Monthly Scorecard

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

Performance (Total return % change)

Index	5/31/19	1 mo.	3 mos.	YTD	1 yr.	2 yrs.
Dow (DJIA)	24,815.04	-6.32	-3.66	7.54	4.05	23.72
S&P 500	2,752.06	-6.35	-0.67	10.73	3.78	18.69
NASDAQ	7,453.15	-7.78	-0.77	12.86	1.26	22.92
Russell 2000	1,465.49	-7.78	-6.64	9.25	-9.08	9.80
Russell 3000	1,619.72	-6.47	-1.32	10.92	2.49	17.92
S&P 500 Equal Wgt.	4,073.60	-6.90	-2.69	10.83	1.54	13.97
MSCI AC World	492.12	-5.86	-1.34	9.39	-0.73	11.63
MSCI Europe	124.47	-5.24	-0.89	9.00	-4.41	0.80
MSCI EAFE	1,817.39	-4.68	-1.18	8.08	-5.16	2.95
MSCI Asia-Pacific	152.36	-5.83	-3.04	5.11	-8.76	5.78
MSCI Emerg. Mkts.	998.00	-7.23	-4.44	4.16	-8.36	4.85
60/40 Allocation[1]	N/A	-3.1	1.1	8.36	4.83	13.61
S&P 500 Sector	**5/31/19**	**1 mo.**	**3 mos.**	**YTD**	**1 yr.**	**2 yrs.**
Consumer Disc.	878.54	-7.59	1.70	13.04	5.90	24.75
Consumer Staples	569.93	-3.84	2.61	10.42	15.59	3.87
Energy	432.10	-11.14	-9.20	3.53	-20.05	-4.11
Financials	430.65	-7.17	-1.46	9.85	-2.32	16.17
Health Care	1,007.00	-2.36	-4.46	1.34	7.67	18.72
Industrials	604.80	-7.76	-5.06	12.55	-1.03	9.30
Information Tech.	1,258.60	-8.69	1.88	16.49	4.40	33.84
Materials	329.32	-8.18	-3.66	4.97	-7.30	3.41
Real Estate	225.08	1.16	5.64	18.34	19.87	22.86
Comm. Services[2]	157.52	-5.93	2.64	14.21	11.59	7.30
Utilities	293.95	-0.77	3.05	11.01	18.40	15.92
FI, FX, & Commod.	**5/31/19**	**1 mo.**	**3 mos.**	**YTD**	**1 yr.**	**2 yrs.**
U.S. Treasuries[3]	2.13%	2.35	4.01	4.22	6.28	5.40
Invest-Grade Credit[4]	3.44%	1.43	4.54	7.23	7.45	7.51
High-Yield Credit[4]	6.57%	-1.19	1.16	7.49	5.51	7.98
WTI Crude Oil[5]	$53.50	-16.29	-6.50	17.82	-20.20	10.72
Dollar Index[5]	$97.75	0.28	1.66	1.64	4.01	0.85
Gold[5]	$1,305.45	1.71	-0.60	1.79	0.53	2.88

[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 May 31, 2019, market close (unless otherwise stated).

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The sky may not be falling

U.S. equity markets had their most challenging month of 2019 in May, underscored by the S&P 500 closing lower in four consecutive weeks for the first time since September and October of 2014. Further highlighting the worst month of the year so far was an uptick in the VIX, referred to as the fear gauge that measures volatility, which averaged 18.5 in May, after averaging 15.5 and 13.6 in March and April, respectively. Global equity markets were affected by the resumption of tariff concerns in May, both the quick deterioration in U.S.-China trade talks and the threat of tariffs against Mexico, the latter risks politicization of tariffs in an attempt to accomplish Mexico-related immigration priorities. As such, global equities were broadly lower and the U.S. was the clear laggard for the first time this year.

Our trusty global equity barometer, the MSCI All Country World Index, declined 5.9% in May with weakness in the U.S. and emerging markets offset by relative strength in Europe and Asia. U.S. small caps and the NASDAQ were the worst-performing segments of global equity markets with their trade-related declines of 7.8% each.

Sector performance saw a change in 2019 leadership. Real Estate was the only sector to deliver gains in May, and, as a direct result, took up the mantle of best-performing sector in 2019. The dethroned champ, Tech, declined nearly 9% on weakness in semiconductors, which lost 17% for the month. The worst-performing sector, Energy, declined on the 16.3% contraction in crude oil prices and the 18% decline in oil field service stocks. Other economically sensitive sectors were near the bottom of the performance ladder as well, while defensively oriented sectors performed more admirably. Falling interest rates, relatively better trade positioning, and investors' risk-off actions assisted Utilities, Health Care, and Consumer Staples in wrapping up the second-, third-, and fourth-best May performances.

