May 7, 2020

RBC WEALTH MANAGEMENT

Global Insight Weekly

Trade tantrum?

Frédérique Carrier – London

As if economies and markets didn't already have their hands full, U.S.-China trade tensions have been rekindled. While it's unlikely a new, full-blown trade war will be unleashed, the two rivals are likely to lock horns over the next few months. This additional layer of uncertainty reinforces our cautious stance toward equities.

Among the good news that many economies are starting to reopen or preparing to, President Donald Trump's tough rhetoric toward China about COVID-19 and trade poses additional risks for equity markets. The U.S.-China rivalry, while never gone, had largely fallen off the radar of the corporate sector and investors alike in recent months.

Will it come back in full force like it did during the trade war? We doubt it, though we wouldn't underestimate the possibility of missteps from either side, which could have serious ramifications at a time when the global economy is particularly weak. We reiterate our message to keep some powder dry.

Turning the heat back up

Following a barrage of statements by top U.S. administration officials about China's handling of the initial COVID-19 outbreak (and some retorts from Chinese officials), Trump recently observed that China hasn't lived up to the terms of the January 2020 trade deal with the U.S. This agreement called for a ceasefire in the two-year conflict, and in particular required China to buy $200 billion worth of American goods. Trump fell short of confirming whether he would use tariffs again.

While his statements captured headlines, his administration has taken several other noteworthy steps recently, such as imposing new export controls on technologies with both military and civilian applications, and new restrictions on the import of foreign parts for U.S. power plants and electricity grids so as to diminish security risks to U.S. infrastructure. These moves have largely flown under the radar due to)the national emergency caused by COVID-19.

While these trade tensions may yet be defused, we think the direction of the U.S.-China relationship is likely to be toward deterioration. Since the global financial crisis, as U.S. households reduced debt and China focused on domestic consumption and self-sufficiency, the two economic powers have drifted apart. The process has accelerated due to Chinese wages increasing, which has reduced the country's attractiveness as a source of cheap labor, Trump's trade war, and now the global pandemic whose first hotspot was in the Chinese city of Wuhan.

Main issue

Policy regarding China will likely become a major issue in the U.S. ahead of the November 2020 presidential election. Historically, U.S. elections have hinged around the economy, and likely will again. But there are always unique "wedge issues" that surface in each election, and we think China will be one of them, with both main presidential candidates competing as to who can sound tougher on China.

Market pulse

Click here for authors' contact information. Priced (in USD) as of 5/7/20 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

A hard line against China seems to have bipartisan support. A Pew Research Center survey conducted in March 2020 suggests that more than 50 percent of Americans have an unfavorable view of China.

Trump is likely to focus on trade and question China's handling of the COVID-19 virus, while Joe Biden, the presumptive Democratic candidate, will likely focus on other issues where the U.S. perceives China to be committing infractions, such as carbon emissions, cyberattacks, and human rights.

As such, both powers are likely to lock horns over the next few months.

Tariffs in a recession

In an effort to boost his reelection chances, and given the U.S. economy is already suffering due to COVID-19, Trump may try to maximize political advantage over China while minimizing the adverse economic impact on the U.S.

This could come in the guise of sanctions (of which there are already more than 8,000 U.S. sanctions against foreign governments, entities, corporations, and individuals) and/or tariffs.

Imposing tariffs while the domestic economy is growing, as in 2019, is one thing, but to do so when it is contracting is another proposition altogether. Eric Lascelles, RBC Global Asset Management Inc.'s chief economist, already expects a severe 10.6 percent contraction in U.S. GDP in 2020. New tariffs would increase the uncertainty many households and businesses already face. Moreover, such a move could encourage China to retaliate. The 1930s are a case in point. The imposition of significant (approximately 25 percent) tariffs contributed to a recession morphing into the Great Depression.

