RBC WEALTH MANAGEMENT

Global Insight Weekly

A closer look

The buyback fuel

Kelly Bogdanov – San Francisco

Among the catalysts behind U.S. equities' impressive surge, share buybacks have garnered relatively little fanfare. We think this shareholder-friendly action can continue to help power the rally, and even when the rally inevitably loses some altitude, buybacks should soften any downside moves.

It's well known the U.S. equity market has been propelled by better economic trends and vastly improved earnings prospects due to the tax cuts. But an under-the-radar reason the U.S. equity rally has moved so forcefully—and could march higher over time—is there are fewer shares to go around.

Many firms have quietly repurchased meaningful chunks of their shares. In the past five years, 39 companies in the S&P 100 Index, which represents the largest U.S. firms by market capitalization, have bought back 10% or more of their outstanding stock.

For example, Apple has repurchased almost 23%, while Home Depot and McDonald's have each bought back more than 20%, and FedEx and 3M have repurchased 15% and 14%, respectively. (A list of companies is on page 2.)

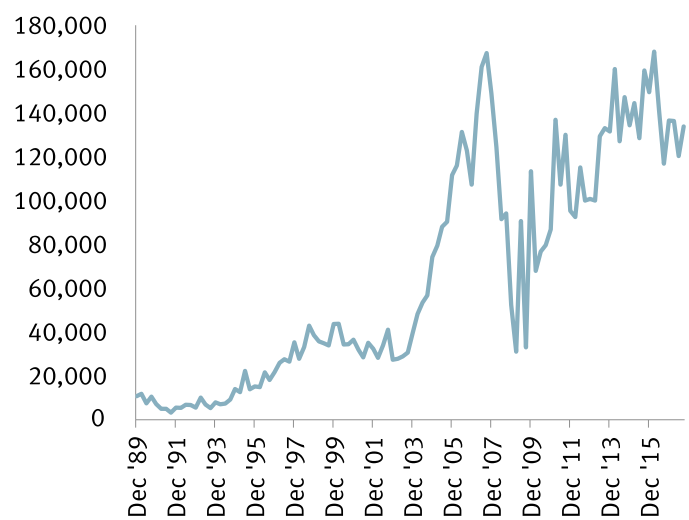
At this more mature point of the equity cycle, and now that the market's momentum has picked up substantially, often times feeding off of itself, in our view the major indexes are being supported by the fact that there are fewer available shares for investors to purchase.

Buyback boost

The dollar value of share repurchases for the S&P 500 trailed off in 2016 and 2017 as the chart illustrates, and the mid- and small-cap indexes did as well. But we believe they will rebound in 2018 because the tax reform package will increase cash flow for the overwhelming majority of public companies. Part of that money seems destined to buy back stock.

After trailing off, buybacks should pick up due to tax cuts

Large-cap buyback activity (in $ millions)



Source - RBC U.S. Equity Strategy, S&P Capital IQ/Clarifi, Compustat; data through 9/30/17

Market pulse

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Priced (in USD) as of 1/18/18 market close, EST (unless otherwise stated).

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Wealth Management

Furthermore, the S&P 500 buyback yield—the total dollar value of shares repurchased as a percentage of market cap—is at its lowest level since the global financial crisis in 2009. With tax cuts expanding free cash flow this will likely move higher, according to Head of U.S. Equity Strategy Lori Calvasina of RBC Capital Markets, LLC.

Calvasina believes there is room for the percentage of companies buying back stock to increase in eight of 11 S&P 500 sectors (see lower chart). On a dollar basis, there is even more latitude to boost buybacks, as activity is currently below the 2015–2016 highs for most sectors.

Overall, Calvasina estimates buybacks will contribute 2 percentage points to her 17.4% y/y S&P 500 earnings growth forecast in 2018, and they should provide another 2 percentage points of growth in 2019.

Helping hand

Buybacks sometimes get a bad rap, as critics complain they only benefit the company and its top executives. But they are often good for shareholders.

First off, they expand the ownership stakes of existing investors. Consider the math. If an investor owns a 5% stake in XYZ company that has a market capitalization (market value) of $100M and 10M shares outstanding, and that company buys back 20% of its shares, the investor's ownership stake rises to 6.25%, all other factors being equal.

Second, stock buybacks indicate a company is willing to invest in the firm and its future.

Third, coincidentally or not, stocks with high buyback yields tend to outperform those with low or no buyback yields, on average, according to Calvasina's research.