Wealth Management

It's evident that shorter-term Treasury spreads have inverted. However ...

Equity performance and the yield curve

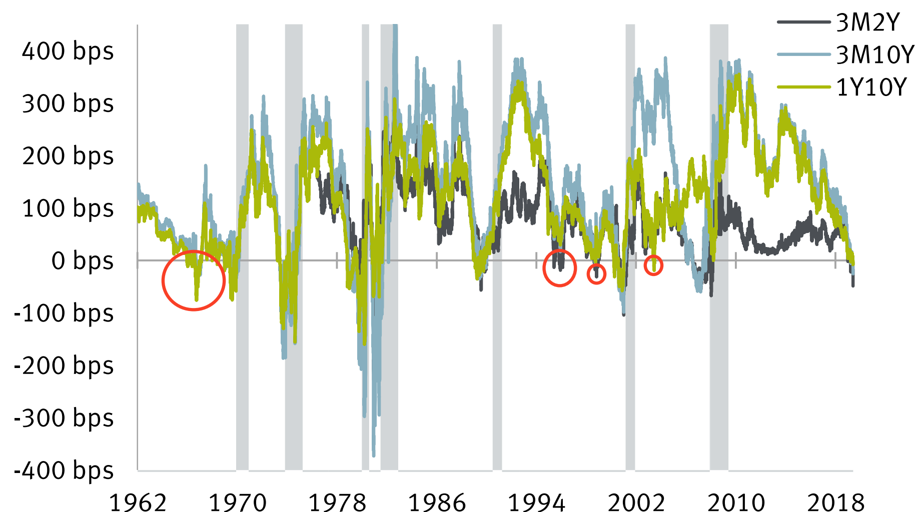
It's hard to turn around these days and not run into someone with an opinion on the yield curve and what it means for the economy. Whether someone is a new bull or an old bear, there's data to be found in the yield curve to make a case that a recession is imminent or this expansion will add to its now record duration. It is important, though, to look past the headline noise to understand the yield curve's real messages, in our view.

In assessing future equity returns, we elect to approach the yield curve holistically and review several Treasury rate spreads as opposed to a single reading in order to more fully address the fact that recessionary odds are a spectrum of percentages as opposed to a binary red or green light. In doing so, there are three key takeaways that we've found.

First, there is precedent for single measures, or segments of the yield curve to invert in a "false alarm" manner. For example, portions of the yield curve inverted in 1966, 1984, 1986, 1995, 1998, and 2003. In these six instances in which the recession alarms proved incorrect, S&P 500 returns over the next 12 months were between 9% on the low end and 37% on the high end. This presents a positive backdrop for U.S. equities if today's partial inversion proves to be a warning rather than a prediction of an imminent recession. History shows that the average time between a curve inversion (1-year/10-year curve) and a recession is approximately 14 months.

Second, we don't dispute that shorter-dated Treasury curves (measured by the 3-month/2-year, 3-month/10-year, and 1-year/10-year spreads) have inverted, and we believe they provide important input in forecasting recessions. But taking our holistic view in assessing future equity returns, we think it is also important to analyze longer-dated yield curves as well as economic data.

Shorter-dated Treasury spreads have inverted



Note: 3M2Y measures the difference between the 3-month and 2-year Treasury rate, with an inversion defined as the 3-month rate exceeding the 2-year rate. This also applies to the 3-month and 10-year (3M10Y) spread and the 1-year and 10-year (1Y10Y) spread.

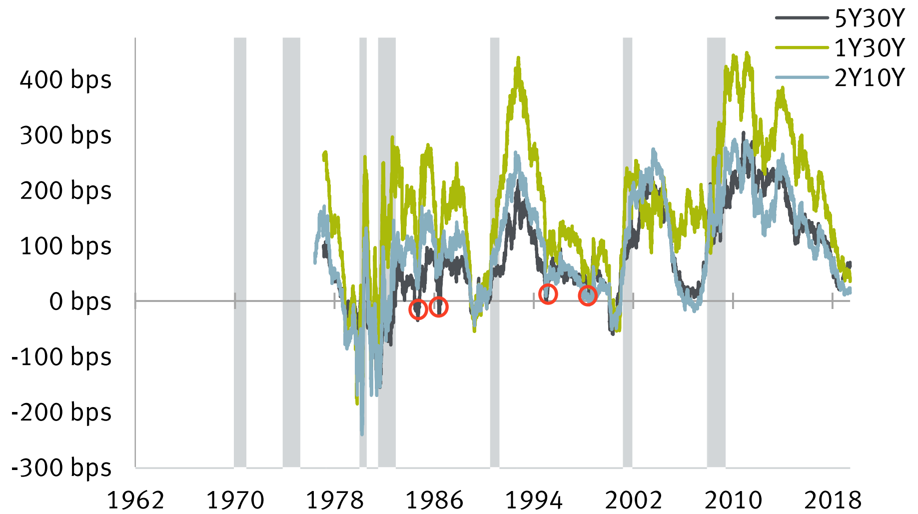
Source - RBC Wealth Management, Bloomberg; data through 5/31/19; red circles apply to periods when portions of the yield curve inverted but a recession failed to manifest itself

