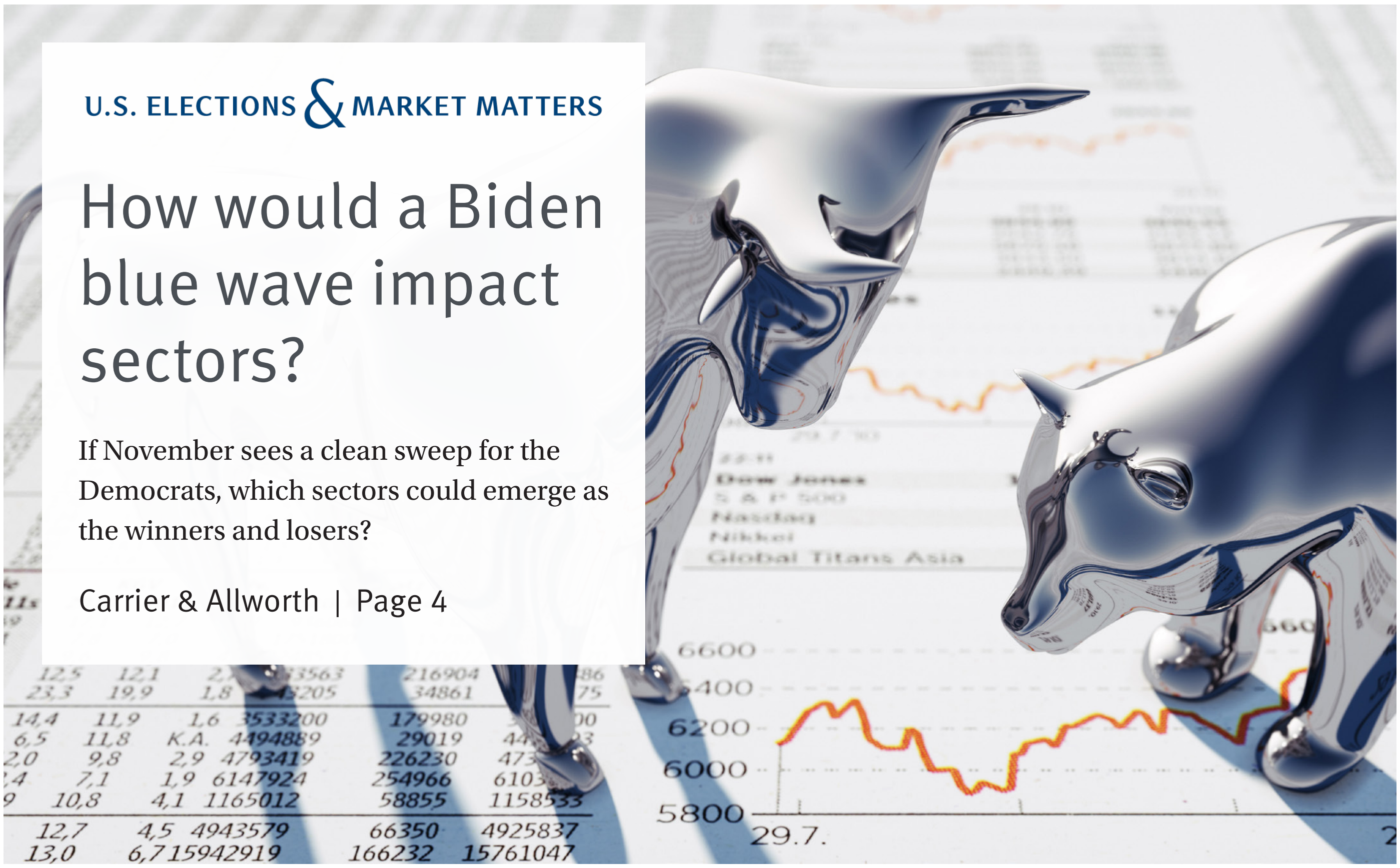
September 2020

RBC WEALTH MANAGEMENT

Global Insight

Perspectives from the Global Portfolio Advisory Committee



U.S. ELECTIONS & MARKET MATTERS

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RBC Wealth Management

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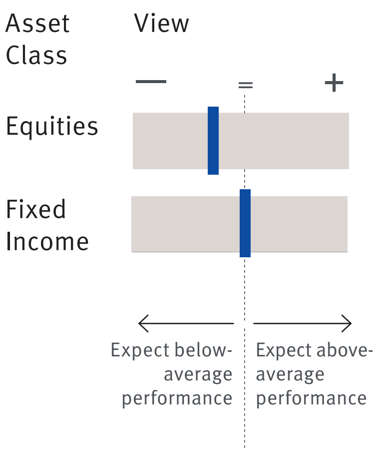


See "Views explanation" below for details

Source - RBC Wealth Management

Equities

- Equities have extended their gains over the summer months, propelled higher by fiscal and monetary stimulus and better-than-feared Q2 corporate earnings in most parts of the world. Valuation levels appear to discount much good news, though they could expand further if earnings continue to be upgraded.

