GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee May 6, 2021

Is it OK to be optimistic?

Kelly Bogdanova – San Francisco

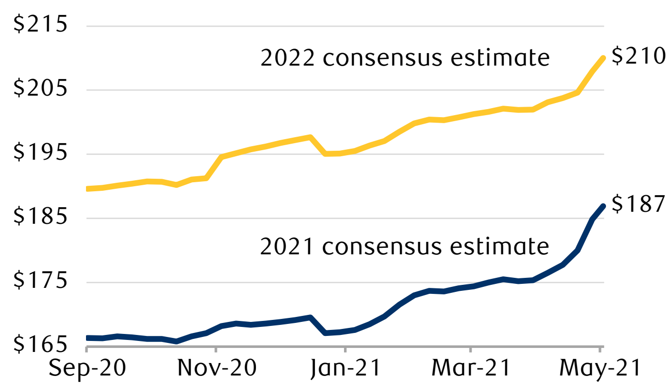
Corporate earnings have started the year off right, and strong GDP growth is expected, but the market response has been tame. We look at the trends that could drive future earnings expansion, and why investors should focus on the long view.

After a significant 28 percent rally since late October 2020, the S&P 500 has been treading water of late despite an ultra-strong earnings season and a surge in earnings estimates for this year and next. The potential implications of higher inflation, supply-chain constraints, and economic overheating, along with jitters about Federal Reserve policy, have contributed to the market's pause and prompted sector rotation. Growth stocks have lagged, particularly those that are technology-oriented. Value sectors have held up better, especially the most economically sensitive areas, otherwise known as cyclicals.

Even though the market is largely yawning at the strong earnings season, we think investors should not overlook the bigger trends that are afoot.

Earnings estimates have risen a lot, especially lately

The change in the S&P 500 annual earnings-per-share consensus estimates since September 2020



Source - RBC Wealth Management, Refinitiv I/B/E/S; weekly data except for the most recent on 5/5/21

Will GDP boost earnings growth?

Strong pent-up demand due to the economic reopening is driving robust Q1 results. Also contributing are prudent cost-savings measures by many companies and improved pricing power, which have led to favorable operating leverage and profit margin expansion.

With 84 percent of S&P 500 companies having reported Q1 results thus far, 87 percent have exceeded the consensus earnings forecast, according to Refinitiv I/B/E/S. Notably, the magnitude of earnings beats has been high at 23 percent, on average, compared to the 6.9 percent five-year average. The Q1 consensus earnings growth rate has jumped to 50 percent y/y from 24 percent at the start of the reporting season. Revenue growth is also strong, pacing at 12.6 percent y/y. The outsized earnings and

For perspectives on the week from our regional analysts, please see pages 3–4.

revenue surprises have been broad, crossing a diverse group of sectors, rather than concentrated in two or three sectors as is usually the case.

Is additional earnings optimism warranted? We think so—especially for this year. While it's common for industry analysts and equity strategists to ultimately get too bullish with their earnings forecasts, we don't think that's the case yet.

U.S. GDP is expected to climb at its fastest pace in nearly four decades. The consensus forecast is for 6.25 percent growth in 2021, but GDP could eclipse that level if strong household demand persists. An economic boom surpassing that of the early 1980s is not out of the question, according to RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli.

Incremental GDP growth matters. Our national research correspondent estimates that every one percent positive change in nominal GDP growth (i.e., real GDP plus inflation) results in an increase of 2.5 to three percent in S&P 500 revenues. While the magnitude of revenue gains differs in other studies, there is little doubt in our minds that incremental nominal GDP growth boosts revenue growth—the two tend to go hand in hand.

Management teams and Wall Street analysts have not yet calibrated their 2021 earnings forecasts for outsized—or even 6.25 percent—GDP growth, in our view. The economy's dramatic on/off switching due to the COVID-19 shutdowns last year and reopening this year, combined with unprecedented fiscal and monetary stimulus, make earnings forecasting very challenging. We think both management teams and analysts have leaned toward conservative estimating or are hesitant to provide forecasts altogether. A much lower proportion of companies have given Q2 or full-year guidance than in the pre-pandemic period.

