September 21, 2017
RBC WEALTH MANAGEMENT
# Global Insight Weekly

A closer look

## Retreat or reset?

Kelly Bogdanov – San Francisco

The rise of so-called populism begs the question: is globalization under siege? We explain how globalization itself is now a populist movement. But despite decades of benefits, there are potential risks ahead.

The modern-day globalization movement—which we loosely define as the interdependence of economies, financial markets, and labor markets—has been vilified in the past couple years, particularly during the U.S. presidential race, the U.K.'s Brexit campaign, and within Continental Europe's populist parties.

With the preference toward national sovereignty increasing at the expense of multilateral organizations, and heightened potential for trade protectionism, is globalization in retreat and what are the implications for investors?

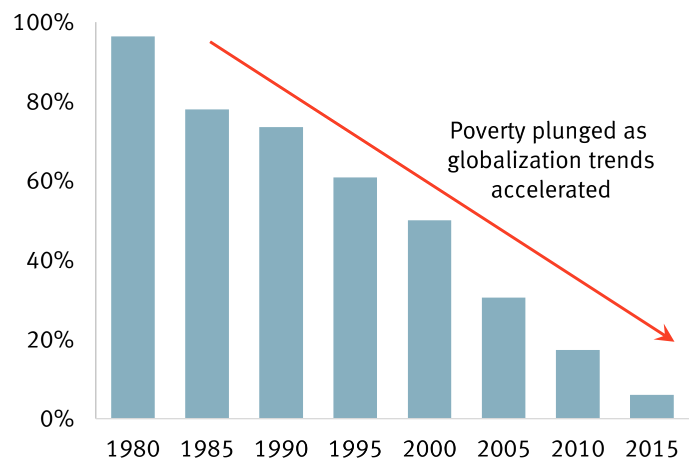
### Power to the people

The modern iteration of globalization is much more entrenched than its detractors acknowledge. It actually descends from something very old. Shades of globalization have ebbed and flowed for centuries and millennia—from the Silk Road, the major trade route that stretched from China, through India, to the Roman Empire more than 2,000 years ago; to the European colonial empires that reached Asia, Latin America, and North America between the 16th and 18th centuries. At times it was temporarily halted or it retrenched due to economic upheaval (the Great Depression), major wars, or shifts in dominant world powers, only to resurface later in other forms. Many nations involved in today's globalization movement have maneuvered similar roads before.

There are critical distinctions between today's globalization era and the periods long ago: (1) It is open to the masses, (2) it is generating unprecedented wealth, and (3) technology is integrating peoples of the world like never before.

China's rural poverty rate declined dramatically

China's rural poverty as a % of rural population




Source - RBC Wealth Management, *2017 OECD Economic Survey of China*, China's National Bureau of Statistics; data published March 2017

### Market pulse





Wealth Management

In a perverse way, globalization is now inherently "populist," contrary to current criticisms. Centuries and millennia ago, royalty, noble classes, rulers or other prominent officials, and explorers were the overwhelming beneficiaries of globalization. Today, middle income citizens of developed and developing countries can directly reap the benefits of globalization through investment portfolios—not to mention employment opportunities and improved standards of living that globalization brings to all strata of society.

Along with the populist characteristic has come an explosion in wealth. China's rural poverty rate, for example, has plunged from roughly 96% in 1980 to a mere 6% in 2015, as the chart on page 1 illustrates.

Most of the world's population—rich, poor, and otherwise—interacts in the global marketplace because of the technology buildout of the 1990s and the warp-speed extension of that in the past 5–10 years with digitization. Use of cross-border bandwidth has multiplied almost 50-fold since 2005. In this regard, there is no turning back.

## What's in the way?

Even with these substantial benefits, globalization's drawbacks are front and center: the growing gap between rich and poor in developed *and* developing countries, labor dislocations, uncontrolled or unsustainable immigration, and, of course, trade imbalances.

Addressing globalization's deficiencies is a delicate process. Take trade imbalances, for example. RBC Global Asset Management's Chief Economist Eric Lascelles has stated, "It should be conceded that the U.S. is actually right in asserting that it is currently getting the raw end of the trade deal." His data shows that U.S. companies tend to pay higher tariffs when conducting business in foreign markets than foreign firms do in the U.S.

