RBC Dominion Securities Inc.

Where Do We go from Here?

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Wealth Management
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Leading Indicators pointing North

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Recession Scorecard

Indicator	Status		
	Expansion	*Neutral*	*Recessionary*
Yield curve (10-year to 1-year Treasuries)	✓		
Unemployment claims	✓		
Unemployment rate	✓		
Conference Board Leading Index	✓		
Non-financial corporate cash flows	✓		
ISM new orders versus inventories	✓		
Fed funds rate vs. nominal GDP growth	✓		

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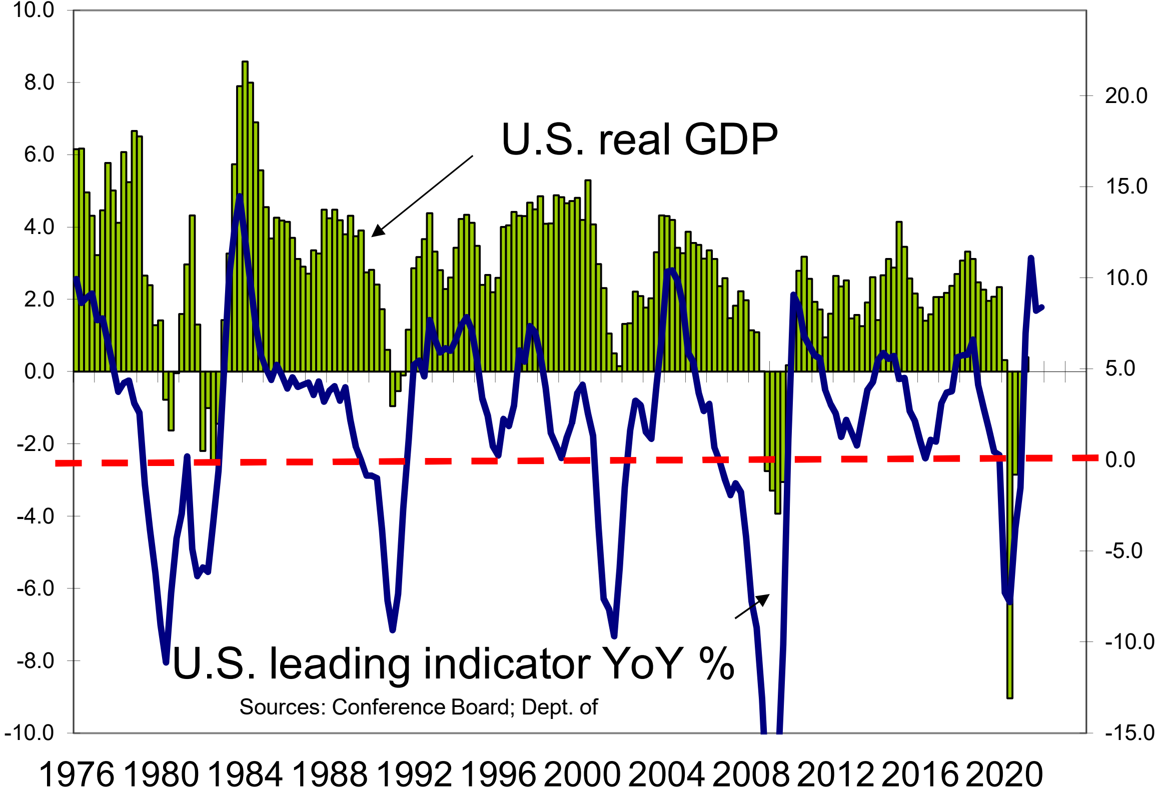
US Leading Indicator vs. GDP