Fourth, buyback programs can function like a put option, or protection, on a stock. When sharp corrections hit the market, companies can repurchase shares at discounted levels, softening the declines.

Downside cushion

No doubt a market pullback or even a correction is possible in 2018 despite the current low volatility environment. One will eventually come—it is a normal part of investing. But we believe lower share counts and the likelihood of higher repurchases this year should help soften any downside moves and can provide further fuel for the market over the longer term.

Not as much stock to go around

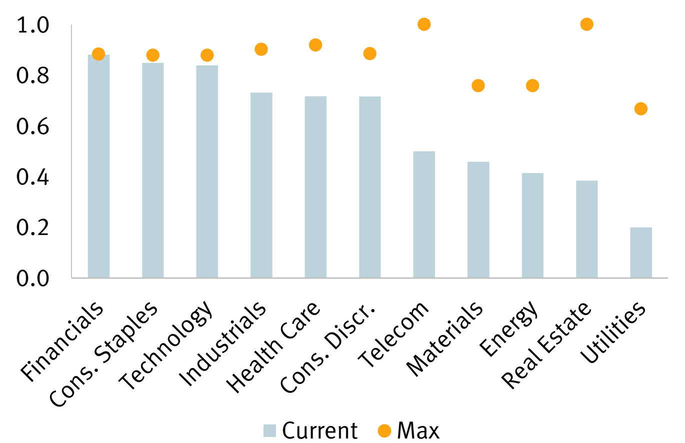
Biggest declines in shares outstanding since 2013 (shares in millions)

Company	Ticker	# shares Jan 2013	# shares Jan 2018	% change
American Int'l Group	AIG	1,476	899	-39.1%
Twenty-First Cent. Fox	FOXA	1,546	1,054	-31.8%
Lowe's	LOW	1,125	830	-26.2%
Allstate	ALL	482	360	-25.3%
Apple	AAPL	6,585	5,087	-22.7%
American Express	AXP	1,119	868	-22.4%
Home Depot	HD	1,495	1,168	-21.9%
Boeing	BAC	754	596	-21.0%
McDonald's	MCD	1,004	797	-20.6%
Goldman Sachs	GS	470	377	-19.7%
Pfizer	PFE	7,363	5,961	-19.0%
CVS Health	CVS	1,247	1,013	-18.7%
IBM	IBM	1,130	926	-18.1%
Time Warner	TWX	947	779	-17.8%
Monsanto	MON	535	441	-17.5%
General Electric	GE	10,486	8,672	-17.3%
Capital One	COF	582	485	-16.7%
Target	TGT	651	544	-16.5%
Union Pacific	UNP	941	787	-16.3%
Mondelez	MDLZ	1,777	1,494	-15.9%
Visa	V	2,142	1,811	-15.5%
General Dynamics	GD	353	299	-15.4%
FedEx	FDX	314	268	-14.8%
Walt Disney	DIS	1,772	1,510	-14.8%
3M	MMM	692	596	-13.9%
Gilead Sciences	GILD	1,515	1,306	-13.8%
Qualcomm	QCOM	1,704	1,474	-13.5%
United Technologies	UTX	917	799	-12.9%
Oracle	ORCL	4,734	4,140	-12.6%
Mastercard	MA	1,193	1,044	-12.5%
Bank of NY Mellon	BK	1,169	1,024	-12.4%
Raytheon	RTN	330	289	-12.4%
Texas Instruments	TXN	1,121	986	-12.1%

Source - RBC Wealth Management, Bloomberg

Plenty of room for buybacks to expand in S&P 500 sectors

Proportion of companies buying back stock by sector (1.0 = 100%)



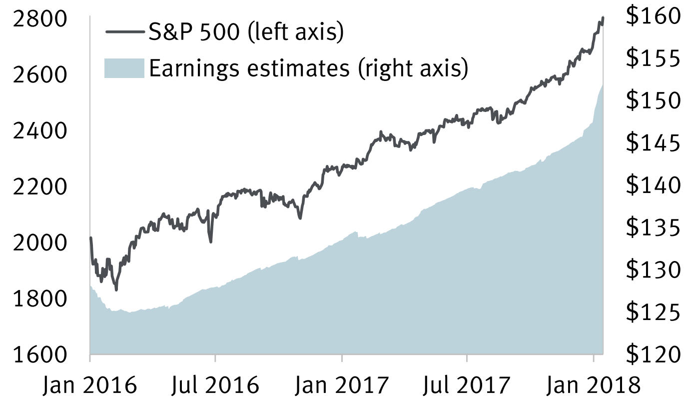
Source - RBC U.S. Equity Strategy, S&P Capital IQ/Clarifi, Compustat

