February 13, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

The resilient rudder

Kelly Bogdanova – San Francisco

The U.S. expansion continues to plow ahead, and investors are finding solace in its resiliency as growth elsewhere underwhelms. While one downside to this positive sentiment has caught our eye, we look at why the U.S. economy should continue to be a guiding force for U.S. stock market gains.

Investors around the world are increasingly thinking of the U.S. as a "safe haven," and not just the Treasury market, which has long been referred to this way. According to RBC Capital Markets, the U.S. economy as a whole is now perceived as having "safe-haven" characteristics—and, importantly, this positive sentiment is spilling into the stock market as well.

While easing concerns about the spread of the coronavirus (COVID-19) outside of China have helped lift the S&P 500 to new all-time highs lately, we think this notion of domestic economic resilience has played an even greater role in boosting the market. The S&P 500 has rallied 4.4 percent so far this year, while other markets have collectively slipped 0.3 percent, as measured by the FTSE All-World ex-U.S. Index.

This sentiment—whether fully warranted or not—is unlikely to dissipate anytime soon considering the domestic expansion is poised to persist and other major economies are facing headwinds.

We believe this should help the U.S. equity market deliver at least moderate returns this year—albeit amid any volatility that could arise due to global economic forces or transitory factors such as the coronavirus.

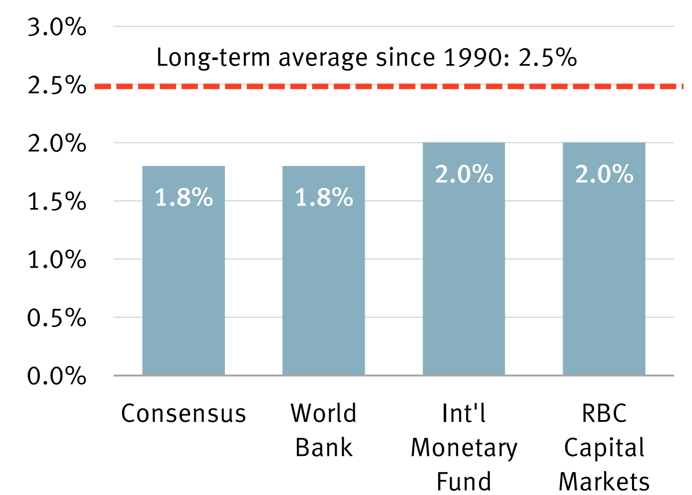
Good vibrations

The positive attitude about the U.S. comes despite expectations that domestic economic activity could trail last year's pace.

RBC Capital Markets forecasts 2020 GDP growth of 2.0 percent, down from 2.3 percent in 2019 and below the 2.5 percent long-term average since 1990. The consensus estimate of economists

Economists anticipate below-average growth

2020 U.S. annual real GDP growth forecasts (y/y %)



Source - RBC Capital Markets, Bloomberg (consensus), World Bank, International Monetary Fund

Market pulse

Click here for authors' contact information. Priced (in USD) as of 2/13/20 market close, ET (unless otherwise stated). **For important disclosures and required non-U.S. analyst disclosures, see page 6.**
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and the projection by the World Bank are more subdued, both calling for only 1.8 percent GDP growth this year.

Nevertheless, since the Phase 1 trade deal with China, CEO confidence in the economy, expectations for capital spending, and hiring intentions have crept up. Also, pockets of weakness that surfaced last year, particularly in the manufacturing sector, have improved.

U.S. consumers have carried a disproportionate load this expansion cycle, as the chart illustrates, and we think this will persist in 2020. Employment and wage growth trends remain healthy.

Relative refuge

We think the "safe-haven" perceptions about the U.S. are partly the result of a "best house in a so-so neighborhood" phenomenon because other key economies face headwinds.

China is expected to slow materially due to the coronavirus outbreak and lingering structural challenges. Given the information that's been released about the virus thus far, RBC Global Asset Management forecasts China GDP growth of 3.0 percent in Q1 instead of the usual 6.0 percent level. It anticipates full-year 2020 growth will slow to 5.6 percent from its prior 5.9 percent estimate and 6.1 percent last year. The Chinese government seems committed to stimulating the economy, and has the capacity to do so, in our view.