Not what companies need

While trade tensions never went away, they were engulfed in the tidal wave of COVID-19 newsflow over the past two months. According to Lori Calvasina, RBC Capital Markets, LLC's head of U.S. equity strategy, the trade war and tariffs were seldom brought up by management teams in the current Q1 2020 earnings season. Throughout 2019, these issues were mentioned by some 40 percent of companies in their quarterly statements.

According to Calvasina, the comments accompanying quarterly earnings statements up to early May indicate that most U.S. companies, other than those operating in the most distressed sectors, are trying to preserve dividends, at the cost sometimes of suspending share buybacks and cutting capital expenditures, as most see the recession as being transitory. Layering in a rekindled U.S.-China trade conflict and other negatives could be the last straw for a corporate sector already under duress, in her view. There is a limit to how much companies can bend so as not to break.

For the recent stock market rally to be sustainable, in Calvasina's view, much needs to go right given valuations are stretched and the market seems to be assuming a strong rebound in earnings in 2021.

On balance, we think it is unlikely the Trump administration would willingly unleash a new trade war that would crimp an economic recovery, but the possibility of missteps remains. Should tough U.S.-China rhetoric escalate regarding COVID-19 and trade, bouts of volatility cannot be ruled out. Therefore, we think it is prudent to keep some powder dry, and we would hold a below-benchmark, or Underweight, position in global equities.

Five key points of the Phase 1 U.S.-China trade deal

Intellectual property	China to implement a legal system of intellectual property protection and enforcement
Chinese purchases	China to purchase $200 billion worth of American goods and services between Jan. 1, 2020 and Dec. 31, 2021
Technology transfer	China and U.S. to ensure the transfer of technology occurs on voluntary, market-based terms
Currency enforcement	U.S. to remove China from its list of currency manipulators
Financial services	China to allow U.S. financial services firms to apply for asset management company licenses, and to remove foreign equity cap in a number of financial services industries