United States

Kelly Bogdanov – San Francisco

- **Another week, another record** with the Dow Jones Industrial Average closing above 26,000 for the first time on Wednesday following **Apple's announcement it will pour $350 billion into the domestic economy** over five years and create 20,000 jobs. The bulk of the funds will come from Apple's overseas cash horde which will be repatriated on more favorable terms due to the tax reform legislation. To put $350 billion in context, **the investment is nearly twice the level of the entire California state budget** in fiscal 2017–18.
- **Positive Q4 earnings results have also helped push the market higher**. With 7% of companies having reported, 78% beat the consensus earnings forecast while 81% exceeded the revenue estimate. Both are well ahead of the recent and long-term averages.
- **We're keeping an eye on the Dow Jones Transportation Average**, as this bellwether index has **lagged the broader market** and Industrials recently. The trends among most transportation stocks are still sturdy from a fundamental standpoint. Strength in the Transports has corresponded with the broader market's significant rally since late November; conversely, any notable weakness in the Transports, especially relative to the broader market, would be a cautionary sign to us.
- In the "here we go again" category, **the risk of a government shutdown lingers** as of this writing. Historically, shutdowns have had transitory impacts on the market. **The S&P 500 fell 3.2%, on average, in the shutdown periods since 1976**, with the market dropping 7.5% during the worst episode. **They can create short-term pullbacks, but are not game changers**.

Accelerating earnings estimates are helping to propel equity markets higher



Source - RBC Wealth Management, FactSet; data through 1/17/18

Canada

Patrick McAllister & Farazeh Mahboob – Toronto

- **RBC Capital Markets held its annual Canadian Bank CEO Conference** on January 9. The leaders of **Canada's largest lenders struck an optimistic tone** in presenting their outlook. The general consensus is that the macro environment should support continued resilience in credit and margin expansion. A notable departure from Street expectations was the group's outlook for domestic mortgage growth in the mid-single digits relative to RBC Capital Markets' 2% growth forecast in 2018.
- **A *Reuters* report that suggested Canadian officials were ascribing a higher probability to a notice of NAFTA withdrawal by the U.S. resulted in short-lived weakness in the S&P/TSX**, as well as the Canadian dollar, on the afternoon of January 10. It is important to note that a notice of withdrawal would start the clock on a six-month cooling-off period subsequent to which there would be no obligation to terminate the trade pact. This fact may increase the probability that a notice of withdrawal may be used as a negotiating ploy.
- **The Bank of Canada (BoC) raised the overnight lending rate** during the week to 1.25% from 1.00%, as expected, **but provided some caution through its Monetary Policy Report**. The BoC expects the economy to grow close to potential over the next two years whilst acknowledging that slack in the labour market has been absorbed more quickly than it anticipated. However, the BoC noted the uncertainty stemming from NAFTA renegotiations. **We believe the bond market is appropriately reflecting additional interest rate hikes in Canada** and think the greater risk is that longer-dated yields move higher. Accordingly, **we continue to favor short-to-intermediate maturity bonds in Canada**.
- **The oil sands are witnessing unprecedented growth**, with RBC Capital Markets now estimating production to be roughly 250,000 barrels/day (bbl/d) in 2017 and 315,000 bbl/d in 2018—before downshifting to around 180,000 bbl/d in 2019. In RBC Capital Markets' view, **Western Canada's oil exports should exceed pipeline capacity in Q1 2018**—structurally widening Western Canadian Select (WCS) spreads until new pipeline expansions move into place. Hence, these barrels will likely get to market via rail, which may result in a wider discount between WTI and WCS due to the higher transportation costs associated with shipping crude via rail and lower prices received by oil sands producers. RBC Capital Markets' WCS-WTI differential outlook now sits at $15.50/bbl in 2018 and $17.50/bbl in 2019—up from $12/bbl and $14/bbl, respectively.

