Monthly Scorecard

February 7, 2019 | Portfolio Advisory Group – U.S. Equities

Performance (Total return % change)

Index	1/31/19	1 mo.	3 mos.	YTD	1 yr.	2 yrs.
Dow (DJIA)	24,999.67	7.29	0.14	7.29	-2.19	31.85
S&P 500	2,704.10	8.01	0.26	8.01	-2.32	23.46
NASDAQ	7,281.74	9.79	-0.02	9.79	-0.65	32.65
Russell 2000	1,499.42	11.25	-0.43	11.25	-3.54	13.01
Russell 3000	1,596.54	8.58	0.44	8.58	-2.27	22.31
S&P 500 Equal Wgt.	4,067.66	9.85	1.91	9.85	-2.89	18.13
MSCI AC World	491.19	7.93	1.89	7.93	-6.98	19.24
MSCI Europe	121.13	6.21	0.81	6.21	-13.31	12.79
MSCI EAFE	1,831.09	6.61	1.36	6.61	-12.01	12.87
MSCI Asia-Pacific	156.65	6.85	5.21	6.85	-12.41	16.93
MSCI Emerg. Mkts.	1,049.93	8.76	10.23	8.76	-14.02	21.67
60/40 Allocation[1]	NA	5.23	1.57	5.23	-0.49	15.86
S&P 500 Sector	**1/31/19**	**1 mo.**	**3 mos.**	**YTD**	**1 yr.**	**2 yrs.**
Consumer Disc.	861.45	10.30	3.90	10.30	1.71	31.19
Consumer Staples	547.94	5.19	-2.54	5.19	-5.14	7.60
Energy	470.81	11.11	-4.56	11.11	-12.34	-6.55
Financials	429.90	8.84	-0.74	8.84	-11.11	15.33
Health Care	1,047.87	4.84	2.57	4.84	4.67	33.28
Industrials	603.74	11.41	3.28	11.41	-8.29	15.24
Information Tech.	1,163.16	6.96	-3.93	6.96	-0.90	41.82
Materials	333.98	5.49	2.19	5.49	-13.59	6.50
Real Estate	212.98	10.79	8.35	10.79	10.40	20.14
Comm. Services[2]	152.75	10.37	1.66	10.37	-3.99	-2.25
Utilities	277.67	3.43	2.82	3.43	11.08	19.22
FI, FX, & Commod.	**1/31/19**	**1 mo.**	**3 mos.**	**YTD**	**1 yr.**	**2 yrs.**
U.S. Treasuries[3]	2.63%	0.47	3.54	0.47	2.73	3.44
Invest-Grade Credit[4]	3.91%	2.35	3.68	2.35	0.75	5.86
High-Yield Credit[4]	6.90%	4.52	1.40	4.52	1.73	8.45
WTI Crude Oil[5]	$53.79	18.45	-17.64	18.45	-16.90	1.86
Dollar Index[5]	$95.58	-0.62	-1.59	-0.62	7.23	-3.95
Gold[5]	$1,321.20	3.02	8.76	3.02	-1.78	9.13

[1] 60% S&P 500 and 40% Bloomberg Barclays U.S. Aggregate; [2] Communication Services returns include data from the previously labeled Telecom sector for returns including dates prior to 9/30/18. [3] Yield reflects 10-year U.S. Treasury, total returns reflect Bloomberg Barclays U.S. Treasury Index; [4] Yield and total returns reflect that of the respective Bloomberg; Barclays Index; [5] Spot prices and price returns.
Source - Bloomberg, RBC Wealth Management

Priced (in USD) as of January 31, 2019, market close (unless otherwise stated).

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Mr. Market works fast

Global equities have rallied from the Christmas Eve doldrums. As we wrote last month, the selloff looked overdone and, apparently, investors largely agreed. U.S. equities provided leadership in January with the S&P 500 delivering its best January performance in over 30 years (1987). International equities also performed well, led by emerging markets rallying 8.8% on a total-return basis, and helped propel the MSCI All Country World Index to a monthly gain of 7.9%. Asian indexes continue to stabilize after a challenging 2018 as trade tensions between the U.S. and China appear to be moving in the right direction, albeit with an uncertain outcome still hanging in the balance. Developed markets' 6.6% return was "hampered" by a 6.2% gain in Europe as fears of a slowing German economy and Italian recession weighed on the continent.

In the U.S., economically sensitive stocks were the leaders. The small-cap Russell 2000 was up 11.3% for the month and has rallied 18.4% from the Christmas Eve low. The NASDAQ rallied about 10% for the month as the index's underweight to bond proxies (Consumer Staples, Utilities, and Real Estate) relative to the S&P 500 were a tailwind. The Tech and Health Care heavy NASDAQ is up 17.6% from recent lows. The S&P 500 was up 8.0% and 15.2%, respectively, over the same time periods while the Dow Jones gained 7.3% for the month.