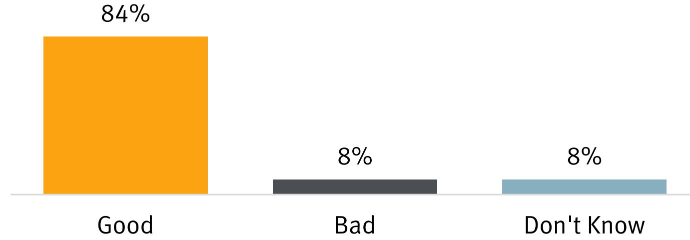
Attempting to right these wrongs with a full-throated protectionist strategy, by ripping up current trade deals and imposing tariffs, could create meaningful economic risks.

Thus far investors have been willing to shrug off protectionist risks. While President Trump has moderated or even changed course on some of his signature campaign pledges, we do not rule out that credible protectionist threats could surface in coming months or years.

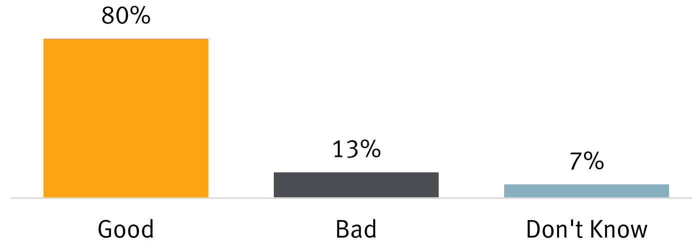
But just how much support does protectionism have? A wider range of U.S. citizens supports globalization than trade hawks acknowledge. This is not confined to just Fortune 500 companies and the Washington Beltway. Data indicates that U.S. small business leaders overwhelmingly support global trade and integration; they believe it is good for the economy and necessary to be competitive (see charts).

### U.S. small businesses overwhelmingly support global trade

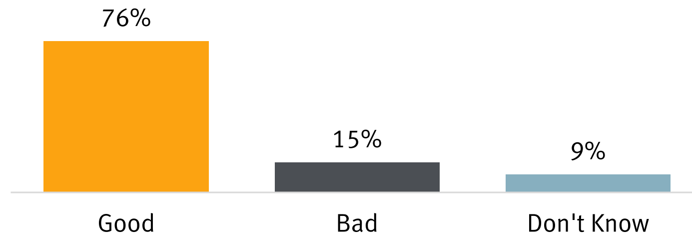
84% of small business leaders say expanding trade and opportunities between the U.S. and foreign customers is a good thing



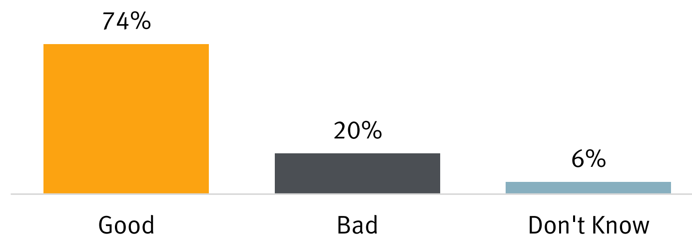

80% of small business leaders agree that increasing trade will improve the economy overall




76% of small business leaders agree that increasing trade will create opportunities and jobs




74% of small business leaders agree that U.S. manufacturers need access to foreign components and parts to be competitive




Source - Morning Consult on behalf of FedEx Corp.; survey conducted March 9–21, 2017