Source - RBC Wealth Management, Bloomberg

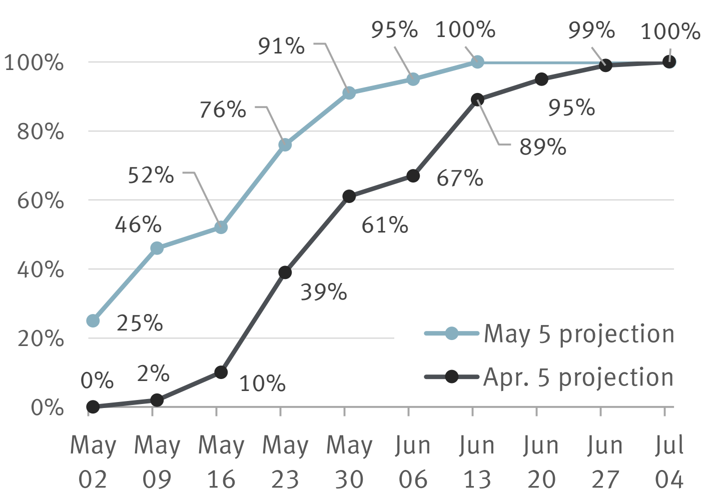
United States

Alan Robinson – Seattle

- U.S. unemployment data was in focus during the week. The ADP private-sector employment report showed 20.2 million jobs were lost in April as many businesses were forced to close shop. The more important **U.S. government jobs report is due on May 8, and consensus forecasts look for a loss of 23 million private-sector jobs, with the unemployment rate jumping to 16%** from the 4.4% reported the prior month. RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli expects unemployment to peak between 15%–17% in April. However, this data is backward-looking, and Porcelli notes that the **faster-than-expected pace of reopening of businesses in some parts of the country implies we may have already clawed back 20%–25% of the initial wave of job losses**.
- As of May 5, 23 states have reopened at least partially and another nine are set to do so by the middle of the month. However, a nationwide poll conducted by Harvard University the last week of April found that 65% of consumers opposed mandating a return to work without adequate COVID-19 testing. In addition, **the Bloomberg Consumer Comfort Index fell to an all-time low** of 39.5 in April, compared to a record high of 67.3 in late January of this year. These data points suggest to us a reticence to resume pre-COVID-19 consumption trends.
- Other high-frequency data suggests April marked the trough in parts of the economy, although at levels worse than initially expected. **Average sales declines for U.S. businesses during the month were estimated around 40% by the Philadelphia Fed**, with tentative signs of improvement near the end of the month.
- Earnings season passed its peak during the week. Management teams appeared universally cautious, largely due to a lack of visibility over the trajectory of the economy. **Dividend cuts or suspensions continued to impact individual share prices.** We estimate 58 of the 439 dividend-paying companies in the S&P 500 will have cut their dividends by the end of earnings season, concentrated in the Energy, Financials, and Consumer Discretionary sectors.
- Consumer retail chains **J.Crew Inc. and Neiman Marcus Group entered bankruptcy** during the week. We expect other mall anchors to follow suit if consumer traffic remains weak.

States under pressure to accelerate economic reopening

Share of U.S. employment captured by state reopening timelines



Source - RBC Capital Markets, Institute for Health Metrics and Evaluation, Bureau of Labor Statistics, New York Times

Canada

Arete Zafiriou & Ryan Harder – Toronto

- **COVID-19 continued to weigh on consumer sentiment in April.** According to RBC Economics, in late April **Canadian consumer spending was down 17% from pre-crisis levels**, an improvement from being down 32% at the end of March. Discretionary spending on apparel and jewelry is still less than half its early 2020 average, but household goods and services expenditures have rebounded, led by a rise in spending on construction materials, appliances, and furniture. **Software spending has benefited from the stay-at-home measures**, up almost 70% from its pre-crisis 2020 average. Gas and automotive expenditures fell as much as 38% by mid-April, but have started to rebound likely due to recovering gas prices. Consumers continue to abstain from international travel, with spending down over 90% in late April. Grocery spending remains elevated after spiking in mid-March. However, restaurant spending dropped sharply in March, but is slowly climbing as consumers have started ordering more take-out and delivery.

- **The Bank of Canada (BoC) appointed a new governor** on May 1, naming Tiff Macklem to be the top monetary policymaker in the country starting June 2. After spending nearly 30 years at the BoC, and rising to the senior deputy governor position, he was passed over for the top job in 2013 when the current governor, Stephen Poloz, was chosen. **From a monetary-policy standpoint, Macklem's outlook seems to fit well with the BoC's current paradigm**: on the highly relevant topic of negative interest rates, Macklem said he was comfortable with the current floor of 0.25% for the key policy rate, saying that the Bank should be "hesitant about introducing a new source of disruption" to an already disrupted financial system.

Europe

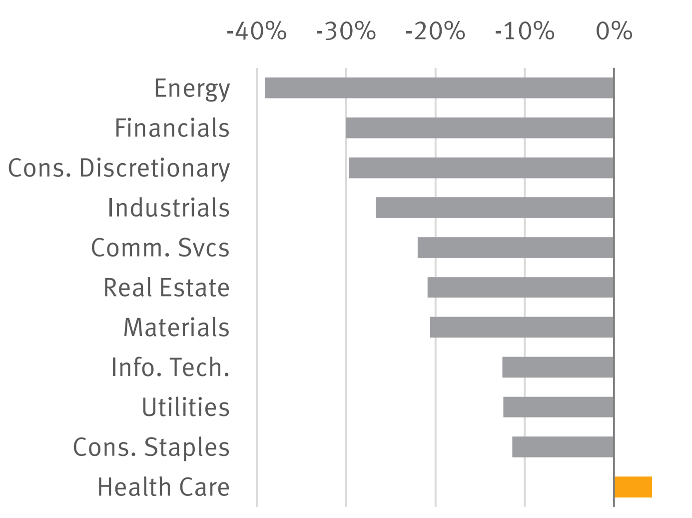
Alastair Whitfield & Thomas McGarrity, CFA – London

- In Europe, **the German Constitutional Court (GCC) ruled against some aspects of the European Central Bank's (ECB) asset purchase programme**, in a largely symbolic move. While the ECB is not bound by the GCC ruling, it could stoke fears around the current programme. In our view, it seems more likely that the ECB will need to reassert the importance and benefits of its current measures and look to extend these if necessary to support the euro area rather than risk fragmentation between northern and southern Europe, as occurred during the 2012 sovereign debt crisis.