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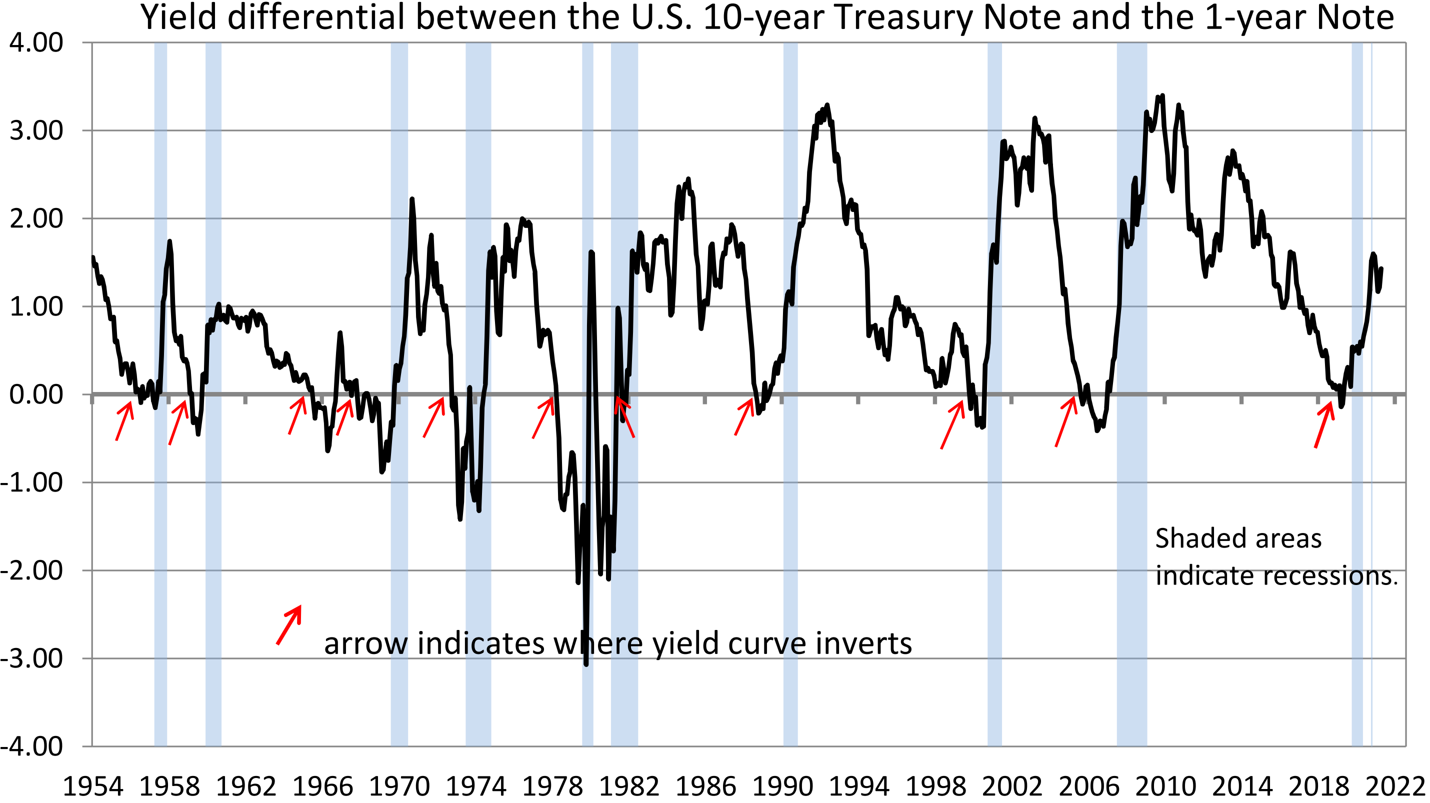
Yield Differential 10yr. Vs. 1 yr.



Sources: Federal Reserve; NBER

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Yield Curve Inversion vs. Recession

Month of yield curve inversion inverts	Month recession begins	Interval between
Dec-56	Sep-57	9
Sep-59	May-60	8
Apr-68	Jan-70	21
Mar-73	Dec-73	9
Sep-78	Jan-80	16
Sep-80	Jul-81	10
Feb-89	Jul-90	17
Apr-00	Mar-01	11
Jan-06	Dec-07	23
Aug-19	Mar-20	7
	average	11 months
	median	11 months