## Whither globalization?

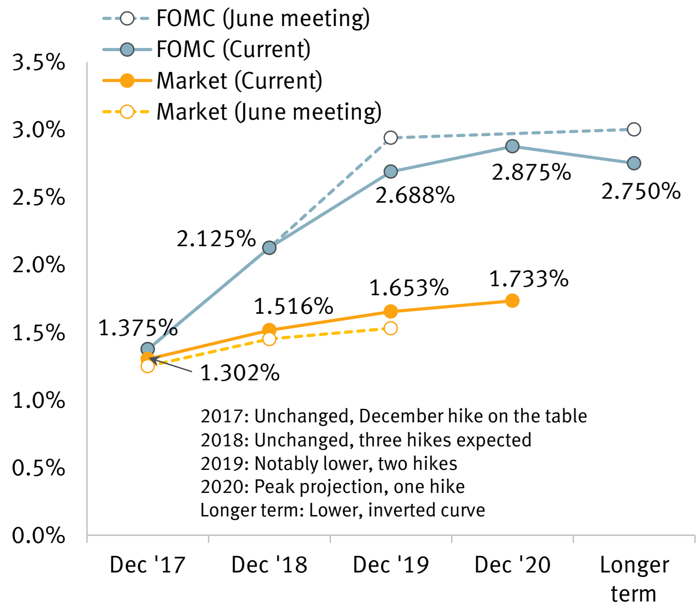
Modern-day globalization, led by the surge in technology that is further binding economies, companies, and peoples around the world, has the potential to usher in a new wave of prosperity and freedoms. But until governments begin to tackle at least some of globalization's shortcomings in prudent ways, the grassroots pushback could persist and investors may have to deal with protectionist risks and setbacks from time to time.

## United States

Craig Bishop, Bill Kuehn, & Sam Renikoff – Minneapolis

- The most anticipated Fed meeting in recent memory resulted in few surprises with the Fed Funds rate held steady. As expected, **the Fed announced that beginning next month it will begin to slowly shrink the $4.5T balance sheet** that was amassed during the three rounds of quantitative easing in order to spur economic growth after the Great Recession.
- We agree with policymakers' assessment that **the balance sheet unwinding process will "be like watching paint dry"** and that the market reaction will be influenced by how the U.S. Treasury funds itself with new debt issuance and not the effects of balance sheet unwinding. We believe the Treasury will be able to fund itself with short-term bills **without disrupting the market**.
- The bulk of changes to the rate projections known as the "dots," as well as the moderation in both the unemployment rate and inflation rate appear to move the Fed closer to market expectations, and thus **we see no reason to adjust strategy** since most of the changes were already well priced into the market.
- **The Fed introduced a 2020 dot for the first time**, which took the spot as the peak of the hiking cycle, with a projected rate of 2.875%. The most notable dot forecast change was the lowering of the "longer-run" dot from 3.00% to 2.75%, indicating that **the projected rate in 2020 would be officially restrictive monetary policy** (see chart). To us, this coupled with the Fed's 2020 uptick in the projection for the unemployment rate and a lower GDP projection than prior years **could be a way of signaling this economic expansion has a few more years to go**.
- As it relates to the more relevant near-term dots, there were no changes to 2017, indicating **the Fed still sees a hike in December, and the forecast for 2018 remains at three hikes**. The revisions put the Fed ever-so-slightly closer to market expectations, **though the market is still pricing in just two hikes by year-end 2019** versus the Fed's projection of six. With the Fed revising its inflation forecast below 2% for 2018, we believe the Fed is firmly committed to a very slow pace of tightening.

Market still skeptical despite the Fed's lower "dots"




Source - RBC Wealth Management, Bloomberg; data through 9/20/17

## Canada

Alicia Buckiewicz & Farazeh Mahboob – Toronto

- **Toys "R" Us** announced that it has **filed for bankruptcy protection in the U.S. and Canada**. The company has received commitments for $3.0B in financing to support its operations. Toys "R" Us stated that its 1,600 stores around the world and its e-commerce sites will continue to operate. **We do not expect any of the Canadian retail REITs** (real estate investment trusts) **within RBC Capital Markets' coverage universe to be materially impacted** by this news as they have limited-to-no exposure to Toys "R" Us.
- **RBC Capital Markets has pushed out its 16,300 price objective for the S&P/TSX Composite Index** to year-end 2018 from year-end 2017. RBC Capital Markets also sharply **reduced its earnings per share (EPS) forecasts** for the S&P/TSX for 2017 and 2018 primarily because of the **decline in RBC Capital Markets' oil price forecasts** in the face of resilient U.S. supply growth. RBC Capital Markets' new 2017 and 2018 EPS forecasts are CA$830 (from CA$877) and CA$907 (from CA$973), respectively.
- **Crude oil rebounded this month above $50/barrel, but prices have struggled to remain there as rising U.S. output stifles supply cuts by OPEC**. The bullish trend for oil was led by upward revisions in oil demand from OPEC and the International Energy Agency, exports from Saudi Arabia dropping to a three-year low in July, and weakness in the U.S. dollar. Earlier in the week, Iraq also commented that OPEC was discussing several options to extend output cuts past March. However, data released Wednesday from the Energy Information Administration showed that for the week ending September 15, crude oil inventories rose more than expected, while U.S. production also rose for a second consecutive week. **RBC Capital Markets continues to assume that oil prices will remain fairly range-bound** in the intermediate term, as any rally will encourage further drilling in U.S. shale oil regions.