- In the UK, **the Bank of England maintained interest rates at 0.1% and its current quantitative easing (QE) programme at £200 billion**. There were dissenting votes calling for increasing QE by a further £100 billion, and given the dovish rhetoric in the meeting minutes, **we think it likely that an increase in QE has only been postponed until the next meeting**, in June. The accompanying Monetary Policy Report also provided an assessment of the COVID-19 pandemic's impact on the UK economy. Based on the current lockdown remaining in place until early June, **the report suggested Q2 real GDP would decline by 25%, with annual GDP down 14% for 2020 and unemployment rising to 9% in Q2 from the current 4% level**.

- Two-thirds of the STOXX Europe 600 Index (Europe + UK) members that were due to report have now released Q1 results. **Aggregate sales growth is running at -6% y/y, while earnings per share are down 25%.** Unsurprisingly, **cyclical sectors are reporting very weak Q1 earnings**, especially Financials, Energy, and Consumer Discretionary. The main bright spot has been the Health Care sector, where sales are up 11% y/y and earnings per share have grown 16% y/y. **Health Care is the only sector in the STOXX Europe 600 Index to be in positive territory year-to-date** (+1.2% versus the index's -18.9%). Despite its significant outperformance, we believe the sector should continue to be a key Overweight in pan-European equity portfolios.

STOXX Europe 600 year-to-date sector performance



Source - RBC Wealth Management, Bloomberg

Asia Pacific

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

- **The market had been anticipating "revenge spending" post the lockdown**. However, data from China's Labor Day holiday (May 1–May 5) showed **mixed signals**.

- According to the Ministry of Commerce, **average daily sales** of key retail businesses monitored **jumped 30.1%** from the week before the holiday.

- However, during the holiday, China recorded 115 million tourist trips domestically, with **tourism revenue of RMB 47.56 billion**, according to the Ministry of Culture and Tourism. That's **a 59.6% slump** compared to last year's Labor Day holiday, which was one day shorter.

- On the other hand, **household deposits at the country's banks climbed RMB 6.47 trillion** in Q1 2020, up 13% y/y, according to the People's Bank of China.

- We think after the virus outbreak, **people may prefer to increase their deposits instead of spending due to the uncertainty of the economy**. Therefore, revenge spending may not be as strong as expected. However, we think **offline consumption will recover** as the lockdown is lifted. Therefore, sectors such as restaurants, beer, apparel and jewelry, etc., could benefit.

- While the risk of trade tension is increasing again, **Reuters reported that, according to unnamed sources, the U.S. Department of Commerce may sign off on a new rule that would allow U.S. companies to work with China's Huawei Technologies** on setting standards for 5G networks. Starting last year, U.S. companies were no longer allowed to develop standards with the world's largest telecommunications equipment maker, which made it difficult for companies to develop their patented technology. The sources said the draft is under final review at the Department of Commerce, and would be sent to other agencies for their approval. It is unclear how long the full process will take. Both the Department of Commerce and Huawei declined to comment for the report.

