelles added, "This is still notably faster than after the global financial crisis, but hardly 'fast.' In all of this, we assume the U.S. avoids any severe fiscal cliffs …"

Other economies face diverse challenges

Outside the U.S., the outlook is better in some places and worse in others.

China is the standout to the upside. Despite a brief and strict COVID-19 lockdown early in the year and a related 6.8 percent y/y economic contraction in Q1, official statistics indicate the economy grew 3.2 percent y/y in Q2.

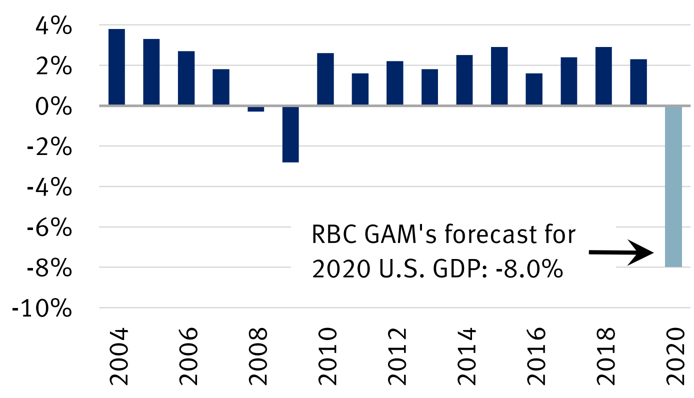
Lascelles wrote of China, "Keep in mind the country grappled with COVID-19 earlier than everyone else, such that Q2 was a recovery quarter, in contrast to elsewhere when it was the trough quarter. Still, the fact that the Chinese economy is larger than a year ago is remarkable. Granted, the economy would normally be perhaps six percent larger than the year before, so something has been lost. But not a great deal."

But he doubts China's quick bounce-back will be replicated elsewhere, noting that, "It is probably not reasonable to expect other countries to manage so complete a recovery over the same timeframe—quarantines elsewhere have been less thorough and developed world economies are more reliant on such sectors as tourism and entertainment that will not be able to fully recover in the near term."

Back in North America, Canada's economic prospects now look somewhat "less bad" than those of the U.S. The forecast from RBC GAM calls for GDP to decline 6.8 percent y/y in 2020, which is a full two percentage point improvement from its previous estimate, and better than the -8.0 percent forecast for the U.S.

No surprise, U.S. growth will take a hit

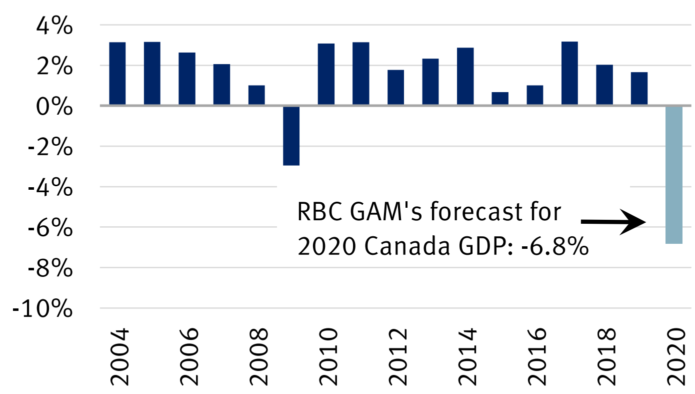
U.S. real GDP (annual year-over-year % change)



Source - RBC Wealth Management, Bloomberg (historical data), RBC Global Asset Management (RBC GAM - 2020 forecast)

Canadian growth likely "less bad" than the U.S.

Canada real GDP (annual year-over-year % change)



Source - RBC Wealth Management, Bloomberg (historical data), RBC Global Asset Management (RBC GAM - 2020 forecast)

The European Union's recovery path has also improved. Preliminary data show that services and manufacturing activity climbed into expansion territory in July, with the former well exceeding economists' consensus forecast. We think the recently agreed to landmark fiscal package will also assist the recovery. RBC GAM upgraded its forecast for EU GDP to a decline of 6.6 percent y/y in 2020. The UK's outlook, however, remains particularly challenging; RBC GAM forecasts a GDP decline of 8.7 percent.

Implications for asset allocation

We think the lingering economic uncertainties support a modest Underweight position in U.S. and global (total) equities in portfolios. We continue to recommend a Market Weight position in Europe due to relatively better valuations and the recent clearing of fiscal hurdles, and we would Overweight Asia ex Japan, in part due to China's better economic prospects.