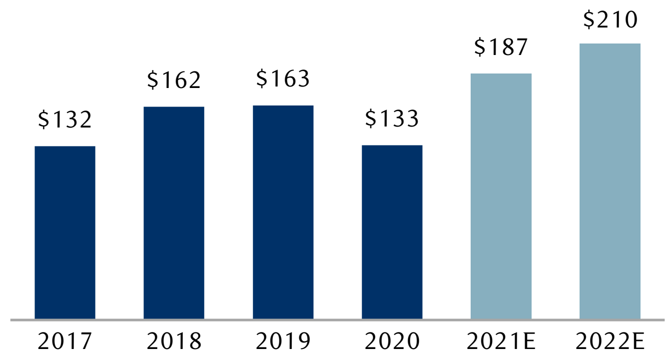
The uniquely buoyant inflation and commodity price environments also point to margin expansion opportunities, in our view. Inflation expectations and stock prices tend to be positively correlated; when the former rises, the later also tends to move up. Furthermore, when commodity prices rise, many industries typically have pricing power—even non-commodity producers.

Good news travels fast

We believe the market has already absorbed a lot of this good earnings news. Stocks' response to strong Q1 trends has been tame, below the excitement of recent quarters, but similar to the long-term average. We think the S&P 500 year-over-year earnings growth rate is likely to peak in the Q2 reporting season due to the very easy comparison to results during the COVID-19 lockdown, although we see upside to the Q2 consensus forecast of 61 percent y/y. Furthermore, RBC Capital Markets points out that the peak in the pace of upward earnings revisions—a metric

This year, U.S. earnings should eclipse the previous record high

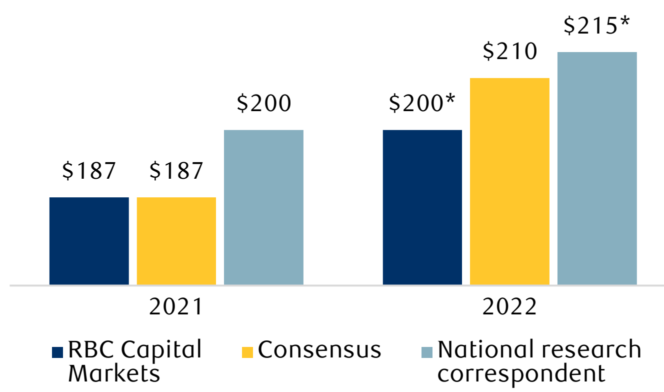
S&P 500 annual EPS: Historical (dark blue) and consensus estimates (light blue)



Source - RBC Wealth Management, Refinitiv I/B/E/S; estimates as of 5/5/21

We think 2021 earnings will beat the consensus forecast; 2022 is a tougher call

S&P 500 annual EPS forecasts



* Incorporates potential corporate tax rate hikes. 2022 earnings estimates of both RBC Capital Markets and our national research correspondent assume the statutory rate will rise to 25% from 21%. Other macro and fundamental factors account for the difference in forecasts between the two sources.

Source - RBC Wealth Management, RBC Capital Markets, Refinitiv I/B/E/S (consensus forecasts), National research correspondent; all estimates as of 5/5/21

that institutional investors take note of—may already be in the rear view mirror. We think revisions could slow meaningfully after Q2 earnings beats are factored in.

A potential slowdown in earnings revisions and growth momentum could nudge the market into a longer consolidation period or a pullback—this would be normal. However, we think any market wobbles would prove transitory. While the S&P 500 is likely to soon reach its maximum earnings growth rate for this cycle, the overall *level* of corporate earnings doesn't seem set to peak any time soon. It's still early in the business cycle, and the tight credit conditions necessary to produce corporate earnings declines, the next recession, and an equity bear market look to be a long way off. We would continue to moderately Overweight equities in portfolios, and tilt U.S. exposure toward value-oriented cyclicals.

UNITED STATES

Atul Bhatia, CFA – Minneapolis

- Comments this week by **Treasury Secretary Janet Yellen on the potential need for higher interest rates to offset possible inflationary impacts** from the Biden administration's spending proposals renewed focus on rising consumer prices. Yellen quickly clarified that her remarks were not a prediction, and speeches by **four separate Fed leaders this week reiterated that the central bank views expected upcoming inflation as transitory and will not adjust policy** in response. Chicago Fed President Charles Evans said that even inflation above 3% would not necessarily be a concern, if it were thought to be temporary.