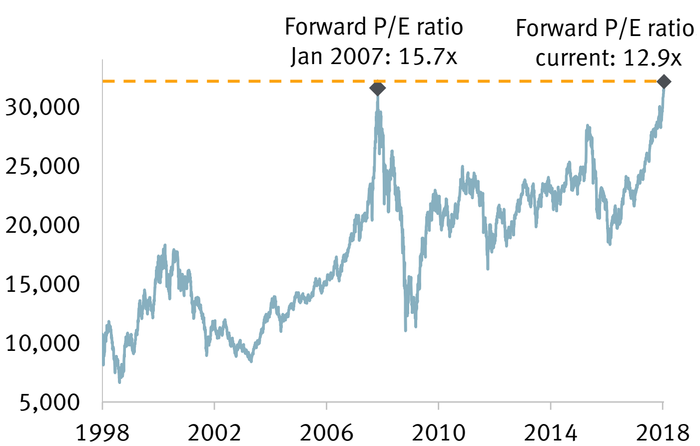
Europe

Thomas McGarrity & Jamie Hayes – London

- **Crisis-hit contractor Carillion**, one of the largest construction and support services groups in the U.K., **entered into compulsory liquidation**. We believe the main fallout from this will be intensified scrutiny for how the U.K. government awards and structures outsourced contracts to private sector contractors. Carillion is the most extreme example of a number of recent missteps from U.K. outsourcing businesses that have seen a number of Carillion's contractor peers issue significant profit warnings and large-scale restructurings. These illustrate the perils of taking on long-term contracts at low margins, as well as the risks from failing to properly integrate acquisitions.
- **While U.K. banks will suffer credit losses related to Carillion, we expect them to be entirely manageable**, a view shared by the U.K. financial services regulator, the Prudential Regulation Authority.
- **The next European Central Bank (ECB) meeting will take place on January 25**. Having reduced bond purchases from €60B to €30B per month until the end of September alongside continuing to reinvest maturity bonds, **current policy remains firmly accommodative**.
- **We expect no major announcements at this month's meeting and, most importantly, no changes to the wording on the sequencing of policy changes**—namely that rate hikes will come "well" after the point that bond purchases come to an end. The removal of the word "well" would suggest that the first rate hike is closer than the market expects. However, whilst core inflation remains at 0.9%—far below the 2% target—we see a change in the language as unlikely.

Equities in Hong Kong surpass 2007 highs on lower valuations

Hang Seng Index and next 12-month P/E ratios at market highs



Source - RBC Wealth Management, Bloomberg; data through 1/18/18

- When the €30B per month bond purchases finish in September **we anticipate an extension and a further reduction of purchases to come**, given the ECB has previously indicated that there will be no "sudden stop" to purchases. As such, **we believe this will push any rate hike firmly into late 2019**.
- **We expect Bund yields to ultimately move higher**, narrowing peripheral spreads.
- In the **U.K., inflation fell to 3% y/y in December**, in line with consensus estimates, and down from 3.1% the previous month. RBC Capital Markets believes that as the effects of sterling's depreciation post the Brexit vote wane, inflation will decline to 2.5% y/y by December 2018.

Asia Pacific

Yufei Yang – Hong Kong

- Asian markets continued to move higher during the week. Hong Kong's **Hang Seng Index closed at an all-time high** on January 16, overtaking the previous high set on October 30, 2007. The Taiwan and Japan markets also traded at their **highest levels in more than 20 years**.
- **China's economy expanded faster than expected in Q4**. With a **6.9% annual growth rate**, the world's second-largest economy saw its first acceleration since 2010 (vs. 6.7% in 2016). Consumption contributed 58.8% of total GDP growth. China also released monthly economic data for December, with fixed asset investment and export shipment data better than expected, while social retail sales of 9.4% missed expectations.
- Chinese smartphone maker **Xiaomi is reportedly preparing to go public** in Hong Kong or New York this year. According to the *Financial Times* (January 15, 2018), the deal **could value the company as high as $100B**, making it the biggest tech IPO since Alibaba in 2014. Xiaomi did not comment for the *Financial Times* article. After raising money at a $45B valuation in 2014, Xiaomi experienced a difficult period under fierce competition from local rivals such as Huawei and Oppo. But the company regained its momentum in recent quarters. IDC research showed Xiaomi doubled its shipments to 27.6 million units in Q3 2017, ranking fifth among global smartphone vendors. Apart from smartphones, Xiaomi has engaged in creating an ecosystem of connected devices. Over 90 startups cooperate with Xiaomi, providing a wide spectrum of products from wearable devices to rice cookers to suitcases.
- After leaving its benchmark rate unchanged at 1.5%, **South Korea's central bank revised up its 2018 growth outlook** for the nation's economy to 3% from 2.9%, but revised down its consumer inflation outlook by 0.1% to 1.7%.