- In recent weeks, we have noted that the leadership of the S&P 500 has progressively narrowed to just a handful of mega-cap issues. If this continues, distortions could build into the market if fund managers feel forced to buy into those stocks just to keep pace with the benchmark or if others become reluctant to sell them. Market performance could suffer if the situation eventually unwinds. This by itself is not a reason to become overtly defensive, but is a new risk. We would remain invested but moderately Underweight equities compared to an appropriate benchmark.

Fixed income

- The Fed's shift to an average inflation targeting regime, where policymakers would allow inflation to run above the 2% target for a period of time to make up for past shortfalls, should continue to drive moderate yield curve steepening on higher growth and inflation expectations; however, it also means that the Fed is likely to leave short-term rates at 0% for even longer. Though risks remain, current market valuations still offer attractive risk/reward profiles in certain fixed income sectors, specifically in corporate credit.
- We maintain our Market Weight in global fixed income. Global demand for "safe" assets remains robust, and with markets continuing to price in a strong economic recovery along with central bank support, we maintain a broad Overweight to corporate credit.

Views explanation

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

+ Overweight implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

= Market Weight implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

– Underweight implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.

Focus article

U.S. ELECTIONS & MARKET MATTERS

How would a Biden blue wave impact sectors?

Frédérique Carrier
London, United Kingdom
frederique.carrier@rbc.com

Jim Allworth
Vancouver, Canada
jim.allworth@rbc.com

The U.S. government moves more like a lumbering supertanker than a speedboat that can suddenly veer off in new directions. Yet a Democratic sweep of the White House and Congress, were that to be the election outcome, would bring with it some key policy changes. We look at how this scenario could affect different market sectors and subsectors, and identify which of these could be the winners and losers.

- The proposed hike in the corporate tax rate potentially affects almost all businesses except utilities, which usually can pass the cost on to consumers, and REITs, which don't pay taxes.
- A big infrastructure bill, a multibillion-dollar commitment to boost R&D spending, and the ability to source more highly skilled workers from abroad could take the sting out of higher tax rates for some sectors.
- Very low interest rates, tighter regulation, and higher tax rates are likely to challenge much of the Financials sector, including banks.

With U.S. elections rapidly approaching, all plausible presidential/congressional configurations remain on the table. Among these, the biggest potential for government policy changes comes from the scenario in which Joe Biden captures the White House and the Democratic Party wins control of both chambers of Congress. This article, the third in our "U.S. elections & market matters" series, outlines what RBC Capital Markets' analysts have determined these policy shifts might mean for each of the 11 U.S. market sectors as well as for the major industry subsectors within each.

The Biden/Democratic platform proposes to unwind about half the Trump corporate tax cuts, increase taxes on high-income earners and investors, and expand health care coverage while lowering costs. It prioritizes addressing climate change, reducing the use of fossil fuels, and increasing development of renewable energy. The platform also calls for a revamp and modernization of the nation's infrastructure, a more active regulatory approach, and an expansion of immigration. Were Democrats to gain full control of Congress, we would expect few barriers to implementing these policies.

Survey says: Winners and losers

To assess the impact of the Biden platform on various sectors, Lori Calvasina, Head of U.S. Equity Strategy for RBC Capital Markets, LLC, surveyed RBC Capital Markets' U.S. equity research industry analysts, asking them to evaluate the outlook for the subsectors under their coverage. She tallied the results in her comprehensive report "Eye on the Election" published in July.

Outlook by sector

Bearish outlook for sectors representing close to 60 percent of the S&P 500

S&P 500 sector (weighting)	Overall sector outlook	Number of subsectors whose outlook is:				
		Very bullish	Bullish	Neutral	Bearish	Very bearish
Utilities (3%)	Bullish	1	1		1	
REITs (3%)	Neutral			2		
Communication Svcs. (11%)	Neutral			3		
Consumer Staples (7%)	Neutral			1		
Health Care (15%)	Mixed		3	1	3	
Materials (3%)	Mixed		2	1	2	
Technology (27%)	Slightly bearish			2	2	
Energy (3%)	Bearish			1	3	1
Consumer Discretionary (11%)	Bearish				5	
Industrials (8%)	Bearish				6	
Financials (10%)	Bearish			1	4	1

Source - RBC Capital Markets, RBC Wealth Management; S&P 500 weightings as of 6/30/20

What are the key drivers?