- The Fed's preferred price measure—the one-year change in the Personal Consumption Expenditures Price Index—was up 2.3% in March, only slightly above the Fed's 2% target. **Prospects are elevated for higher prices in the near future, however, as input costs are rising rapidly and the ongoing semiconductor shortage continues to hamper production of a wide range of consumer goods**. The Bloomberg Commodity Index in April rose at its fastest yearly pace in four decades, and March automobile inventories hit an 11-year low on robust consumer demand and chip-related production shutdowns. The resulting $37,500 average automobile transaction price was the highest ever for the first quarter, according to industry data provider ALG.

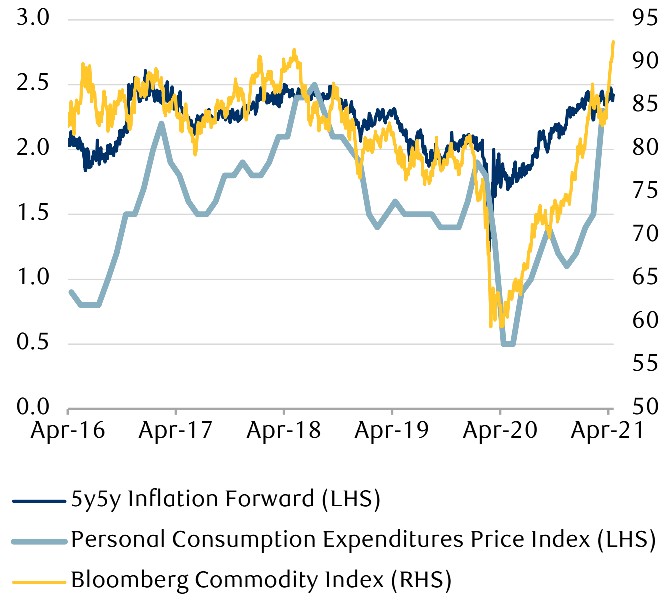
- The U.S. government currently operates under a **debt ceiling waiver** that expires on Aug. 1, and the **Treasury Department this week gave an update on its funding resources should Congress fail to renew the waiver**. Without the ability to borrow, Treasury would be forced to redirect federal spending to debt service and rely on incoming tax receipts as its only source of income. In prior debt ceiling fights, these measures have lasted for months, but Treasury believes its alternatives to debt issuance will be exhausted much more quickly this time as a result of the pandemic. For investors, the initial impact would likely be even further downward pressure on money market rates, as the issuance of new Treasury bills—already in short supply—would fall.

CANADA

Carolyn Schroeder & Richard Tan, CFA – Toronto

- **The Q1 earnings season is well underway**, with approximately 36% of companies on the S&P/TSX Composite having reported thus far. Generally speaking, **corporate earnings have rebounded sharply** on a year-over-year basis and results have been in-line to better-than-expected relative to consensus expectations. **The S&P/TSX Composite continues to benefit from its orientation toward value and cyclical stocks**, and the index has rewarded investors with a series of new all-time highs. From a valuation perspective, the index is trading above its long-term price-to-earnings average; however, we believe investors are being compensated with above-average equity risk premiums in the context of a low-interest-rate environment. **We remain constructive on Canadian equities**, and believe there is room for further upside as COVID-19 headwinds dissipate. The S&P/TSX Composite has returned about 11.5% year-to-date, modestly outpacing the S&P 500 in local-currency terms.

Commodities likely to drag inflation higher near term, but market pricing reflects limited longer-term impact



Note: 5y5y refers to annual inflation during a five-year period starting five years in the future

Source - RBC Wealth Management, Bloomberg

- Seven of Canada's provinces reported record-breaking GDP declines in 2020. Of all the provinces, Alberta faced the most severe contraction (-8.2%) as a result of the collapse in oil prices coupled with rock-bottom demand for energy products amid global travel restrictions. Now, **Canadian GDP is on track for a robust first quarter**. The increase in GDP in February and March came alongside some easing in containment measures between the second and third waves of virus spread. **For the first time since last spring, growth can be attributed entirely to strength in service industries**; with the reopening of indoor shopping in some regions, retail sales reversed a large part of the GDP declines seen in December 2020 and January 2021 and accounted for more than half of growth in February. **Overall, an increase of approximately 0.9% in March would leave GDP up 6.7% (annualized) in Q1 2021**, in line with the 7% increase from the Bank of Canada's latest projections and slightly above RBC Economics' 6.0% forecast.