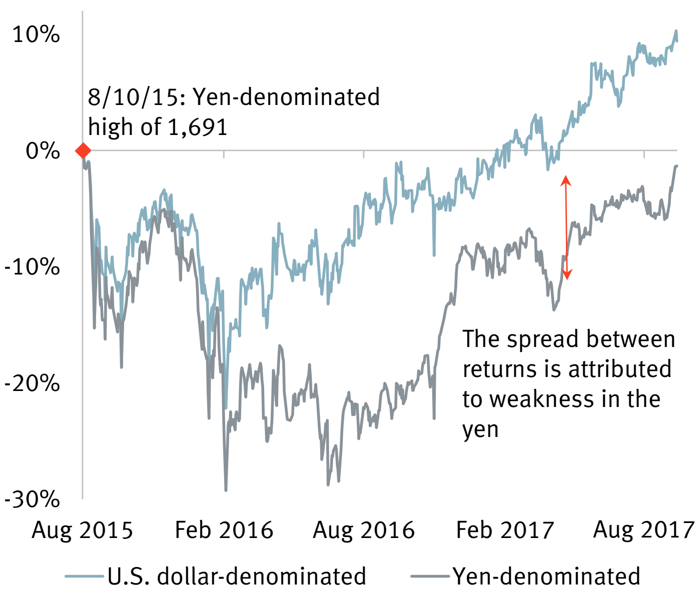
## Europe

Frédérique Carrier & Thomas McGarrity – London

- The minutes from the September meeting of the Bank of England's **Monetary Policy Committee** (MPC) suggested that "a majority of MPC members" believed **"some withdrawal of monetary stimulus was likely to be appropriate over the coming months."** Despite the slowdown of the economy, inflation has perked up and with unemployment at a mere 4.3%, the lowest level since 1975, **further inflation pressures could be building up**. Indeed, even the most dovish member of the MPC has endorsed that view. **RBC Capital Markets** has thus changed its forecast and now **expects a 0.25% interest rate hike in November**, bringing the bank rate to 0.5%. It believes this will be a **one-off**, merely reversing the monetary loosening which happened after the Brexit vote, and does not expect further interest rate increases in 2018, as Brexit uncertainties weigh on the economy.
- **The hawkish remarks lifted the pound** to more than 1.35 against the dollar, thus retracing over the past six months half the losses which occurred after the Brexit vote. We believe **this strength is overdone in the short term**. Economic indicators continue to soften and the weaker pound is failing to foster export growth. RBC Capital Markets expects political risks will reassert themselves and sterling to reach USD1.24 in one year's time.
- Much has been made in the press of **U.K. Prime Minister Theresa May's speech addressing EU leaders** on September 22. The key will be **whether it offers enough substance**, particularly in regards **to settling the so-called "divorce bill,"** for EU chief negotiator Michel Barnier to decide that enough progress has been made in the exiting negotiations to move on to discuss the U.K.'s future relationship with the EU. With less than 18 months to leave the EU, **little time is left to agree on the intricacies of a complex trade agreement**. If the U.K. fails to do so, it will have to fall back on the World Trade Organization's trading rules, where onerous non-tariff barriers could prove an impediment to business.