Sector leadership was provided by Industrials (+11.4%) with strength in Aerospace & Defense stocks and Construction & Engineering firms. Energy (+11.1%) was the second-best performing sector as Oilfield Services stocks rallied sharply, gaining 18.8% in January. Real Estate was a surprising performer, taking home the bronze, and Communication Services hit cleanup on a sharp rally in Social Media and Entertainment stocks. In fact, both Facebook, Inc. and Netflix, Inc. gained more than 26% for the month and are up 35.5% and 46.8%, respectively, since their December 2018 lows.

Wealth Management

Volatility can cut both ways. Following the sharp Q4 selloff that nearly entered bear market territory, U.S. stocks have compressed multi-year returns into six weeks.

Despite appreciating 3.4% for the month, Utilities was the worst-performing group in the U.S. Other underperformers were Health Care, which struggled on a flat month for pharmaceuticals, and Consumer Staples due to weakness in Food and Staples Retailing companies. These "laggards" and the fact that equity markets just delivered their best January returns in over 30 years underscore the sharp rise in the market off the December lows. In fact, more than one-third of all S&P 500 companies are up 20% or more from their December lows.

S&P 500 gains since Christmas Eve, by company count

Return since Christmas Eve	Number of companies	Percent of S&P 500*
Less than 5%	38	7.5%
>5% and <10%	56	11.1%
>10% and <15%	111	22.0%
>15% and <20%	130	25.7%
>20% and <25%	87	17.2%
>25% and <30%	46	9.1%
Greater than 30%	37	7.3%
	505	100%

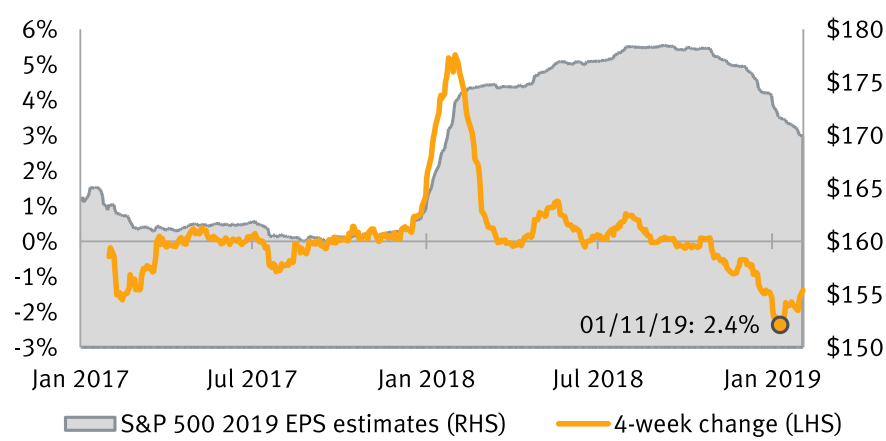
*There are technically 505 constituents in the S&P 500.
Source - RBC Wealth Management, FactSet; data through 1/31/19, priced as of the 12/24/18 intraday low

Investors feeling slightly disoriented by the roller coaster of the last four months are not alone. The S&P 500, to say nothing of more volatile indexes, lost 19.8% in slightly more than two months and then subsequently rallied more than 15% in the ensuing weeks. U.S. equities remain almost 10% below their all-time highs and, while not as attractive as they were in late December, continue to offer select opportunities. We prefer higher-quality companies with strong balance sheets and durable earnings at this time of the economic cycle.

Looking at 2019 EPS estimates, it's clear their sharp decline was part of the problem in Q4 2018. The decline in estimates coincides very closely with the selloff that started in October. 2019 estimates likely got ahead of themselves and the natural

Clearly there was a relationship between the fourth-quarter selloff and the decline in 2019 earnings estimates. However, equity markets typically recover prior to the trough date of earnings estimates, and the blue line shows a clear slowing in the rapidity of EPS estimate declines.

S&P 500 2019 EPS estimate declines decelerating



Note: The 4-week change is a measure of the rate in which earnings are advancing or declining.
Source - RBC Wealth Management, FactSet; data through 2/4/19

result when that happens is a correction to the underlying EPS estimates. That decline materialized in October and actually accelerated lower all the way through January 11. The good news is that there is a two-fold silver lining here. First, the pace of the decline is slowing. And second, according to RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina, equity markets typically recover prior to earnings growth trending positively. We think that's the moment we're in currently, where equities act as a forward discounting mechanism and recover in advance of earnings returning to growth.