The factor most often cited in Calvasina's survey as a negative for sector outlooks is higher corporate taxes. This isn't surprising. According to our national research correspondent and RBC Capital Markets, if half of the Trump corporate tax cuts were reversed and the top individual rate raised—as Biden has promised to do—S&P 500 profits could be 5.5 percent to 9.0 percent lower than they otherwise would be during the first year of implementation. Calvasina suggests the effect could be somewhat greater due to secondary impacts. For example, demand for some products could fall as companies hike their prices in an attempt to pass on some of this additional burden to customers.

Another corporate concern is the prospect for stricter regulation. "Too much regulation" has been a longstanding beef that has shown up perennially in surveys of small and medium-sized businesses. The concerns center mostly on the perceived high costs of compliance rather than on the goal of the regulation in question. Large businesses too—notably banking, pharmaceuticals, energy, and now large tech—are all wary of new constraints on business.

There are also positive drivers in the Democratic platform, which has committed to additional investment in scientific research and development (R&D), as well as higher, targeted immigration. The latter could result in higher demand for some products and services as well as improve the supply of highly skilled workers—the lack of which is often cited by several industries as a major growth limitation.

Under a blue wave scenario an infrastructure bill would almost certainly be introduced and have a strong likelihood of being passed. The platform, among other things, proposes improvements to roads, bridges, ports, airports, and high-speed rail, as well as the extension of high-speed internet to underserved rural areas.

We have a winner

Utilities: Bullish (subsectors – one very bullish; one bullish; one bearish)

The utilities companies that are stable dividend payers should continue to stand out as bond alternatives in an environment where the Fed is committed to an extended period of ultralow interest rates. RBC Capital Markets' analysts see very bullish prospects in particular for the alternative energy companies as they should benefit from significant government support under a blue wave scenario.

The outlook would also be bullish for electric and water utilities due to the Democratic platform's focus on infrastructure investment. As well, utility regulators typically permit any higher corporate taxes to be passed on to consumers. The outlook is more cautious for independent power producers as they are most exposed to fossil fuel generation. Any mandated accelerated retirement of coal-fired plants would fall more heavily on this group.

Net neutral (three sectors)

Real estate investment trusts (REITs): Neutral (subsectors – two neutral)

Biden's policies would not alter the business model or environment for REITs in a meaningful way, as they are not taxpayers.

Communication Services: Neutral (subsectors – three neutral)

The potential negative impact of some policies could be offset by the positive impact of others. For instance, the sector would have to grapple with higher taxes, a more restrictive view on future mergers and acquisitions, and an anti-stock buyback stance. On the other hand, it would benefit from proposed higher government investments in R&D, support for new technologies including 5G, policies supportive of greater access to broadband for underserved regions, and a more expansive immigration policy.

Consumer Staples: Neutral (subsector – one neutral)

Worker-friendly policies like support for a higher minimum wage; tighter rules on what can be designated "Made in America"; child care initiatives; student debt relief; tuition assistance; teacher pay; and a renter's tax credit could boost wages and household spending on consumer staples goods, partially offsetting the impact of higher corporate taxes.

Mixed outlook (two sectors)

A Biden presidency and Democratic-controlled Congress would be "mixed" (i.e., equal number of subsectors with bearish and bullish outlooks) for Health Care and Materials.

Health Care: Mixed (subsectors – three bullish; one neutral; three bearish)

The sector encompasses seven subsectors; a Democratic sweep would be bullish for three, neutral for one, and bearish for three. Higher corporate taxes are the principal headwind facing the sector.

The three subsectors with a bullish outlook (equipment & services; service providers; services & distribution) would all benefit from an expansion of health insurance coverage (i.e., the Affordable Care Act), which would reduce uninsured volumes for providers. The three subsectors with a bearish outlook (biotech; large pharma; specialty pharma) would all suffer from drug pricing reform. The outlook for the managed care subsector is neutral as the policies put forward by Biden would not have an obvious negative effect.