Recent gains for Japanese equities are magnified by a weakening yen

TOPIX Index returns since 2015 highs




Source - RBC Wealth Management, Bloomberg; data through 9/27/17

## Asia Pacific

Jay Roberts – Hong Kong

- Asian equities marched higher again. The **MSCI AC Asia Pacific Index** is at 164, a **decade-high**. A further increase of 5% would take the index past its peak in 2007 and to a record high.
- The **Bank of Japan** (BoJ) kept its **policy unchanged while comments from BoJ Governor** Haruhiko Kuroda were **a bit dovish**. The market's interpretation of the latest moves from the U.S. Federal Reserve and the BoJ was to weaken the yen. The yen has fallen against the dollar by quite a large margin over the past couple of weeks from USDJPY107 to over 112.
- **Weakness in the yen has presented a nice tailwind for the TOPIX Index**, which hadn't done much for several months but then rallied up to 1,668. The index has **rallied over 4% in two weeks** and is only 0.5% lower than its cycle-peak in 2015. Given the outlook for earnings and reasonable valuations, **we expect the TOPIX to break through to a new high**. Notably, when measured in U.S. dollar terms, the TOPIX is already at a new high, well above its 2015 level.
- **AIA Group** (1299 HK), one of the largest life insurers in Asia and a major constituent of the Hang Seng Index in Hong Kong, **will buy the life insurance business of Commonwealth Bank of Australia** (CBA AU) for A$3.8B. This is **AIA's largest-ever acquisition** and will make it the largest life insurance company in Australia and New Zealand.

## MARKET SCORECARD

### Data as of September 21, 2017

| Equities (local currency) | Level | MTD | YTD | 1 yr | 2 yr |
|---|---|---|---|---|---|
| S&P 500 | 2,500.60 | 1.2% | 11.7% | 15.6% | 27.1% |
| Dow Industrials (DJIA) | 22,359.23 | 1.9% | 13.1% | 22.2% | 35.4% |
| NASDAQ | 6,422.69 | -0.1% | 19.3% | 21.3% | 33.0% |
| Russell 2000 | 1,444.18 | 2.8% | 6.4% | 16.0% | 24.4% |
| S&P/TSX Comp | 15,454.92 | 1.6% | 1.1% | 5.1% | 12.2% |
| FTSE All-Share | 3,985.05 | -2.2% | 2.9% | 6.9% | 18.4% |
| STOXX Europe 600 | 382.88 | 2.4% | 5.9% | 11.8% | 7.0% |
| EURO STOXX 50 | 3,539.59 | 3.5% | 7.6% | 18.7% | 11.1% |
| Hang Seng | 28,110.33 | 0.5% | 27.8% | 18.8% | 29.2% |
| Shanghai Comp | 3,357.81 | -0.1% | 8.2% | 11.0% | 6.4% |
| Nikkei 225 | 20,347.48 | 3.6% | 6.5% | 21.1% | 12.6% |
| India Sensex | 32,370.04 | 2.0% | 21.6% | 13.5% | 23.6% |
| Singapore Straits Times | 3,213.82 | -1.9% | 11.6% | 12.7% | 11.5% |
| Brazil Ibovespa | 75,604.34 | 6.7% | 25.5% | 29.5% | 62.3% |
| Mexican Bolsa IPC | 50,545.75 | -1.3% | 10.7% | 7.7% | 15.9% |

| Commodities (USD) | Price | MTD | YTD | 1 yr | 2 yr |
|---|---|---|---|---|---|
| Gold (spot $/oz) | 1,291.30 | -2.3% | 12.1% | -3.2% | 13.9% |
| Silver (spot $/oz) | 16.98 | -3.5% | 6.6% | -14.4% | 11.7% |
| Copper ($/metric ton) | 6,482.00 | -4.1% | 17.4% | 36.8% | 22.7% |
| Oil (WTI spot/bbl) | 50.20 | 6.3% | -6.6% | 11.2% | 7.5% |
| Oil (Brent spot/bbl) | 56.48 | 7.8% | -0.6% | 20.6% | 15.5% |
| Natural Gas ($/mmBtu) | 2.96 | -2.8% | -20.6% | -3.3% | 14.8% |

| Govt bonds (bps chg) | Yield | MTD | YTD | 1 yr | 2 yr |
|---|---|---|---|---|---|
| U.S. 10-Yr Tsy | 2.277% | 16.0 | -16.8 | 62.5 | 7.5 |
| Canada 10-Yr | 2.120% | 27.1 | 39.9 | 97.1 | 57.8 |
| U.K. 10-Yr | 1.367% | 33.3 | 12.8 | 56.1 | -51.7 |
| Germany 10-Yr | 0.455% | 9.4 | 24.7 | 45.3 | -22.9 |
| **Fixed Income (returns)** | **Yield** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. Aggregate | 2.54% | -0.5% | 3.1% | 0.5% | 5.8% |
| U.S. Invest Grade Corp | 3.17% | -0.4% | 5.0% | 2.6% | 11.1% |
| U.S. High Yield Corp | 5.48% | 0.6% | 6.7% | 9.6% | 19.2% |