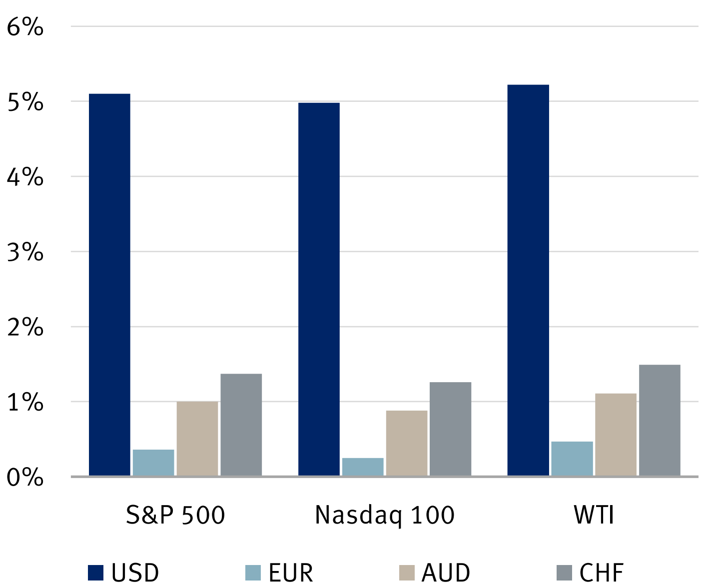
United States

Atul Bhatia, CFA – Minneapolis

- **There were few surprises from this week's Federal Reserve Board meeting**, as the Fed kept policy rates and asset purchase amounts unchanged and reiterated its willingness to use all tools at its disposal to assist the economy. In his post-meeting press conference, Fed Chair Jerome Powell emphasized the likely long-term nature of the economic recovery, the sensitivity of employment and consumption to upticks in coronavirus cases, and the critical need for both fiscal and monetary support at this time.
- **While recent monetary policy has been characterized by stability and predictability, the path of fiscal policy is murkier.** The immediate focus is on the $600 weekly federal supplement to state unemployment benefits. With the payments—which amount to approximately $100 billion per month of stimulus—scheduled to expire nationwide on July 31, Congressional leaders are signaling large differences in the two parties' respective proposals and little progress in negotiations. Fiscal transfers to lower-income workers are historically spent at a very high rate, so a full or partial lapse of the policy will likely have an immediate negative impact on personal spending.
- **The pandemic may end up slightly pushing back the Fed's discussion of its ongoing review of monetary policy strategy and communication.** The recommendations from the review—which had been expected at the September meeting—will likely center on enhancing the Fed's guidance on the future path of interest rates, possibly by conditioning rate hikes on specific targets for unemployment, growth, or inflation. Other policies—such as incorporating historic inflation results into rate setting—will be discussed but are less likely to make the official policy toolkit, in our opinion.
- **The Fed's aggressive monetary response** has caught the attention of foreign exchange markets. **The U.S. Dollar Index**—a blended exchange rate against a basket of world currencies—**is down over 4% this month and at its lowest level since 2018**. For non-dollar-based investors, this currency weakness has cut into many of the gains their dollar-based counterparts have enjoyed.

July rally or fading dollar?

Month-to-date returns highlight currency impact



Source - RBC Wealth Management, Bloomberg; data through 7/29/20

Canada

Arete Zafiriou & Richard Tan, CFA – Toronto

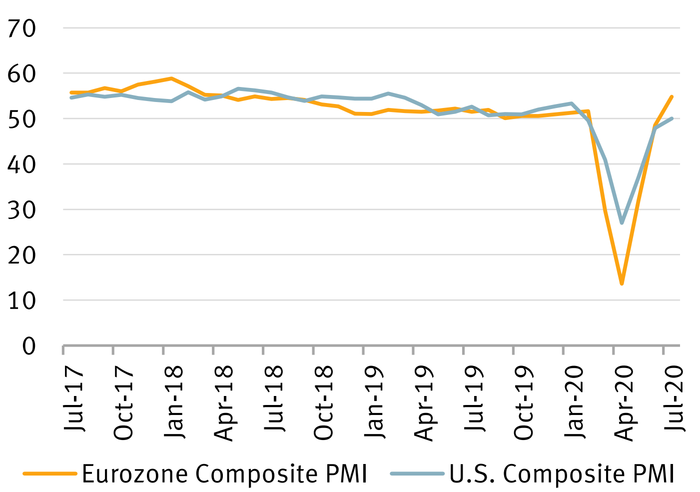
- **Q2 2020 earnings season is ramping up in the Canadian market** with about 20% of the S&P/TSX Composite having reported. Not surprisingly, many companies have been posting top- and bottom-line year-over-year declines given the economic slowdown. However, this is not necessarily the case for all sectors, as **Information Technology and Materials have flourished** in the current environment driven by increased demand for e-commerce and precious metals (e.g., gold and silver). Information Technology and Materials have also been the best-performing sectors year to date, returning approximately 65% and 31%, respectively. This compares to the S&P/TSX Composite which remains in the red on the year but has recovered significantly from its March lows. On the other end of the sector spectrum, Energy, Health Care, and Real Estate have significantly underperformed in 2020.
- **Canadian home sales rebounded off April and May lows in June**. After falling 57% y/y in April, and 39% y/y in May, home sales increased 15% y/y in June. RBC Capital Markets attributes the growth to pent-up demand from the spring, further declines in mortgage rates, increased buying ahead of the Canada Mortgage and Housing Corporation's tightening of mortgage rules that went into effect on July 1, and upsizing as homebuyers spend more time at home amid the COVID-19 pandemic. **RBC Capital Markets expects home sales to remain robust through the summer**, but it is cautious looking past the next few months as mortgage payment deferrals and other financial support programs are set to expire by the fall. Residential mortgage loans are up 6.0% y/y as of May 31, but RBC Capital Markets forecasts weaker growth over the next 12 months as elevated unemployment levels and weak economic activity weigh on the housing market.