Materials: Mixed (subsectors – two bullish; one neutral; two bearish)

While higher corporate taxes would be an added burden across all subsectors here, the Democratic plan to spend $640 billion over 10 years to build affordable housing would benefit forest products. Infrastructure investment would be supportive of them, as well as the coatings group. Tax increases would fall hardest on domestic producers while trade frictions cloud the outlook for both exporters and importers within the sector.

Bearish outlooks

Finally, the outlook is slightly bearish for one sector (Technology), and bearish for the remaining four (Energy, Consumer Discretionary, Industrials, and Financials). Digging deeper into each sector reveals disparities at the subsector level.

Technology: Slightly bearish (subsectors – two neutral; two bearish)

Higher corporate taxes are the principal headwind facing this sector. A related issue would be reduced offshoring, which would simultaneously raise operating costs and expose a greater proportion of profits to higher domestic taxes. More intrusive regulation is very much a headline topic, although the momentum behind this seems to be bipartisan. However, regulation is likely to be targeted and not affect the majority of the sector's constituents.

Positives include: a more relaxed immigration stance for higher-skilled IT workers; the proposed $300 billion investment on R&D; and the anticipated push for accelerated 5G development.

Sector impact of Biden blue wave

A Biden/Democratic Congress would have a neutral impact for payments, processors & IT services, and software. At the same time, this outcome would be bearish for enterprise/IT hardware, and semiconductors and semi-capital equipment.

Energy: Bearish (subsectors – one neutral; three bearish; one very bearish)

The Democratic proposal to achieve a 100 percent clean energy economy and net-zero emissions no later than 2050 means almost all subsectors within the energy complex would face the prospect of a challenging operating environment, according to RBC Capital Markets' analysts. Moreover, higher corporate taxes, greater federal royaties, and lower tax credits would substantially add to the burden already confronting the sector. Oil services companies are the exception, with a neutral outlook, as they have an opportunity to pivot toward providing services for carbon capture, offshore wind installations, and new energy technologies.

Integated oil and gas companies could potentially transform themselves by becoming major owners and developers of renewable energy. But the headwinds facing their fossil fuel operations would likely dominate the group's earnings outlook for some time. Midstream pipelines/processors as well as non-integrated refiners are looking at many years of stagnant/declining end markets.

The outlook for exploration and production companies would be very bearish as the proposed goal for net-zero emissions by 2050 could accelerate demand destruction for oil and gas, while the prospect of higher royalties and reduced tax credits would be painful.

Consumer Discretionary: Bearish (subsectors – five bearish)

Higher corporate taxes and rising wages are the biggest negative factors for the sector, especially for those companies and subsectors with largely domestically driven operations like homebuilders. While the clean energy push is an opportunity for some automakers, it's a costly conversion exercise for most. Retailers without a viable online presence will continue to be marginalized by those who do while also contending with higher wages. RBC Capital Markets' analysts view the prospects for all subsectors in the Consumer Discretionary space as bearish under a Democratic sweep.

Industrials: Bearish (subsectors – six bearish)

Higher taxes, rising wages, as well as the higher costs and disruption caused by onshoring would be headwinds for a swath of subsectors including rails, waste, machinery/capital goods, and multi-industry & electrical equipment. Aerospace and defense will also have to contend with tighter government budgets. Onshoring may offer some positive offsets, such as lower transportation costs, for certain companies, but the overall balance of the proposed new policies of the Democratic platform is likely to be negative.

Financials: Bearish (subsectors – one neutral; four bearish; one very bearish)

The Financials sector has the most broadly bearish outlook. It has only one subsector with a neutral outlook, four considered bearish, and one—national and money center banks—seen as very bearish.

The outlook for property & casualty (P&C) insurance is neutral as most companies in the group are state-regulated, so a Biden presidency would have little impact. In contrast, national and money center banks would struggle not only with higher taxes but also with the re-regulation of certain industries, such as oil, which would lead to fewer loan opportunities. Life insurers, regional banks, asset managers, and specialty/consumer finance companies have a bearish outlook as higher taxes and the prospect for tighter regulation would likely weigh on earnings.

Parting thoughts

Much can change between now and Election Day. Undoubtedly, a great deal of ink will be spilled about where things may be headed, both in terms of the eventual election outcomes and what that all may mean for the U.S. and global economies as well as financial markets.

We would offer three considerations to keep in mind moving forward:

- History strongly suggests that while political change can have an effect on the economy in the long run, over a span of a year or two it's the business cycle and the credit cycle that have the most influence on the direction of the economy.
- Of the three plausible outcomes—Trump/divided Congress; Biden/divided Congress; Biden/Democratic Congress—it is the last, in our opinion, that would likely see the biggest policy shift away from the status quo.
- The economy and markets have shown they can adapt to new policy directions. By drilling down deeper into the levels of sectors, industry groups, and individual companies, we can see what may emerge as the winners and losers.