Source: Federal Reserve; NBER

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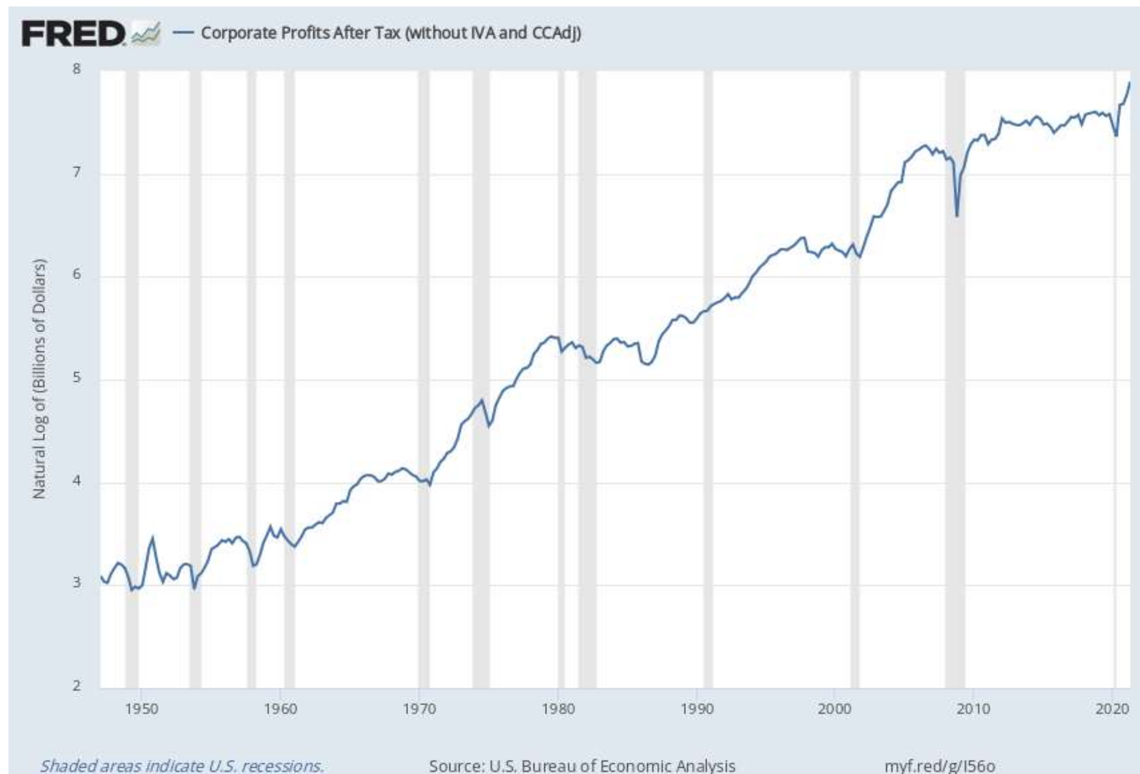
Corporate profits on a National Accounts basis already at new all-time highs…



…Usually a year or so ahead of S&P profits. Peak well before recession begins

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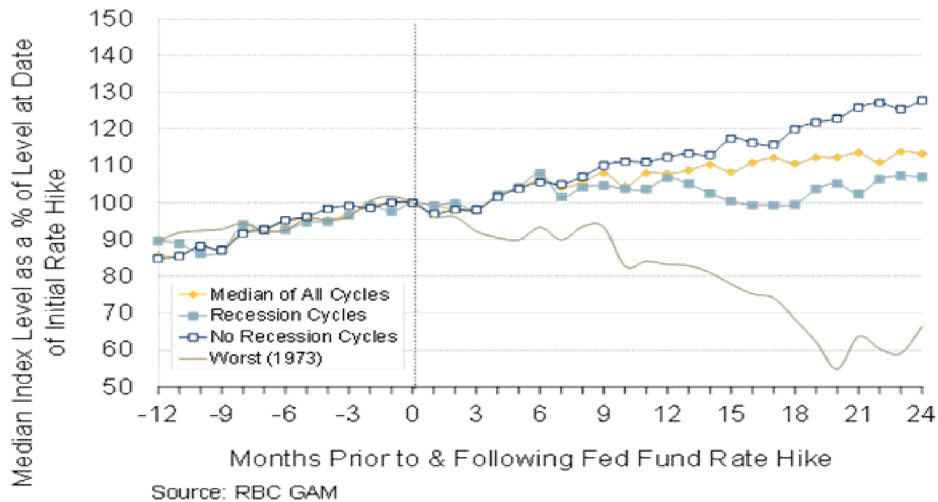
S&P Reaction to First Rate Hike