Europe's economy has stabilized and some green shoots have even sprouted lately. But it is still likely to only muddle along this year. RBC Capital Markets forecasts a paltry 1.0 percent growth rate for the euro area in 2020, down from 1.2 percent last year.

India's economy—more important than is often given credit—is also in retreat. RBC Global Asset Management estimates GDP growth will drift down to 5.5 percent in 2020 from 6.1 percent in 2019 and a 7.2 percent average rate since 2009.

Too many good vibrations?

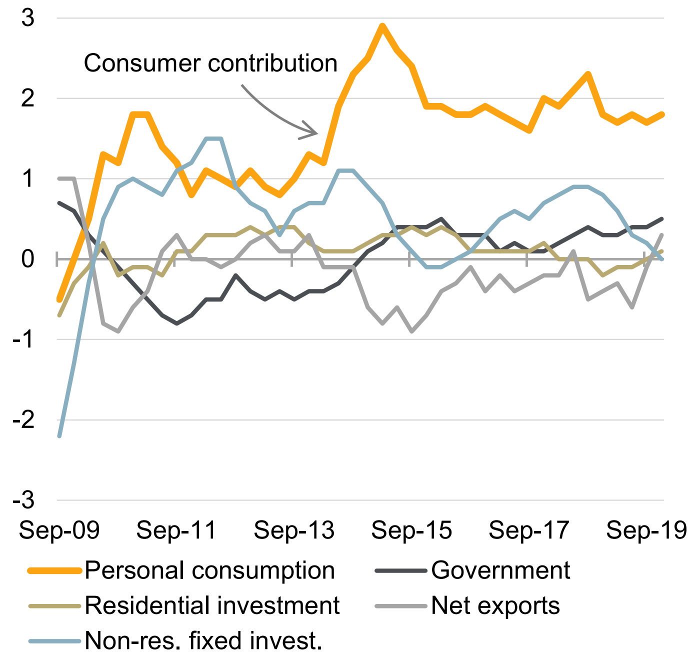
There is a downside to the so-called "safe-haven" sentiment.

While we think it has resulted in money flowing into the U.S. market that may have otherwise found different destinations, it has also brought about highly euphoric positioning among institutional investors in U.S. equities.

According to RBC Capital Markets, an important proxy for attitudes and positioning of institutional investors is at the highest level since at least 2006. Specifically, this is indicated by asset managers' net long position in S&P futures. This measure became elevated in late 2019, and in January it surged well beyond the peaks in previous years.

Consumers have carried the biggest load

Contribution to U.S. real GDP growth during this expansion cycle (in percentage points)



Source - Bloomberg Intelligence, Bureau of Economic Analysis, RBC Wealth Management; quarterly data through 12/31/19

Effectively, this means institutional investors have much more bullish positioning in U.S. equities than normal. Euphoric sentiment can be a contrary indicator for market performance. In such circumstances, at the very least, the market is more vulnerable to a pullback if bad news hits.

Support system

Even if a pullback materializes in the coming months, the good news is the U.S. equity market is more correlated to GDP trends over time than many other major markets.

Since 1990, there has been a nearly 60 percent correlation between S&P 500 performance and GDP growth, whereas the correlation is under 40 percent for markets in Europe, a study by RBC Capital Markets found.

While continued economic growth is no guarantee the U.S. equity market will follow along in lockstep, we think it does provide a foundation for at least moderate or average returns in 2020—albeit with some volatility along the way.

United States

Alan Robinson – Seattle

- **The U.S. stock market hit new highs again during the week, prompting investors to scrutinize and justify the historically high valuation of the broad market.** RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina addressed this in her monthly deep dive. In her most recent survey of institutional investors, she noted that only 11% of respondents viewed U.S. equity valuations as attractive or very attractive.