Sector impact of Biden blue wave

Sector outlook for a Biden presidency and Democratic control of Congress

Higher taxes the most-cited concern

Communication Services	Outlook: Neutral
+ Higher investment in R&D and technologies (5G)	
+ Greater access to broadband in rural areas	
– Higher corporate taxes	
Cable & telecom	Outlook: Neutral
+ $300 billion investment in R&D and technologies (5G) would be positive for telecoms	
+ $20 billion investment to expand broadband access in rural areas would be bullish for cable/wireline telecom operators	
– Higher corporate taxes	
– The $300 billion investment in R&D would increase fixed wireless to mobile substitution risks, increasing competitive threats to cable	
Internet	Outlook: Neutral
+ Greater immigration of skilled workers	
– Higher corporate taxes	
Media	Outlook: Neutral
– Rural broadband investments and improved connectivity could further migrate customers toward streaming services and away from traditional pay TV	
– Potential prevention of further industry consolidation	
– Higher corporate taxes	

Consumer Discretionary	Outlook: Bearish
+ Higher disposable income from rising wages in the longer term	
– Higher taxes and higher minimum wages in the short term increase costs	
Autos & auto parts	Outlook: Bearish
+ Manufacturers geared towards "green transportation" would benefit	
– Higher taxes	
– Higher minimum wages	
Global apparel & specialty softlines	Outlook: Bearish
+ Higher disposable income from rising wages in the longer term and free college for qualifying students	
– Higher taxes and higher minimum wages in the short term	
Homebuilding	Outlook: Bearish
+ Proposed $640 billion investment in housing over the next 10 years	
+ First-time buyer credit of up to $15,000	
– Higher corporate taxes	
Hardlines/Broadlines	Outlook: Bearish
– Higher corporate and individual taxes	
Restaurants	Outlook: Bearish
+ Higher disposable income from rising wages in the longer term	
– Higher taxes and higher minimum wages in the short term	

Consumer Staples	Outlook: Neutral
+ Higher disposable income in the longer term	
– Higher taxes	
Food, beverage, household & personal care, tobacco	Outlook: Neutral
+ Higher disposable income from rising wages in the longer term	
– Higher taxes and higher minimum wages in the short term	

+: Positive impact ◆: Neutral –: Negative impact
Source - RBC Capital Markets, RBC Wealth Management

Sector outlook for a Biden presidency & Democratic control of Congress, continued

Energy	Outlook: Bearish
– Policy of achieving 100 percent clean energy by 2050 would reduce demand for crude oil and related products	
Oil services	Outlook: Neutral
+ A move to 100 percent clean energy would open opportunities to provide carbon capture, offshore wind installations and new energy technologies	
– A move to 100 percent clean energy would reduce demand for crude oil	
Integrated oil & gas	Outlook: Bearish
– Higher corporate taxes	
Midstreams & master limited partnerships (MLPs)	Outlook: Bearish
– Focus on clean energy would reduce demand for refined products	
Refiners	Outlook: Bearish
– Clean energy targets would require a near phase-out of refined products over time	
Exploration & production	Outlook: Very bearish
– Clean energy policy would accelerate demand destruction for oil and gas	
– Higher corporate taxes	

Financials	Outlook: Bearish
– Higher corporate taxes	
– Anti-stock buyback stance	
– Potentially enhanced scrutiny of banks/consumer lenders through regulatory appointments	
Property & casualty (P&C) insurance; insurance brokers	Outlook: Neutral
◆ Most P&C firms are state-regulated so no specific policy implications	
Life insurance	Outlook: Bearish
+ No policy with a negative bias has been announced to date	
– Democratic Congresses usually negative towards consumer and retirement financial products	
U.S. asset managers	Outlook: Bearish
+ No policy with a negative bias has been announced to date	
– Higher corporate taxes	
– Possible negative implications if a Biden administration changes the definition of a fiduciary within retirement plans, as the Obama administration did	
Regional banks	Outlook: Bearish
– Appointment of stricter regulators	
– Higher corporate taxes	
Specialty/consumer finance	Outlook: Bearish
– Heightened regulatory scrutiny around lower income customers could reduce lending opportunities	
– Higher corporate taxes	
Banks	Outlook: Very bearish
– Re-regulation of select industries (e.g., energy) would lessen loan opportunities	
– Higher corporate tax rates	