Europe

Thomas McGarrity, CFA & Blaine Karbonik, CFA – London

- **The latest euro area Purchasing Managers' Index survey data beat consensus expectations for the third consecutive month**, adding to the positive momentum in the region. The July "flash" Composite reading rose **well above pre-COVID-19 levels** to reach a two-year high, suggesting economic activity has bounced back faster than expected in the bloc. However, with most European countries having relaxed social distancing measures, the thrust from the re-opening of economies is **set to fade in coming months**, leaving improving demand to do the heavy lifting in the next stage of the recovery.
- The twin effect of the **recent upbeat economic data and the agreement on the EU Recovery Fund has helped propel European currencies higher**, with the euro strengthening nearly 5% against the U.S. dollar in July so far. A good deal of euro-specific positive news, political and economic, is now priced into the currency, and with **investors holding the euro net long at substantial levels**, further upside could be limited, in our view.
- The Q2 earnings season in Europe is in full swing, and one trend so far is **consumer goods companies generally reporting better-than-expected Q2 results**. Shares of global brewing giant **Anheuser-Busch InBev** outperformed on July 30 following the company reporting Q2 sales declined by less than the consensus forecast and its volumes sequentially improved as it moved through the quarter (-32.4% in April, -21.1% in May, +0.7% in June) as lockdowns eased. **Nestlé's** organic sales and profit results were slight beats to consensus expectations, with the largest growth contribution coming from its pet care brand Purina, while a double-digit sales increase for its at-home coffee products outweighed a sharp decline in the out-of-home channel. **Reckitt Benckiser** reported group like-for-like sales growth of almost 12% for H1 2020 as the COVID-19 crisis led to surging demand for the company's disinfectant cleaning products (e.g., Dettol and Lysol).

Deeper trough, sharper bounce—European PMI leads the U.S.



Source - RBC Wealth Management, Bloomberg, Markit

Asia Pacific

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

- **Asia Pacific equity markets have traded mostly higher during the week**, led by Taiwan and China. The TAIEX reached an all-time high this week, lifted by the strong rally in Taiwan Semiconductor Manufacturing Company (2330 TT, +12.4% week to date) which represents close to 30% of the index weight.
- **Hong Kong's economy contracted for the fourth straight quarter** as the COVID-19 pandemic and political tensions continued to weigh on sentiment and activity. According to an advance reading from the Census and Statistics Department, Q2 2020 GDP contracted 9% y/y, missing the median consensus forecast of -8.3%. Separately, **Hong Kong's chief executive warned on Wednesday that the city is on the brink of a large-scale coronavirus outbreak** and urged people to stay indoors as strict new distancing measures take effect. With the number of new virus cases rising again in July, domestically and overseas, we think the Q3 GDP outlook remains very challenging.
- **Rating agency Fitch revised its outlook on Japan's long-term foreign currency debt rating to negative from stable while reaffirming its A rating**. Fitch expects Japan's GDP to contract 5% y/y in 2020 followed by a 3.2% rebound in 2021. While most economic indicators bottomed in April and May, we note the recovery has slowed. We expect private consumption to remain below the pre-crisis level for the rest of 2020 on the back of persistent fears of infection and a less supportive household income.
- **The Monetary Authority of Singapore has called on local banks to cap their total dividends per share for FY2020 at 60% of the amount in the previous financial year** while offering shareholders the option to receive the dividends in scrip in lieu of cash. The announcement came despite stress tests showing the banks remain well capitalised under adverse scenarios. We view the latest move as both pre-emptive and precautionary. While disappointing to some investors, we believe the move **will put the banks in a stronger capital position** for FY2021.