S&P 500 return statistics prior to and following the first rate hike
Data since July 1954

		Median trailing returns (%)		-- First rate hike --		Median forward returns (%)*		
	# of observations	12 months	6 months		6 months	12 months	24 months	36 months
ALL CYCLES								
All cycles	17	16.8	4.4		5.0	8.9	6.3	7.8
No-recession cycles	9	17.1	3.9		4.2	12.4	11.0	7.8
Recession cycles	8	13.2	9.7		5.9	6.4	0.7	6.4

Source: RBC GAM   *periods greater than 12 months are annualized

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Valuations

Stock valuations are mixed – S&P at 21.4x forward is 4 multiples above its 30 year average. But the TSX, FTSE, Eurostoxx, and Japan's TOPIX, all in the mid-teens, are at or only marginally above theirs. The S&P multiple has been driven higher by large cap tech. But these stocks are also delivering the strongest sales and earnings growth. The 5 largest S&P 500 constituents comprise about 23% of market value.

At the Dot.Com peak in 2000 the tech sector alone was nearly 50% of the market. In 1980 the five largest US oil companies were almost 50% of the S&P.

There is a lot of "bubble" talk but bubbles can inflate for a long time, especially when, as now, earnings estimates are rising, offsetting worries about higher inflation and bond yields.

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How to pick stocks

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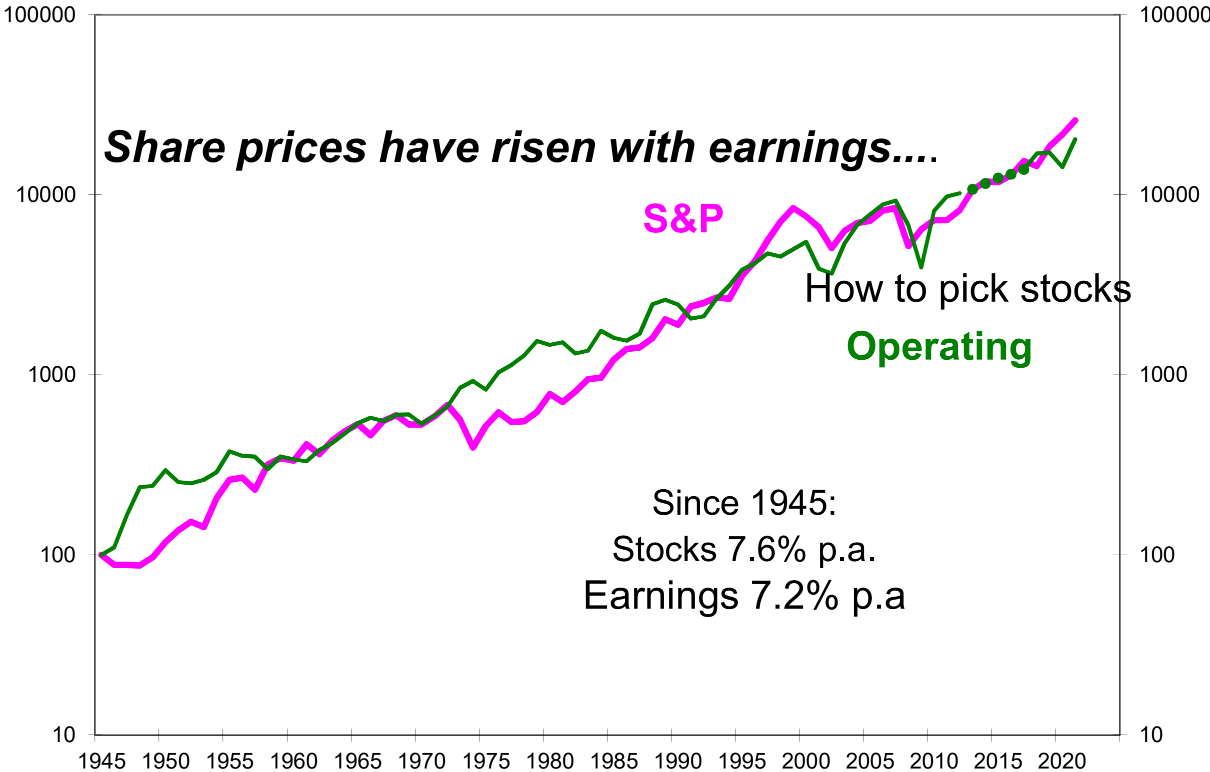
Earnings vs. Share Price