| Currencies | Rate | MTD | YTD | 1 yr | 2 yr |
|---|---|---|---|---|---|
| U.S. Dollar Index | 92.1970 | -0.5% | -9.8% | -3.6% | -3.9% |
| CAD/USD | 0.8110 | 1.2% | 9.0% | 6.2% | 7.5% |
| USD/CAD | 1.2330 | -1.2% | -8.3% | -5.9% | -7.0% |
| EUR/USD | 1.1941 | 0.3% | 13.5% | 6.7% | 6.7% |
| GBP/USD | 1.3582 | 5.0% | 10.1% | 4.2% | -12.4% |
| AUD/USD | 0.7931 | -0.2% | 10.0% | 4.0% | 11.2% |
| USD/JPY | 112.5300 | 2.3% | -3.8% | 12.2% | -6.7% |
| EUR/JPY | 134.3700 | 2.6% | 9.3% | 19.7% | -0.4% |
| EUR/GBP | 0.8792 | -4.6% | 3.0% | 2.4% | 21.9% |
| EUR/CHF | 1.1593 | 1.5% | 8.1% | 6.4% | 6.6% |
| USD/SGD | 1.3499 | -0.4% | -6.7% | -0.3% | -4.3% |
| USD/CNY | 6.5904 | 0.0% | -5.1% | -1.2% | 3.5% |
| USD/MXN | 17.8887 | 0.0% | -13.7% | -9.4% | 7.4% |
| USD/BRL | 3.1413 | -0.2% | -3.5% | -2.0% | -21.2% |

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 8:35 pm GMT 9/21/17.

Examples of how to interpret currency data: CAD/USD 0.81 means 1 Canadian dollar will buy 0.81 U.S. dollar. CAD/USD 9.0% return means the Canadian dollar rose 9.0% vs. the U.S. dollar year to date. USD/JPY 112.53 means 1 U.S. dollar will buy 112.53 yen. USD/JPY -3.8% return means the U.S. dollar fell 3.8% vs. the yen year to date.

## UPCOMING EVENTS

**Fri, Sep 22**

- Eurozone Markit Manuf. PMI (57.2)
- Eurozone Markit Serv./Comp. PMI
- Germany Markit Manuf. PMI (59.0)
- Germany Markit Serv./Comp. PMI
- U.S. Markit Manuf. PMI (53.0)
- U.S. Markit Serv./Comp. PMI
- Canada CPI (0.2% m/m, 1.5% y/y)

**Sun, Sep 24**

- Japan Nikkei Manufacturing PMI

**Sun, Sep 24, cont.**

- German Federal Elections

**Mon, Sep 25**

- China Conf. Board Leading Eco. Index
- Germany IFO Expectations
- U.S. Chicago Fed National Activity
- NY Fed President Dudley Speaks (NY)

**Tue, Sep 26**

- China Industrial Profits
- U.S. New Home Sales (660K, 5.1% m/m)

**Tue, Sep 26, cont.**

- U.S. Conf. Board Consumer Confidence
- Fed Chair Yellen Speaks (OH)

**Wed, Sep 27**

- China Swift Global Payments
- U.S. Durable and Capital Goods
- U.S. Pending Home Sales (-0.5% m/m)

**Thu, Sep 28**

- China Caixin Manufacturing PMI
- Japan CPI

**Thu, Sep 28, cont.**

- Japan Industrial Production
- Eurozone Economic Confidence
- Eurozone Consumer Confidence
- Eurozone Industrial Confidence
- Germany CPI
- U.S. Q2 GDP Rev. (3.1%, q/q annlz'd)
- U.S. Personal Consumption
- U.S. Core PCE

The dates reflect North American time zones. All data reflect Bloomberg consensus forecasts where available.

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As of June 30, 2017

| | | | Investment Banking Services Provided During Past 12 Months | |
|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
| Buy [Top Pick & Outperform] | 826 | 52.01 | 293 | 35.47 |
| Hold [Sector Perform] | 657 | 41.37 | 144 | 21.92 |
| Sell [Underperform] | 105 | 6.61 | 7 | 6.67 |

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