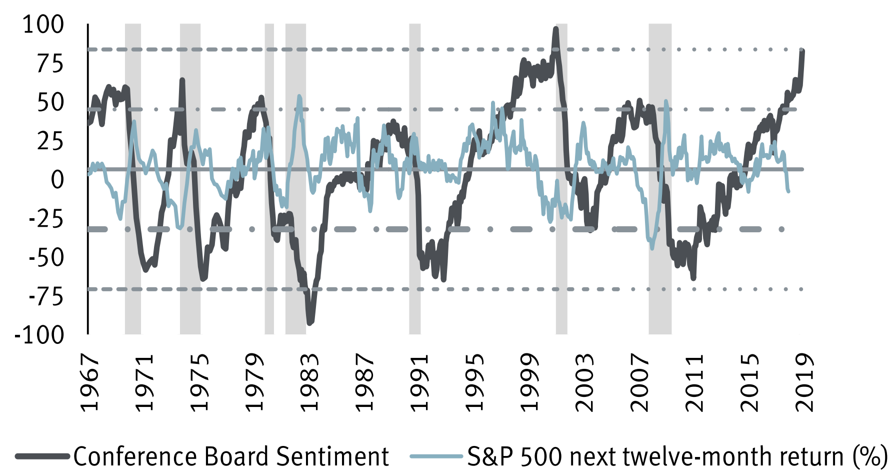
Context matters though when it comes to these things, and we also have to put the Q4 2018 selloff into its proper place. Since 1946, there have been 11 instances in which the S&P 500 declined more than 19% in just 60 days. Of those previous 10 instances, 9 have seen positive returns over the ensuing six- and 12-month time horizons. During the 10 previous occurrences, the average next six-month and next twelve-month returns have been 15% and 20%, respectively. Drilling down one level further and isolating for economic backdrops with Purchasing Managers' Indexes greater than 50, the six- and 12-month forward returns jump to 21% and 31%, respectively. Put differently, sharp pullbacks similar to that which was experienced in December often mark a trough-like moment in markets, and outsized returns are the norm in the aftermath of these waterfall declines—particularly when the economy is sturdy.

However, one challenge we see emerging is sentiment that has recovered from extremely bearish readings to a more neutral one. Remember, last month we took a look at the AAII bulls minus bears data. That number has moved upward from a three-month average reading of -12.5 to -8.3. While still a contrarian bullish indicator, the trend is important, particularly in light of our next sentiment indicator, which indicates a more challenging path forward.

Well-known bond investor Jeffrey Gundlach recently suggested a more bearish sentiment indicator for U.S. equities. He tweeted that the difference between Conference Board Consumer Expectations and Present Situations data is "the most recessionary signal at present." We looked at the data and found similar results but exited the exercise with mixed takeaways. As the chart below shows, when the current setup has been this bullish, it's been bad for equities in the past. However, it's unclear if the indicator is a leading or coincidental one, but it's not unreasonable

While sentiment appears to be near peak levels, it's unclear how much more of an impact it can have on U.S. equity markets after 2018's challenges. We view the elevated reading and lowered returns in tandem, resulting in our neutral view.

Conference Board Consumer Confidence readings near all-time highs



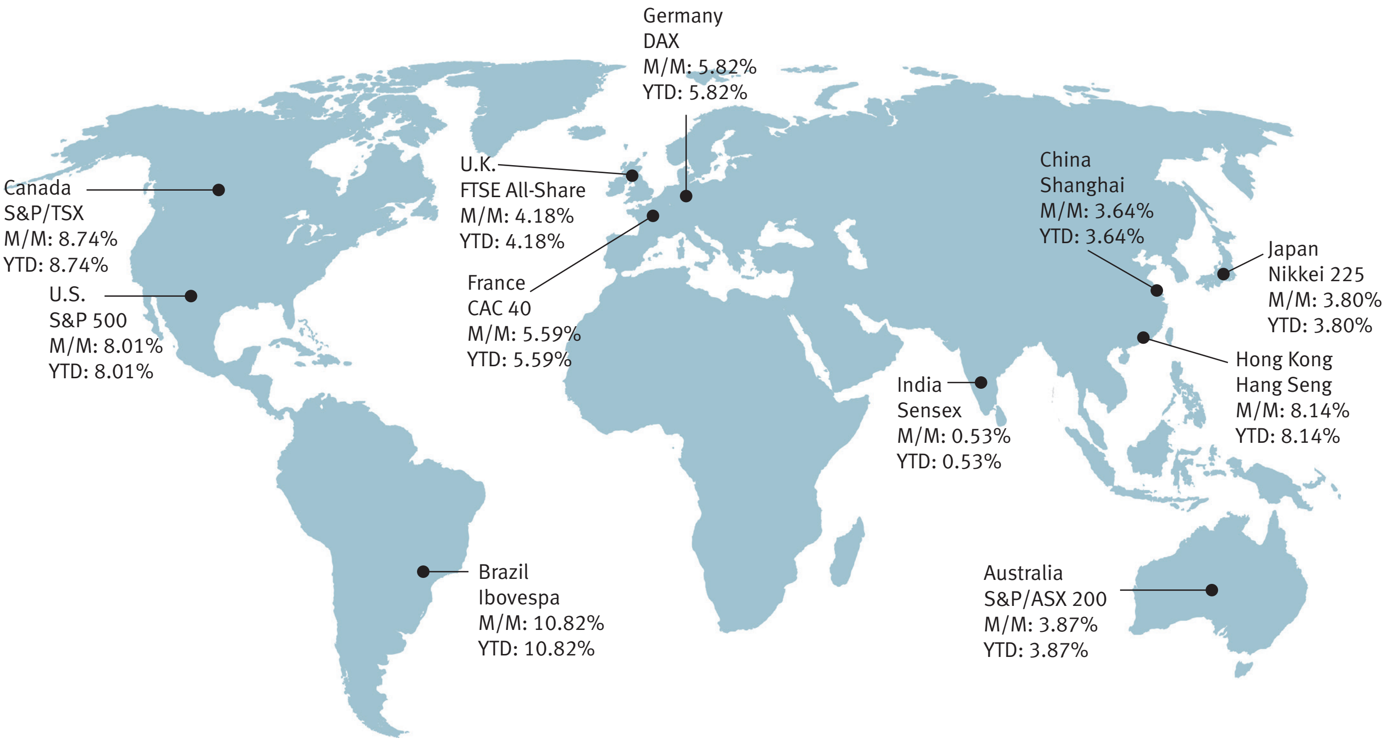
Note: Sentiment is defined as Conference Board Consumer Confidence Expectations minus the Conference Board Consumer Confidence Present Situations.
Source - RBC Wealth Management, Bloomberg; data through 1/26/19