- Calvasina noted that the recent rotation into equities by tactical fund managers was largely funded by a reduction in bond allocations. In our view, this gets to the heart of the justification for **current stock valuations—they may look expensive in isolation, but they look inexpensive relative to the low level of interest rates.** We believe that as long as interest rates resist moving significantly higher, stocks can continue to yield positive returns, and perhaps trade back up to the valuation level highs seen over the past six years.

- Given the importance of the U.S. consumer to the strength of the economy, any data that casts shade on consumers' likely spending power gets our attention. The release of a report on credit card debt by the New York Fed during the week was one such example. The report notes that total **credit card balances have risen to $927 billion, well above the peak seen prior to the 2008 financial crisis**. It also notes that the proportion of debt overdue by 90 days or more rose to an eight-year high of 5.3%.

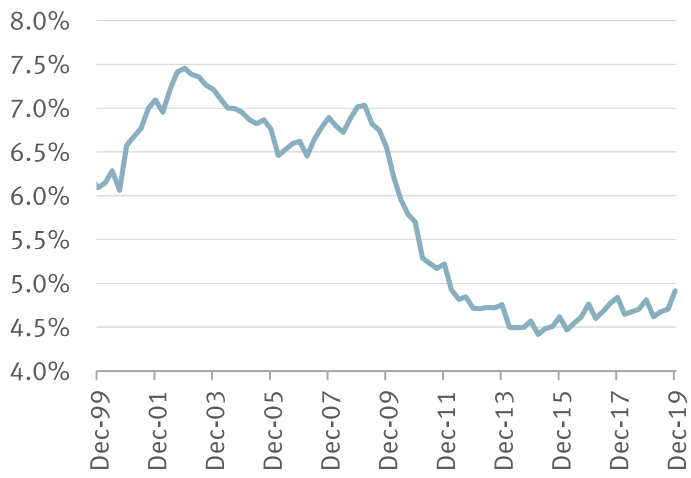
- However, it is important to put this figure in context. While the delinquency rate has indeed trended higher, personal incomes have grown even more strongly during this cycle. Consequently, **credit card debt as a share of total personal income has only increased slowly**, and is still far below the levels seen prior to the 2008 crash (see chart).

- In political news, **Senator Bernie Sanders won the New Hampshire Democratic primary, but underperformed expectations**. The centrist candidates, former South Bend, Ind., Mayor Pete Buttigieg and Senator Amy Klobuchar, finished second and third, respectively, and performed better than expected. This provided some support to U.S. equity markets, as some of Sanders' fiscal and regulatory policies have spooked institutional investors.

- However, the eventual outcome of the contest to challenge U.S. President Donald Trump won't be clearer until a majority of states have weighed in, likely after the "Super Tuesday" primaries on March 3.

Credit card delinquencies are rising, but overall debt levels are still low

U.S. credit card debt as a percentage of personal income



Source - Haver Analytics, RBC Economics, RBC Wealth Management; quarterly data through 12/31/19

Canada

Carolyn Schroeder & Richard Tan, CFA – Toronto

- **The current Canadian earnings season is well underway**, with approximately 20% of the S&P/TSX Composite Index having reported thus far. **Results have been generally in line with or slightly better than consensus expectations**. Year to date, the S&P/TSX is up approximately 4%, but market participants will likely pay close attention to the upcoming results of the Financials and Energy sectors as these two together make up roughly half of the index. With earnings season in full bloom, headline risks of further escalation in the coronavirus outbreak continue to be center stage. The total number of confirmed cases has crossed the 40,000 threshold on a global basis, far exceeding the scale of the SARS outbreak back in 2003.

- The longer the **coronavirus outbreak** disrupts China's economy and economic activity, the greater the potential for a temporary spillover into other countries, including Canada. At this point, the **economic impact in Canada looks limited to a pullback in international air travel, along with some disruption to industrial supply chains** as a result of production interruptions in China. First, we expect China-Canada bilateral travel to decline, and Air Canada has already announced the suspension of all flights to Beijing and Shanghai until at least the beginning of March, joining a growing list of airlines globally cutting flights to and from China. Second, **concerns about Chinese fuel demand have pushed global oil prices lower**, with WTI crude now trading around $52/barrel, versus closer to $60/barrel ahead of the outbreak. While that drop should be temporary, it will presumably reduce revenue for the Canadian oil & gas sector in the near term. For now, the negative economic fallout in Canada from the coronavirus will just **add to an already soft economic growth backdrop that RBC Economics thinks is putting the Bank of Canada in a position to cut the policy rate by midyear**.

Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- **Political developments dominated recent European news.** The leader of Germany's Christian Democratic Union (CDU) and prime contender to become the next chancellor, Annegret Kramp-Karrenbauer, resigned from her post following a scandal in local elections. Changes within the CDU do not impact German Chancellor Angela Merkel's ruling coalition, which is widely expected to complete its term ending in September 2021. The policies of the key contenders to lead the CDU do not differ materially, and the chosen candidate is likely to run for the chancellorship at the next election.

- Nevertheless, **this news and the result of the Irish elections weighed on the euro**, which reached a 33-month low of 1.0874 against the dollar. **Sinn Féin, the party traditionally linked to the IRA, mustered a surprisingly strong 37 seats in Parliament**, one less than the party with the most seats. Sinn Féin will attempt to form a government with a number of left-wing parties, having campaigned on housing and health care issues. The party's strong showing illustrates the plight of mainstream centrist parties, which often seem to struggle to convince voters they will successfully tackle key issues. The euro was also probably held back by a perception that the U.S. dollar is a "safe haven"in the face of the coronavirus outbreak. A weaker euro will be a boon to the exporting corporate sector.

- Sovereign fixed income markets were much more forgiving. **The spreads of Italian bond yields over their German equivalents narrowed to levels last seen in early 2018**, before the right-wing populists and EU-sceptic League party stepped into government. Meanwhile, **Greek bond spreads over German bonds returned to 2009 levels**. Both cases suggest markets are no longer concerned about the countries' political risks.

- **In the UK, Chancellor of the Exchequer Sajid Javid resigned over pressure from Downing Street to fire his advising team** and replace it with special advisors appointed by the prime minister's office. He becomes the shortest-serving chancellor. Rishi Sunak, 39 years old and chief secretary to the Treasury for seven months, was appointed to replace Javid. Gilt yields rose and the pound rallied, as market participants expect the UK will move towards more aggressive fiscal stimulus.

Asia Pacific

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

- **Asia equity markets have traded mostly higher** during the week as sentiment improved on news that the pace of new **confirmed coronavirus infections slowed** yesterday to its lowest level since late January.

- **The positive news quickly turned negative after Chinese officials revised the method for counting infections** to include cases confirmed by clinical diagnosis (using CT scans to diagnose patients). As a result, Hubei reported **14,840 new cases** (13,332 clinically diagnosed) and **the number of fatalities more than doubled to 242** for February 12. Excluding the clinically diagnosed cases, **the increase in global new cases would be 1,912, little changed from the previous day**. All eyes will be on tomorrow's numbers update that should help determine if the massive jump is a one-time adjustment or the beginning of a sharp deterioration of the current situation.

- **We believe the increase in social contact within China** as workers return to work in the coming days **could lead to another rise in new infections**. However, we also believe that any possible increase **may be on a smaller scale** compared to the past two weeks, given heightened public awareness of the disease.

- **China's government has taken decisive steps to prevent a virus-driven economic downturn**. The latest measures include allocating US$10.3 billion to fight the virus, new tax guidelines to reduce financial pressure in key sectors, and extending special re-lending funds (totaling US$43 billion) to help key enterprises combat the coronavirus impact.