+: Positive impact ◆: Neutral –: Negative impact
Source - RBC Capital Markets, RBC Wealth Management

Sector impact of Biden blue wave

Sector outlook for a Biden presidency & Democratic control of Congress, continued

Health Care	Outlook: Mixed
+ Affordable Care Act (ACA) restored & coverage expanded	
+ Government purchase of critical medical supplies	
+ Investment in R&D and technology	
+ Expanded access to long-term care services in local settings	
– Drug pricing reform	
– Higher corporate taxes	
– Anti-stock buyback stance	
Health care equipment & services	Outlook: Bullish
+ Expanded health insurance coverage (ACA), thereby reducing uninsured volumes for providers	
Health care service providers	Outlook: Bullish
+ Expanded health insurance coverage (ACA), thereby reducing uninsured volumes for providers	
Health care services & distribution	Outlook: Bullish
+ ACA & commitments to invest in biotech and R&D could benefit life science and diagnostic tools providers	
Health care payors (managed care)	Outlook: Neutral
◆ Medicare for all is not a Biden policy	
Biotechnology	Outlook: Bearish
– Drug pricing reform	
Large-cap pharma	Outlook: Bearish
– Drug pricing reform	
Specialty pharma	Outlook: Bearish
– Drug pricing reform	

Industrials	Outlook: Bearish
– Higher corporate taxes	
– Pro-union stance	
– Higher regulation of end markets	
Business services	Outlook: Bearish
– Higher corporate taxes	
– Higher minimum wages	
Machinery & capital goods	Outlook: Bearish
– Higher corporate taxes	
– Restrictive fossil fuel policies	
– Pro-union position	
Railroads	Outlook: Bearish
– "Made in America" policies and tightening of domestic content rules could weaken carload volumes	
Waste	Outlook: Bearish
– Higher corporate taxes	
– Pro-union position	
Multi-industry & electrical equipment	Outlook: Bearish
– "Made in America" policies would increase manufacturing costs	
– Pro-union position	
– Higher minimum wages	
Aerospace & defense	Outlook: Bearish
– Pressure on government defense budgets could cap growth	
– Higher corporate taxes	

+: Positive impact ◆: Neutral –: Negative impact
Source - RBC Capital Markets, RBC Wealth Management

Sector outlook for a Biden presidency & Democratic control of Congress, continued

Materials	Outlook: Mixed
+ Increased spending on infrastructure and housing	
– Higher corporate taxes	
Forest products	Outlook: Bullish
+ Plan to invest $640 billion over 10 years to provide affordable housing to Americans	
+ Investment in infrastructure a boon to non-residential construction	
Coatings	Outlook: Bullish
+ Increased federal spending on infrastructure	
Packaging	Outlook: Neutral
◆ No meaningful impact	
Chemicals	Outlook: Bearish
– Higher corporate taxes	
– Focus on clean energy would reduce U.S. shale gas advantage, hurting chemical raw costs	
Building products	Outlook: Bearish
+ Increased spending on infrastructure and housing	
– Higher corporate taxes	

Real Estate Investment Trusts (REITs)	Outlook: Neutral
◆ No specific policy impact as REITs are not corporate taxpayers	
Communications infrastructure	Outlook: Neutral
◆ No specific policy impact	
Other REITs	Outlook: Neutral
– Impact negative if policies limit economic growth	

Technology	Outlook: Slightly bearish
+ Additional spending on R&D	
+ Higher immigration of highly skilled IT personnel	
– Reduced offshoring	
– Higher corporate taxes	
– More regulation	
Payments, processors & IT services	Outlook: Neutral
+ Democratic policies neither accelerate nor detract from secular trends	
+ The $300 billion proposed spending on R&D & technology could drive fintech innovation	
– Proposal to reduce offshoring could hurt IT services names	
Software	Outlook: Neutral
+ Higher immigration of highly skilled IT personnel	
– Higher corporate taxes	
Enterprise/IT hardware	Outlook: Bearish
+ Accelerated 5G infrastructure investment	
– Higher corporate taxes	
Semiconductors and semi-cap equipment	Outlook: Bearish
– Higher corporate taxes	
– More regulation	

+: Positive impact ◆: Neutral –: Negative impact
Source - RBC Capital Markets, RBC Wealth Management

Sector impact of Biden blue wave

Sector outlook for a Biden presidency & Democratic control of Congress, continued