EUROPE

Thomas McGarrity, CFA & Frédérique Carrier – London

- **The Bank of England (BoE) adopted a somewhat hawkish tone** at its Monetary Policy Committee (MPC) meeting on May 6, **though it made no change to its main policies**, leaving the Bank Rate unchanged at 0.1% and maintaining its asset purchase target of £895 billion. Forward guidance was also unchanged, with the MPC stating it "does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably."

- **The hawkishness came from the MPC increasing its 2021 GDP growth forecast markedly**, to 7.25% from 5.0%, even as it reduced its 2022 forecast to 5.75% from 7.25%—in effect, **bringing forward the recovery**. The forecast for 2023 was maintained at 1.25%. Moreover, the MPC expects that unemployment will peak at 5.5% in Q3 of this year, versus 7.75% previously, and that the economy will recover to pre-pandemic levels over this year (instead of in Q1 2022, as it had expected previously).

- Moreover, the MPC announced **the BoE would reduce asset purchases to £3.4 billion per week from £4.4 billion as soon as next week** and maintain that level until August, when the policy would be re-evaluated. That the taper comes so soon after the announcement surprised observers.

- A stronger-than-expected recovery in the UK could bring forward the first rate rise, which consensus currently expects late in 2022.

- **It has been a strong pan-European Q1 reporting season so far**. With more than two-thirds of those STOXX Europe 600 companies expected to report having done so, over 70% have reported earnings ahead of consensus expectations, the highest level in more than a decade. Aggregate earnings per share has grown at a rate of over 40% y/y thus far, albeit clearly against a depressed comparative base period as we lap the onset of the pandemic.

- Despite the high level of beats, share price reaction, in aggregate, has been negatively skewed to results, indicating that **strong results were already anticipated by investors**. Even in instances where earnings beat consensus expectations, if the beat and/or forward guidance did not translate into consensus earnings upgrades, stocks have been penalised on the day of results.

ASIA PACIFIC

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

- **Asia-Pacific equity markets traded mixed during the holiday-shortened week**. Japan's Nikkei 225, having underperformed the region in April, is leading the pack as the country returns from the long holiday.

- **Hong Kong's economy grew year over year in the first quarter after six consecutive year-over-year quarterly contractions**. The preliminary report showed GDP grew 7.8% y/y in Q1 2021, compared to -2.8% in the previous quarter. Growth was supported by exports of goods. Looking ahead, **economists expect a broad-based improvement later in the year** provided the pandemic remains under control. The government had earlier forecast real GDP growth of 3.5%–5.5% for 2021. A revised forecast is expected to be released on May 14.

- **China thermal coal futures posted its highest intra-day price on May 6 as supply failed to meet the very strong demand from China's post-pandemic recovery**. Analysts expect the world's second-largest economy to burn a record amount of coal this year as industries rebound. Meanwhile, **supply of the fuel had been disrupted by safety checks** following a spate of mining accidents, and a purchasing halt from Australia. All in, thermal coal prices are expected to remain resilient in 2021.

- Following a sharp increase in the number of community COVID-19 cases in Singapore, **the government announced new restrictions that will bring the republic one step backward into Phase 2 of the reopening**. Key changes include reducing dining-in group size, shopping mall capacity, event sizes, number of employees in offices, closure of high-risk settings, and extending broader restrictions. We think the measures are aimed at pre-empting the spread of more infectious COVID-19 strains and avoiding a shift to a circuit breaker. In the near term, **we expect some downward pressure on the reopening plays and, meanwhile, defensive names could experience renewed interest, albeit, short-lived**.