In transitioning to the longer-dated spreads (measured by the 1-year/30-year, 2-year/10-year, and 5-year/30-year spreads), it's clear they have narrowed but not inverted, and our research clearly indicates the impact on equity performance

between a narrowing curve and an inverting one is very different. To this point, the mid-to-late 1990s experienced flattening yield curves and even a few false alarms in 1994–95 and 1997–98. These head fakes include the Fed's interest rate hikes in 1994 and 1995, which were subsequently reversed in 1997 with the Asian financial crisis and the implosion of Long-Term Capital Management in 1998. In each case, investors would have missed excellent returns if they exited the market at these times, fearing an imminent recession.

... the lack of inversions on the longer-term Treasury spreads shows that if a recession were to happen in the immediate future, it would be the first one on record that wasn't confirmed by an inversion in the longer-dated Treasury curve.

Longer-dated Treasury spreads have not inverted



Note: 5Y30Y measures the difference between the 5-year and 30-year Treasury rate, with an inversion defined as the 5-year rate exceeding the 30-year rate. This also applies to the 1-year and 30-year (1Y30Y) spread and the 2-year and 10-year (2Y10Y) spread.

Source - RBC Wealth Management, Bloomberg; data through 5/31/19; red circles apply to periods when portions of the yield curve inverted but a recession failed to manifest itself

For our third takeaway, we rely on an aggregation of six different Treasury spread measures and the historical returns over the ensuing 3, 6, and 12 months. For example, using an aggregate of the same six spread measures from the above charts, we've found that the average 12-month return from here, given the current curve environment, would be 3.6% with a 60% probability of being positive. This compares somewhat disappointingly to the average 12-month return of 8.2% with a 74% positive outcome.

The short and long ends of the curve tell very different stories for equity markets in the coming year. In our opinion, balancing them appropriately is prudent to diligently manage equity positioning.

12-month forward returns under various yield curve scenarios

	Since 1962	Today's curve - aggregate	Today's curve - short end	Today's curve - long end
Average	8.2%	3.6%	-3.9%	11.0%
High	68.6%	41.9%	35.1%	48.7%
Low	-48.8%	-38.5%	-43.9%	-33.1%
Positive outcomes (%)	74%	60%	41%	78.6%

Note: Today's curve is defined by taking the average historical forward equity returns from the 3M2Y, 3M10Y, 1Y10Y, 2Y10Y, 1Y30Y, and 5Y30Y Treasury spreads at levels similar to today.