Utilities	Outlook: Bullish
+ **Clean energy & infrastructure drive**	
+ **Higher taxes passed through to consumers**	
Yieldcos & alternative energy	Outlook: Very bullish
+ Industry to get more support under a Biden presidency	
Utilities (electric, gas, multi, water)	Outlook: Bullish
+ Focus on infrastructure investment	
+ Higher taxes passed through to consumers	
Independent power producers	Outlook: Bearish
– Group has important exposure to fossil fuel generation	
– Acceleration of retirement of coal plants	

+: Positive impact ◆: Neutral –: Negative impact
Source - RBC Capital Markets, RBC Wealth Management

Narrowing leadership

In one important sense, stocks are behaving as one would expect. Leading the way are shares of companies whose businesses are thriving and for whom the post-pandemic world looks bright—big tech comes immediately to mind. At the other end of the spectrum are shares of companies whose business conditions are challenging and might remain so after COVID-19 departs the scene—oil and gas for instance or bricks and mortar retailing.

This distinction is even more sharply drawn than usual because, for the most affected parts of the economy, the longer the pandemic keeps economic activity well below normal the greater the chance some established businesses won't survive. So investors, understandably, have chosen to move more decisively than usual toward companies for whom the risk of failure seems very low and the promise of above-average sales and earnings growth appears assured.

So far, so good, as long as the market's assessment of future business prospects is correct. And this relative shift can go on for a long time; back at the peak of the decade-long oil/commodity boom in 1980, the five largest U.S. oil stocks accounted for more than 40% of total S&P 500 value. The Technology sector reached similar proportions at the peak of the dot-com boom in 2000.

But at some point the market may come to give today's highly favored, sought-after mega-cap leaders more than they are due. It becomes a more problematic phase when market leaders are going up faster than the broad market simply because they have already been going up faster than the market.

Equity views

Region	Current
Global	–
United States	–
Canada	–
Continental Europe	=
United Kingdom	–
Asia (ex-Japan)	+
Japan	=

\+ Overweight = Market Weight – Underweight
Source - RBC Wealth Management

To some extent that phase may be upon us. From the bottom of the market in March until June, the S&P 500 unweighted index—which gives an equal weight to each stock—was doing as well or better than the S&P 500 capitalization-weighted index. Since then, the large caps have taken charge and even within that category the leadership has progressively narrowed in recent weeks to just a handful of mega-cap issues big enough to drive the index higher on their own.

This can go on for some time. But to the extent this phenomenon forces fund managers to buy into stocks they might otherwise have not chosen to own just to keep pace with the benchmark or makes others reluctant to sell the same issues, it can build distortions into the market which, if they eventually unwind, can be painful for market performance.

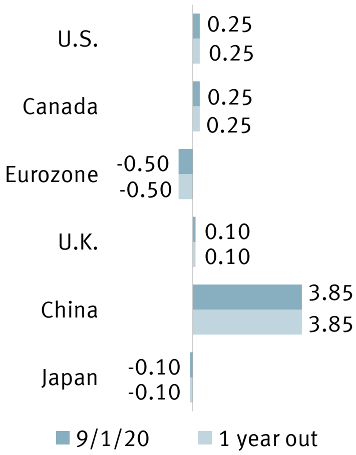
This by itself is not a reason to become overtly defensive but it is a risk factor that was not present just a few months ago or for a long time before that.

Our stance has not changed. A global portfolio should carry an exposure to equities modestly below benchmark.

Jim Allworth
Vancouver, Canada
jim.allworth@rbc.com

The opening salvo against low inflation

Central bank rate (%)



*1-yr base lending rate for working capital, PBoC

Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

The Fed's 2020 Economic Policy Symposium, held virtually this year, laid out a new approach to how policymakers plan to achieve one side of the central bank's dual mandate: price stability. Instead of aiming for 2% annual inflation on a go-forward basis, the Fed will now take the past into consideration, meaning that any shortfalls of the goal will be made up for via greater-than-2% inflation, though to be sure, only moderately so. For example, the Fed would likely be tolerant of 2.5% inflation for a period of time given past misses. Regardless, the change only means that rates will likely remain low for even longer.

Though central banks are laser-focused on achieving moderately higher levels of inflation, that objective remains—as it has for some time now—easier said than done. We don't see higher inflation as something that investors need to fear over the near-to-intermediate term, at least with respect to the potential for markedly higher interest rates and yields. As Fed Chair Jerome Powell has said, this policy change is an evolution, not a revolution. It will take some time for both higher inflation expectations, and actual inflation, to materialize.