China thermal coal prices at all-time high

Zhengzhou Commodity Exchange Thermal Coal Futures

Source - RBC Wealth Management, Bloomberg; daily data since inception

MARKET
Scorecard

Data as of May 6, 2021

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,201.62	0.5%	11.9%	47.5%	43.3%
Dow Industrials (DJIA)	34,548.53	2.0%	12.9%	46.0%	30.7%
Nasdaq	13,632.84	-2.4%	5.8%	54.0%	67.8%
Russell 2000	2,241.42	-1.1%	13.5%	77.5%	38.8%
S&P/TSX Comp	19,290.98	1.0%	10.7%	30.1%	17.0%
FTSE All-Share	4,032.10	1.2%	9.8%	25.0%	-0.4%
STOXX Europe 600	441.02	0.8%	10.5%	31.9%	14.0%
EURO STOXX 50	3,999.44	0.6%	12.6%	40.6%	15.5%
Hang Seng	28,637.46	-0.3%	5.2%	18.6%	-2.0%
Shanghai Comp	3,441.28	-0.2%	-0.9%	19.6%	18.4%
Nikkei 225	29,331.37	1.8%	6.9%	49.5%	31.8%
India Sensex	48,949.76	0.3%	2.5%	54.5%	26.8%
Singapore Straits Times	3,173.00	-1.4%	11.6%	22.4%	-3.6%
Brazil Ibovespa	119,920.60	0.9%	0.8%	51.7%	26.2%
Mexican Bolsa IPC	48,934.91	1.9%	11.0%	32.3%	10.9%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	1.570%	-5.6	65.6	86.7	-90.0
Canada 10-Yr	1.515%	-3.1	83.8	90.2	-21.9
UK 10-Yr	0.792%	-5.0	59.5	56.1	-42.7
Germany 10-Yr	-0.225%	-2.3	34.4	28.2	-23.1
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	1.50%	0.2%	-2.4%	0.5%	17.1%
U.S. Investment-Grade Corp	2.15%	0.4%	-3.2%	6.1%	22.9%
U.S. High-Yield Corp	3.95%	0.2%	2.1%	19.6%	19.9%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,815.33	2.6%	-4.4%	7.7%	41.7%
Silver (spot $/oz)	27.33	5.5%	3.5%	84.0%	83.4%
Copper ($/metric ton)	9,949.00	1.2%	28.4%	92.5%	59.7%
Oil (WTI spot/bbl)	64.71	1.8%	33.4%	169.7%	4.0%
Oil (Brent spot/bbl)	68.22	1.4%	31.7%	129.5%	-4.2%
Natural Gas ($/mmBtu)	2.94	0.1%	15.6%	51.0%	16.3%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	90.9120	-0.4%	1.1%	-9.2%	-6.8%
CAD/USD	0.8226	1.1%	4.7%	16.4%	10.6%
USD/CAD	1.2154	-1.1%	-4.5%	-14.1%	-9.6%
EUR/USD	1.2062	0.3%	-1.3%	11.7%	7.7%
GBP/USD	1.3894	0.5%	1.6%	12.5%	6.1%
AUD/USD	0.7783	0.9%	1.2%	21.6%	11.3%
USD/JPY	109.0800	-0.2%	5.6%	2.8%	-1.5%
EUR/JPY	131.5700	0.1%	4.3%	14.9%	6.0%
EUR/GBP	0.8682	-0.2%	-2.9%	-0.7%	1.5%
EUR/CHF	1.0953	-0.2%	1.3%	4.1%	-3.9%
USD/SGD	1.3333	0.2%	0.8%	-6.1%	-2.2%
USD/CNY	6.4641	-0.2%	-1.0%	-6.9%	-4.5%
USD/MXN	20.0944	-0.7%	0.9%	-17.6%	5.8%
USD/BRL	5.2746	-3.0%	1.5%	39.6%	32.9%

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.

Examples of how to interpret currency data: CAD/USD 0.82 means 1 Canadian dollar will buy 0.82 U.S. dollar. CAD/USD 4.7% return means the Canadian dollar rose 4.7% vs. the U.S. dollar year to date. USD/JPY 109.08 means 1 U.S. dollar will buy 109.08 yen. USD/JPY 5.6% return means the U.S. dollar rose 5.6% vs. the yen year to date.

Source - Bloomberg; data as of 4:35 pm ET 5/6/21

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As of March 31, 2021

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Buy [Outperform]	762	55.46	299	39.24
Hold [Sector Perform]	559	40.68	179	32.02
Sell [Underperform]	53	3.86	4	7.55

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