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Earnings vs. GDP

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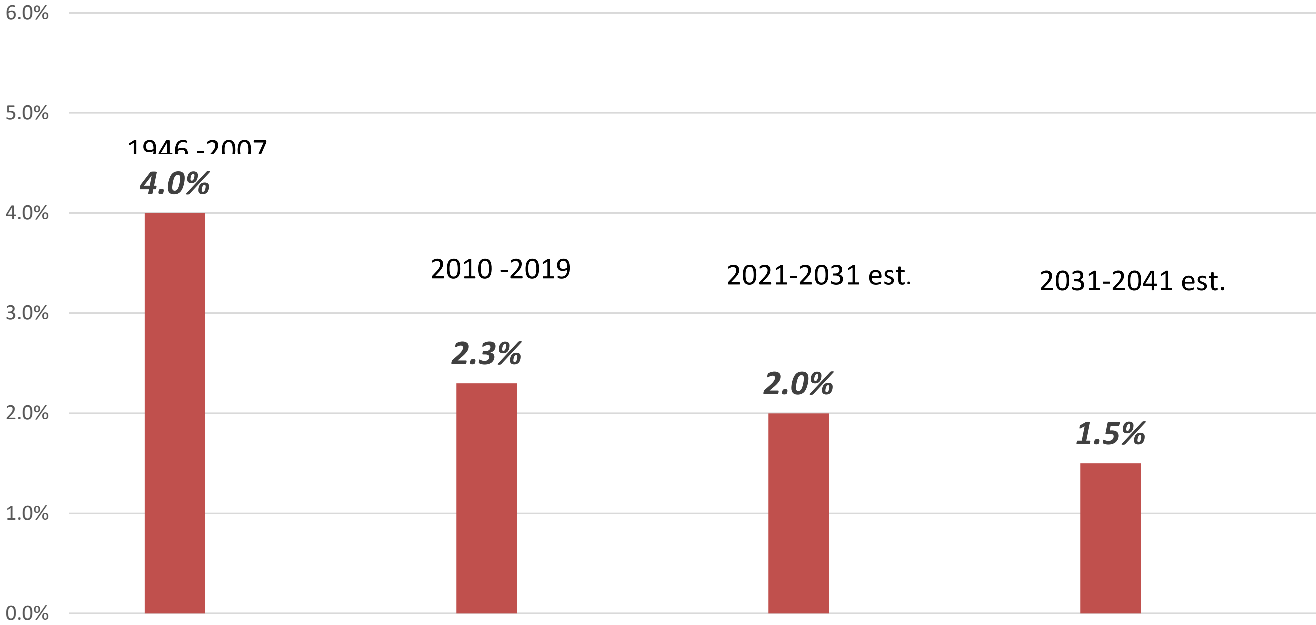
U.S. real GDP run rate in non-recession years



