USIC News Stream

Wealth Management

May 17, 2022 | Commentary from the U.S. Investment Committee

Think long-term, think opportunistically

Equity markets have remained the focal point for investors in 2022, with the S&P 500 down approximately 16% year to date through May 16. Investors' patience has also been tested by historically weak performance in Fixed Income, with the Bloomberg U.S. Aggregate Bond Index down about 10% year to date through May 16. Inflation concerns and inflation's impact on monetary policy and economic growth have driven both markets to one of the worst starts to a year

Last week, the most recent inflation data came in up 8.3% year over year for April, slightly above consensus forecasts but below the 8.5% high reached a month earlier. Continued inflation above expectations has created an increasingly hawkish tilt at the Federal Reserve. With the Russia-Ukraine conflict and Chinese pandemic lockdowns adding risk to the economic recovery, the Fed is in an increasingly challenging position—forced to balance rising inflation and the related need to raise rates against the potential for weaker economic growth as it attempts to engineer a "soft landing" for the economy.

As we look at what might be ahead for both Equity and Fixed Income markets, we are focused on three key areas: Inflation, Monetary Policy, and Growth.

- **Inflation:** While predicting the trend of inflation and determining if we have reached a peak remain shifting guessing games, we've come to believe that if we get more visibility into how inflation will trend, we have much greater predictability for Monetary Policy and Growth. With the data we have today, we still expect inflationary pressures to ease in H2 2022. It remains to be seen if the March year-over-year inflation numbers were the peak, which the April numbers may have indicated. However, the bigger question is how "sticky" or elevated inflation will remain over the next couple of years.

Active portfolio Overweights:

Equity

- U.S. and Emerging Markets
- U.S. Energy Infrastructure
- U.S. Technology

Fixed Income

- U.S. Preferreds
- High-Yield – Senior Bank Loans

- **Monetary Policy:** Inflation will likely be the tail the wags the monetary policy dog as the Fed reacts to inflationary pressure. Our expectation is the Fed will take policy interest rates to a 2.50%–2.75% level by the end of the year. From there, we envision the Fed adopting a "data-dependent" approach. Said differently, we think the Fed will raise rates quickly to a more normal level and then react to the inflation data as necessary.
- **Growth:** While GDP growth is an important factor in gauging the health of economic activity, we are more focused on corporate earnings growth as a gauge to where equity markets may be headed. With Q1 earnings season largely complete, we've seen minimal changes to 2022 earnings expectations despite some high-profile disappointments. The bottom line, in our view, is as long as inflationary pressure remains high, the Fed will be forced to raise rates, which tightens financial conditions, resulting in the lowering of earnings expectations.

While we monitor these and other measures, the question we get the most often is: What should investors do now? The importance of exercising patience amidst uncertainty and heightened volatility remains vital. With that in mind, we recommend two things: think long-term, and think opportunistically.

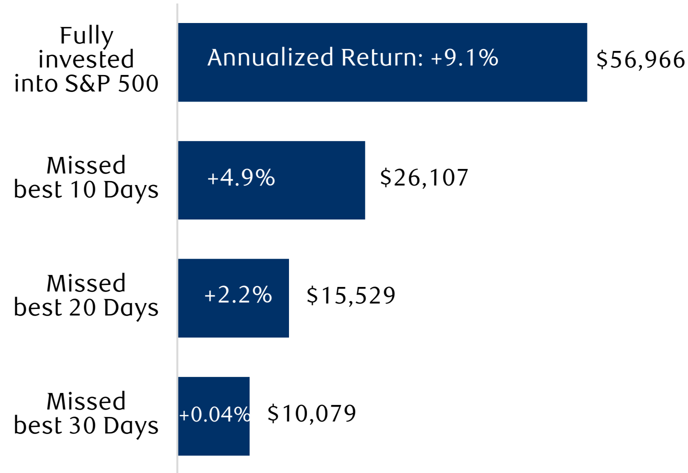
The significance of sticking to long-term goals only grows when markets get tough, and we've frequently reiterated the need to stay invested, with dramatic hindrances in long-term results if investors miss even a few days of a potential recovery.

We note that staying invested and focused on the long-term does not mean remaining complacent. Quite the contrary, we believe the current market environment offers the potential for investors to think opportunistically about their long-term goals.

For multiple years, the Fixed Income landscape has been a battle of preserving a return in a constantly lower rate environment. As rates have risen, we are seeing some of the highest yields in years across the Fixed Income marketplace, and the opportunity to increase yield for portfolios may represent a compelling option.

In Equity markets, the dramatic price declines have to-date occurred with minimal changes to long-term earnings forecasts. Put simply, standard valuation metrics such as P/E ratios have declined to what we think are more attractive levels. As Equities have become largely "cheaper,"

Dollar value of $10,000 invested May 2002 to April 2022



Source - FactSet, RBC Wealth Management; returns based on S&P 500 Total Return Index. Past performance is not indicative of future returns; individuals cannot invest directly in an index.

the opportunity from a valuation standpoint for long-term-oriented portfolios is better than we have seen in years.

We are in a unique environment; therefore, we think the need to remain flexible, focused, and patient combined with taking advantage of opportunities as they emerge offers the best paths toward long-term success.

U.S. Investment Committee and Resources

This content is produced by the U.S. Investment Committee (USIC) within RBC Wealth Management. This group consists of members from various investment areas at RBC Wealth Management. It meets monthly and is responsible for providing views on asset allocation, fulfillment selection, and portfolio construction and management for the firm's investment advisors. The Committee leverages the firm's vast resources, including asset allocation, asset class, and manager and individual security research from RBC Global Asset Management, RBC Capital Markets, and third-party resources.