MARKET SCORECARD

Data as of July 30, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,246.22	4.7%	0.5%	7.7%	15.8%
Dow Industrials (DJIA)	26,313.65	1.9%	-7.8%	-3.3%	4.0%
NASDAQ	10,587.81	5.3%	18.0%	28.0%	38.8%
Russell 2000	1,495.10	3.7%	-10.4%	-5.7%	-9.6%
S&P/TSX Comp	16,299.29	5.1%	-4.5%	-1.0%	-0.3%
FTSE All-Share	3,325.68	-2.5%	-20.8%	-20.1%	-21.4%
STOXX Europe 600	359.52	-0.2%	-13.5%	-6.6%	-8.0%
EURO STOXX 50	3,208.20	-0.8%	-14.3%	-7.4%	-8.7%
Hang Seng	24,710.59	1.2%	-12.3%	-12.2%	-14.0%
Shanghai Comp	3,286.82	10.1%	7.8%	11.3%	14.6%
Nikkei 225	22,339.23	0.2%	-5.6%	2.9%	-0.9%
India Sensex	37,736.07	8.1%	-8.5%	0.9%	0.6%
Singapore Straits Times	2,529.82	-2.3%	-21.5%	-24.5%	-23.5%
Brazil Ibovespa	105,008.70	10.5%	-9.2%	2.0%	30.8%
Mexican Bolsa IPC	37,136.78	-1.5%	-14.7%	-9.8%	-25.3%

Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot $/oz)	1,955.73	9.8%	28.9%	36.7%	60.1%
Silver (spot $/oz)	23.44	28.7%	31.3%	41.5%	51.4%
Copper ($/metric ton)	6,482.00	8.0%	5.4%	9.4%	4.2%
Oil (WTI spot/bbl)	39.92	1.7%	-34.6%	-31.2%	-43.1%
Oil (Brent spot/bbl)	43.24	5.1%	-34.5%	-33.2%	-42.3%
Natural Gas ($/mmBtu)	1.83	4.6%	-16.3%	-14.3%	-34.5%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.541%	-11.5	-137.6	-151.7	-243.2
Canada 10-Yr	0.446%	-8.2	-125.6	-104.8	-185.3
U.K. 10-Yr	0.088%	-8.4	-73.4	-54.6	-125.5
Germany 10-Yr	-0.542%	-8.8	-35.7	-14.3	-98.8
Fixed Income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.10%	1.3%	7.5%	10.0%	18.9%
U.S. Invest Grade Corp	1.90%	2.9%	8.1%	12.4%	24.0%
U.S. High Yield Corp	5.46%	4.3%	0.3%	3.8%	11.0%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	92.9580	-4.6%	-3.6%	-5.2%	-1.5%
CAD/USD	0.7448	1.1%	-3.2%	-2.0%	-2.9%
USD/CAD	1.3426	-1.1%	3.4%	2.1%	3.0%
EUR/USD	1.1847	5.5%	5.7%	6.2%	1.2%
GBP/USD	1.3095	5.6%	-1.2%	7.8%	-0.3%
AUD/USD	0.7192	4.2%	2.4%	4.7%	-2.9%
USD/JPY	104.7200	-3.0%	-3.6%	-3.6%	-5.7%
EUR/JPY	124.0700	2.3%	1.9%	2.4%	-4.6%
EUR/GBP	0.9046	-0.1%	6.9%	-1.5%	1.5%
EUR/CHF	1.0771	1.2%	-0.8%	-2.5%	-6.9%
USD/SGD	1.3721	-1.5%	1.9%	0.1%	0.8%
USD/CNY	7.0088	-0.8%	0.7%	1.8%	2.8%
USD/MXN	22.0391	-4.1%	16.4%	15.6%	18.9%
USD/BRL	5.1542	-5.7%	27.9%	36.4%	38.2%

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 7/30/20.

Examples of how to interpret currency data: CAD/USD 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD -3.2% return means the Canadian dollar fell 3.2% vs. the U.S. dollar year to date. USD/JPY 104.72 means 1 U.S. dollar will buy 104.72 yen. USD/JPY -3.6% return means the U.S. dollar fell 3.6% vs. the yen year to date.

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As of June 30, 2020

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Buy [Outperform]	776	51.63	238	30.67
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Sell [Underperform]	92	6.12	12	13.04

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