to wonder due to the fact that we're still 10% below January 2018 highs. Current levels may be properly discounting this indicator currently. Given the AAII and Conference Board consumer sentiment data, we're viewing sentiment as relatively neutral as opposed to the extreme bearish reading as recently as one month ago.

To recap, U.S. equities appear poised for modest gains from here. While we're not looking for another 15% gain in the next two months, we do believe the backdrop is supportive for equities over the next 6–12 months. Clearly, there are some puts and takes and a bullish stance is not as clear cut as it was in late December. When it comes to stocks, we like average and would happily accept average returns for the next 12 months, given what we've experienced in the last four. Earnings revision trends appear to have bottomed and sentiment appears mixed, neither clearly bullish nor bearish, and valuations appear reasonable. While not as clear to us as Christmas Eve, U.S. equity markets appear to be going higher over the next 12 months.

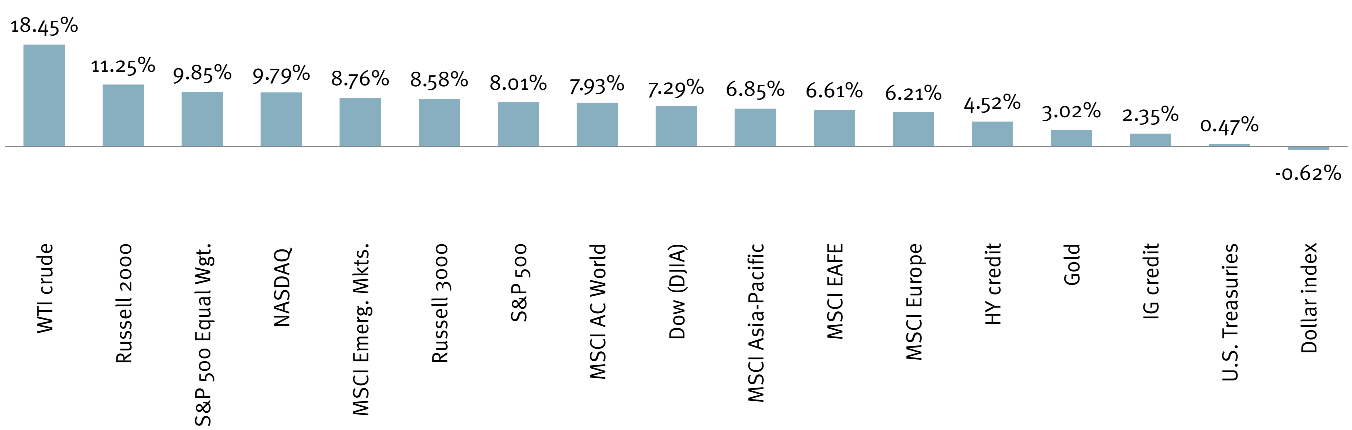
World markets

January month-over-month and year-to-date total return



Source - Bloomberg; priced in local currency

Total monthly returns for select indexes – January 2019



Source - Bloomberg

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