Source - RBC Wealth Management, Bloomberg; data through 5/31/19

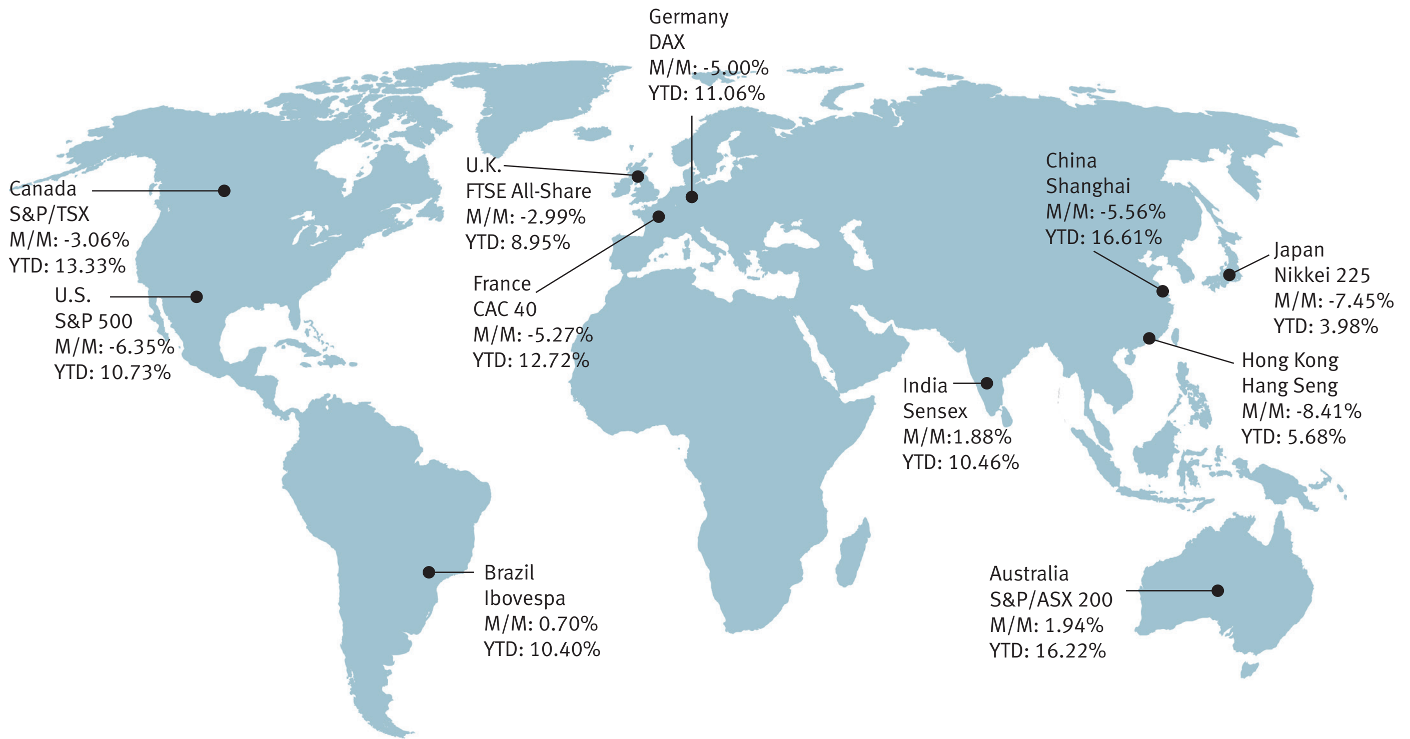
The historical precedent set by long-end curves should, in our opinion, give investors confidence to remain invested throughout this cycle.

However, if we take a closer look, there is some divergence in what the yield curves are suggesting for future returns. Separating for the same short- and long-end spread characterizations above, the shorter end of the curve suggests a 3.9% decline in the next 12 months with a mere 41% chance of a positive return. Meanwhile, the longer-dated spreads suggest an 11.0% return in the coming 12 months with a 79% chance of a positive return.

The hard part for investors is making sense of these conflicting data points, but by carefully understanding that there are numerous yield curves and that by taking a holistic approach to spreads across the curve, we can understand the signals they provide. The inverted short end of the yield curve clearly lends itself to allocating to higher-quality companies, while the historical precedent set by long-end curves should, in our opinion, give investors confidence to remain invested throughout this cycle.

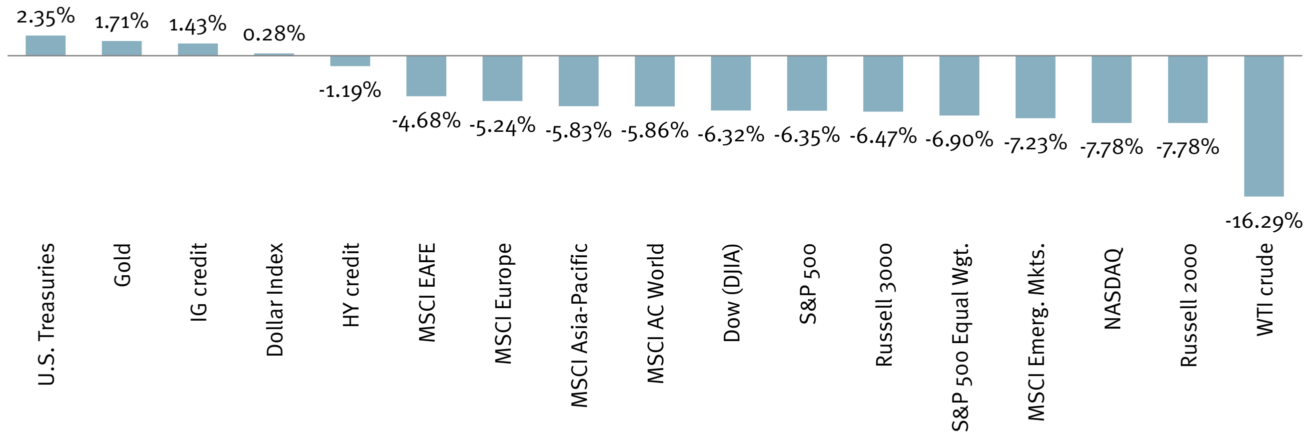
World markets

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



Source - Bloomberg; priced in local currency

Total monthly returns for select indexes – May 2019



Source - Bloomberg

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