MARKET SCORECARD

Data as of May 7, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,881.19	-1.1%	-10.8%	-0.1%	7.8%
Dow Industrials (DJIA)	23,875.89	-1.9%	-16.3%	-8.0%	-2.0%
NASDAQ	8,979.66	1.0%	0.1%	12.8%	23.6%
Russell 2000	1,282.93	-2.1%	-23.1%	-18.9%	-18.7%
S&P/TSX Comp	14,833.69	0.4%	-13.1%	-9.3%	-6.2%
FTSE All-Share	3,270.55	0.2%	-22.1%	-17.9%	-21.4%
STOXX Europe 600	337.98	-0.6%	-18.7%	-11.4%	-13.2%
EURO STOXX 50	2,880.60	-1.6%	-23.1%	-15.3%	-19.2%
Hang Seng	23,980.63	-2.7%	-14.9%	-18.3%	-20.0%
Shanghai Comp	2,871.52	0.4%	-5.9%	-1.9%	-8.5%
Nikkei 225	19,674.77	-2.6%	-16.8%	-10.3%	-12.4%
India Sensex	31,443.38	-6.7%	-23.8%	-17.9%	-10.7%
Singapore Straits Times	2,591.60	-1.2%	-19.6%	-21.8%	-26.6%
Brazil Ibovespa	78,118.60	-3.0%	-32.4%	-17.2%	-5.6%
Mexican Bolsa IPC	36,792.41	0.9%	-15.5%	-15.6%	-20.8%

Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot $/oz)	1,717.47	1.8%	13.2%	33.7%	30.7%
Silver (spot $/oz)	15.35	2.5%	-14.0%	2.9%	-6.8%
Copper ($/metric ton)	5,167.50	0.1%	-16.0%	-16.2%	-23.9%
Oil (WTI spot/bbl)	23.55	25.0%	-61.4%	-61.6%	-66.7%
Oil (Brent spot/bbl)	29.44	16.5%	-55.4%	-57.9%	-61.3%
Natural Gas ($/mmBtu)	1.91	-2.3%	-13.0%	-24.9%	-30.5%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.633%	-0.6	-128.5	-182.4	-231.7
Canada 10-Yr	0.544%	-0.3	-115.8	-114.0	-178.3
U.K. 10-Yr	0.235%	0.4	-58.7	-92.3	-116.5
Germany 10-Yr	-0.545%	4.1	-36.0	-50.7	-107.7

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.39%	-0.5%	4.4%	9.9%	16.2%
U.S. Invest Grade Corp	2.78%	-1.2%	0.2%	8.4%	16.0%
U.S. High Yield Corp	7.99%	0.2%	-8.5%	-3.7%	2.6%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	99.8740	0.9%	3.6%	2.3%	7.7%
CAD/USD	0.7148	-0.3%	-7.1%	-3.7%	-7.9%
USD/CAD	1.3991	0.3%	7.7%	3.8%	8.6%
EUR/USD	1.0831	-1.1%	-3.4%	-3.2%	-9.2%
GBP/USD	1.2364	-1.8%	-6.7%	-5.4%	-8.8%
AUD/USD	0.6492	-0.3%	-7.5%	-7.4%	-13.6%
USD/JPY	106.2800	-0.8%	-2.1%	-3.6%	-2.6%
EUR/JPY	115.1000	-2.0%	-5.5%	-6.7%	-11.5%
EUR/GBP	0.8760	0.7%	3.6%	2.3%	-0.4%
EUR/CHF	1.0539	-0.4%	-2.9%	-7.6%	-11.8%
USD/SGD	1.4141	0.3%	5.1%	3.8%	5.9%
USD/CNY	7.0842	0.3%	1.7%	4.5%	11.3%
USD/MXN	24.0413	-0.6%	27.0%	26.3%	23.5%
USD/BRL	5.8485	6.6%	45.1%	54.8%	64.7%

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 5/7/20.

Examples of how to interpret currency data: CAD/USD 0.71 means 1 Canadian dollar will buy 0.71 U.S. dollar. CAD/USD -7.1% return means the Canadian dollar fell 7.1% vs. the U.S. dollar year to date. USD/JPY 106.28 means 1 U.S. dollar will buy 106.28 yen. USD/JPY -2.1% return means the U.S. dollar fell 2.1% vs. the yen year to date.

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