MARKET SCORECARD

Data as of January 18, 2018

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,798.03	4.7%	4.7%	23.2%	48.8%
Dow Industrials (DJIA)	26,017.81	5.3%	5.3%	31.4%	62.7%
NASDAQ	7,296.05	5.7%	5.7%	31.3%	62.6%
Russell 2000	1,576.73	2.7%	2.7%	16.1%	56.5%
S&P/TSX Comp	16,284.47	0.5%	0.5%	5.8%	36.4%
FTSE All-Share	4,227.86	0.1%	0.1%	7.6%	32.8%
STOXX Europe 600	398.73	2.5%	2.5%	9.8%	21.3%
EURO STOXX 50	3,620.91	3.3%	3.3%	9.9%	23.4%
Hang Seng	32,121.94	7.4%	7.4%	39.1%	67.0%
Shanghai Comp	3,474.75	5.1%	5.1%	11.6%	19.3%
Nikkei 225	23,763.37	4.4%	4.4%	25.8%	40.2%
India Sensex	35,260.29	3.5%	3.5%	29.4%	45.8%
Singapore Straits Times	3,521.31	3.5%	3.5%	17.4%	35.8%
Brazil Ibovespa	80,962.65	6.0%	6.0%	26.2%	113.4%
Mexican Bolsa IPC	49,911.97	1.1%	1.1%	7.7%	22.9%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,327.18	1.9%	1.9%	10.2%	21.9%
Silver (spot $/oz)	16.94	0.0%	0.0%	-0.7%	21.4%
Copper ($/metric ton)	6,994.25	-3.0%	-3.0%	21.8%	59.8%
Oil (WTI spot/bbl)	63.95	5.8%	5.8%	25.2%	117.4%
Oil (Brent spot/bbl)	69.19	3.5%	3.5%	28.3%	142.3%
Natural Gas ($/mmBtu)	3.20	8.4%	8.4%	-3.0%	52.5%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	2.620%	21.5	21.5	19.0	58.5
Canada 10-Yr	2.220%	17.5	17.5	51.2	105.7
U.K. 10-Yr	1.330%	14.0	14.0	-0.6	-36.2
Germany 10-Yr	0.573%	14.6	14.6	21.8	3.6
Fixed Income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	2.86%	-0.6%	-0.6%	2.6%	4.6%
U.S. Invest Grade Corp	3.36%	-0.5%	-0.5%	5.3%	11.8%
U.S. High Yield Corp	5.62%	0.7%	0.7%	7.0%	30.6%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	90.5280	-1.7%	-1.7%	-10.3%	-8.5%
CAD/USD	0.8046	1.1%	1.1%	6.8%	17.2%
USD/CAD	1.2428	-1.1%	-1.1%	-6.3%	-14.6%
EUR/USD	1.2242	2.0%	2.0%	15.2%	12.4%
GBP/USD	1.3898	2.8%	2.8%	13.4%	-2.4%
AUD/USD	0.7997	2.4%	2.4%	6.6%	16.5%
USD/JPY	111.0600	-1.4%	-1.4%	-3.1%	-5.3%
EUR/JPY	135.9600	0.5%	0.5%	11.6%	6.4%
EUR/GBP	0.8808	-0.8%	-0.8%	1.6%	15.2%
EUR/CHF	1.1737	0.3%	0.3%	9.6%	7.2%
USD/SGD	1.3211	-1.1%	-1.1%	-7.6%	-8.2%
USD/CNY	6.4200	-1.3%	-1.3%	-6.3%	-2.4%
USD/MXN	18.6122	-5.3%	-5.3%	-15.2%	2.2%
USD/BRL	3.2109	-3.1%	-3.1%	-0.4%	-20.4%

Source - Bloomberg. Note: Equity returns do not include dividends, except for the German DAX and 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 1/18/18.

Examples of how to interpret currency data: CAD/USD 0.80 means 1 Canadian dollar will buy 0.80 U.S. dollar. CAD/USD 1.1% return means the Canadian dollar rose 1.1% vs. the U.S. dollar year to date. USD/JPY 111.06 means 1 U.S. dollar will buy 111.06 yen. USD/JPY -1.4% return means the U.S. dollar fell 1.4 vs. the yen year to date.

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As of December 31, 2017

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Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	868	52.42	281	32.37
Hold [Sector Perform]	683	41.24	155	22.69
Sell [Underperform]	105	6.34	8	7.62

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