- **DBS Group** (DBS SP Equity), the largest bank in Singapore, **reported strong FY2019 results**. Management did not make any changes to its previous 2020 guidance but stated that under the scenario of the coronavirus being controlled by summer, it expects a 1%–2% revenue impact and the specific provision to rise a few basis points while the general provision should provide some cushion. **DBS will be providing liquidity relief measures for customers affected by the virus outbreak.**

MARKET SCORECARD

Data as of February 13, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	3,373.94	4.6%	4.4%	22.6%	26.7%
Dow Industrials (DJIA)	29,423.31	4.1%	3.1%	15.2%	19.4%
NASDAQ	9,711.97	6.1%	8.2%	30.9%	38.5%
Russell 2000	1,693.74	4.9%	1.5%	9.8%	13.3%
S&P/TSX Comp	17,821.17	2.9%	4.4%	14.0%	17.1%
FTSE All-Share	4,150.02	2.3%	-1.1%	5.5%	5.3%
STOXX Europe 600	431.08	5.0%	3.7%	18.1%	16.3%
EURO STOXX 50	3,846.74	5.7%	2.7%	20.1%	15.1%
Hang Seng	27,730.00	5.4%	-1.6%	-2.7%	-7.1%
Shanghai Comp	2,906.07	-2.4%	-4.7%	6.8%	-8.8%
Nikkei 225	23,827.73	0.7%	0.7%	12.7%	12.2%
India Sensex	41,459.79	1.8%	0.5%	15.1%	20.9%
Singapore Straits Times	3,220.09	2.1%	-0.1%	-0.8%	-5.7%
Brazil Ibovespa	115,662.40	1.7%	0.0%	20.7%	43.0%
Mexican Bolsa IPC	45,005.12	2.0%	3.4%	6.4%	-6.1%

Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot $/oz)	1,576.13	-0.8%	3.9%	20.7%	18.5%
Silver (spot $/oz)	17.65	-2.2%	-1.2%	13.3%	6.4%
Copper ($/metric ton)	5,747.00	3.5%	-6.5%	-6.1%	-17.2%
Oil (WTI spot/bbl)	51.42	-0.3%	-15.8%	-4.6%	-13.1%
Oil (Brent spot/bbl)	56.49	-2.9%	-14.4%	-11.2%	-9.9%
Natural Gas ($/mmBtu)	1.83	-0.4%	-16.3%	-28.8%	-29.3%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	1.619%	11.2	-29.9	-108.3	-121.0
Canada 10-Yr	1.394%	12.1	-30.8	-54.0	-93.2
U.K. 10-Yr	0.652%	12.8	-17.0	-53.0	-96.6
Germany 10-Yr	-0.386%	4.8	-20.1	-50.9	-113.6

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	2.09%	-0.3%	1.7%	9.5%	12.8%
U.S. Invest Grade Corp	2.62%	-0.1%	2.2%	14.3%	17.1%
U.S. High Yield Corp	5.15%	1.0%	1.1%	9.8%	14.5%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	99.1000	1.8%	2.8%	2.0%	10.5%
CAD/USD	0.7538	-0.2%	-2.1%	-0.1%	-5.1%
USD/CAD	1.3265	0.2%	2.1%	0.1%	5.3%
EUR/USD	1.0840	-2.3%	-3.3%	-3.7%	-12.2%
GBP/USD	1.3046	-1.2%	-1.6%	1.6%	-6.1%
AUD/USD	0.6720	0.4%	-4.3%	-5.2%	-14.5%
USD/JPY	109.8200	1.4%	1.1%	-1.1%	1.9%
EUR/JPY	119.0500	-0.9%	-2.2%	-4.8%	-10.6%
EUR/GBP	0.8310	-1.1%	-1.8%	-5.2%	-6.5%
EUR/CHF	1.0618	-0.7%	-2.2%	-6.6%	-8.1%
USD/SGD	1.3899	1.8%	3.3%	2.2%	5.1%
USD/CNY	6.9770	1.0%	0.2%	3.2%	10.0%
USD/MXN	18.5990	-1.3%	-1.7%	-4.3%	-0.3%
USD/BRL	4.3537	1.7%	8.2%	15.8%	31.9%

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 9:45 pm GMT 2/13/20.

Examples of how to interpret currency data: CAD/USD 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD -2.1% return means the Canadian dollar fell 2.1% vs. the U.S. dollar year to date. USD/JPY 109.82 means 1 U.S. dollar will buy 109.82 yen. USD/JPY 1.1% return means the U.S. dollar rose 1.1% vs. the yen year to date.

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Hold [Sector Perform]	625	42.46	127	20.32
Sell [Underperform]	82	5.57	5	6.10

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