Sources: Congressional Budget Office; RBC WM

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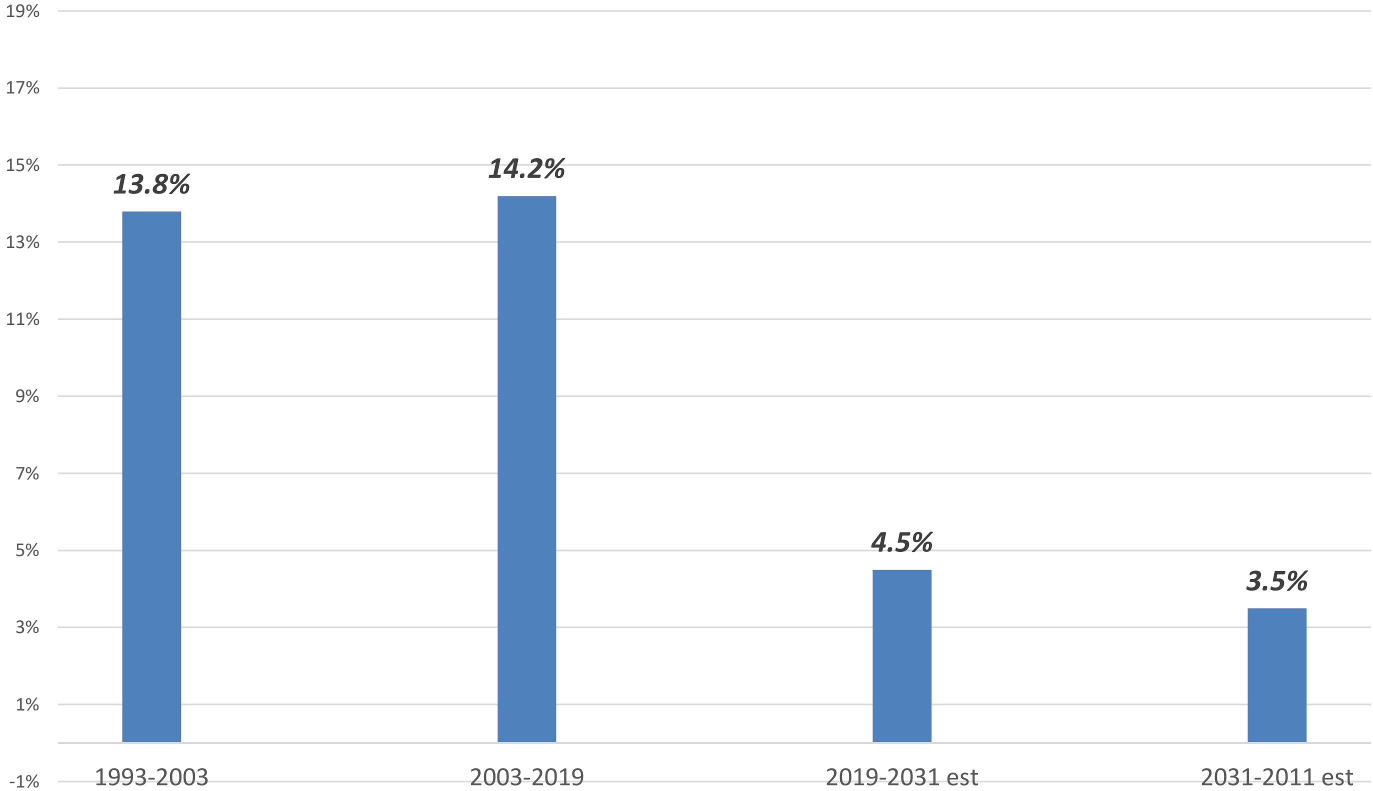
China real GDP growth rate



Sources: World Bank; RBC WM

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Long-term considerations

- CBO forecasts U.S. GDP will grow at just 1.5%-2.0% per annum over the next decade or two.
- Much slower than the 70 years following WWII when growth averaged 3.5%-4% and slower than the 2.0-2.5% over the "slow growth" post-financial crisis decade.
- Slower growth means more intense competition, even more corporate concentration than we saw in the last decade, a sharper distinction between winners and also - rans.
- Second and third tier companies that can't win will either be taken over or will try to compete, igniting at least two more waves of heavy tech spending designed to lower costs and mitigate chronic labour shortages.
- There is roughly $100 trillion of debt maturing over the next decade held by pension funds and endowments much of which will head to private equity in search of returns necessary to fund obligations to beneficiaries. Seeking those higher returns probably means riskier allocations, some capital destruction, and lower-than-advertised returns.

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Summary

- Portfolios should be populated with stocks for which there is a high conviction that sales, earnings, and dividends will grow faster than the economy
- Dividend growth conviction is more important/valuable than yield.
- Beware of value traps – high yield, high payout ratio, high debt, low/no growth.

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