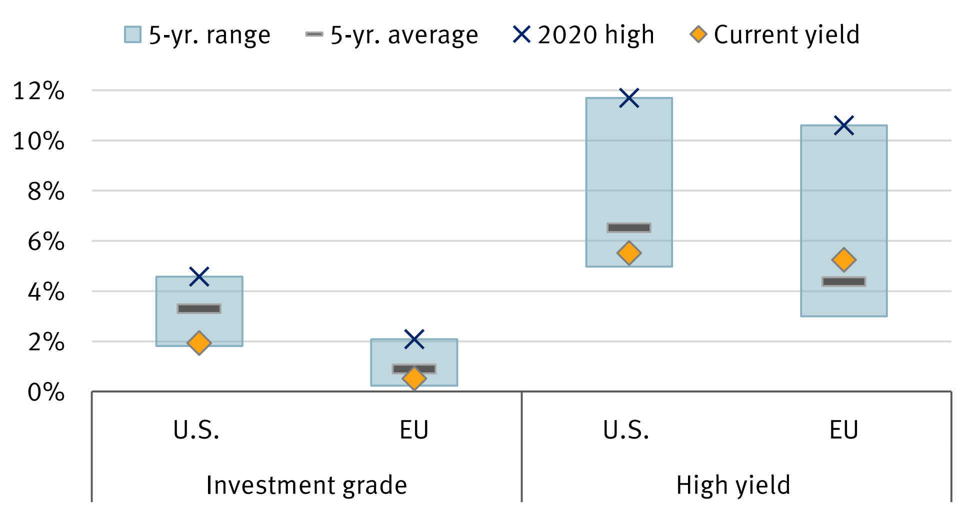
Fixed income views

Region	Gov't Bonds	Corp. Credit	Duration
Global	=	+	5–7 yr
United States	=	+	7–10 yr
Canada	=	+	3–5 yr
Continental Europe	=	+	5–7 yr
United Kingdom	–	=	3–5 yr

+ Overweight = Market Weight – Underweight

Source - RBC Wealth Management

2020 has seen it all as credit yields fall back to near-record lows

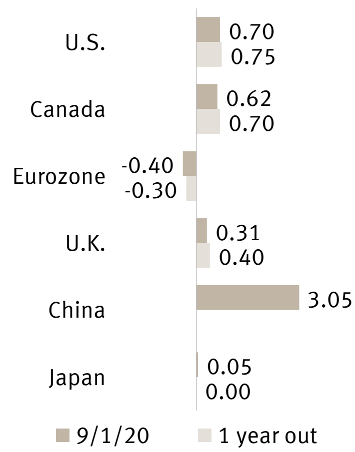


Source - RBC Wealth Management, Bloomberg; data through 8/24/20

Thomas Garretson, CFA
Minneapolis, United States
tom.garretson@rbc.com

Global fixed income

10-year rate (%)



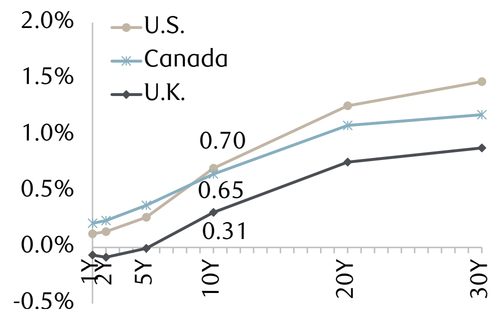
Note: Eurozone utilizes German Bunds.

Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

While central banks shift their focus to the years ahead, recent actions to support market functioning have largely proved successful, and nowhere is that more evident than in credit markets—which have now returned to pre-pandemic levels.

As the chart on the previous page shows, credit markets really have seen it all this year. Market volatility has offered investors at times both the highest yields available in at least the past five years, and some of the lowest yields not just of the last five years, but on record in some cases. In all major markets we continue to favor corporate credit over government debt, and we maintain a modestly more positive outlook for high-yield bonds over investment-grade debt, as the latter offers increasingly little cushion in the form of yield over government bonds.

Sovereign yield curves

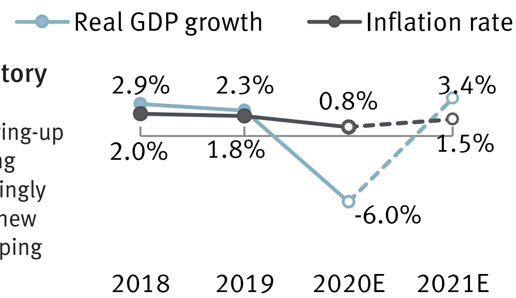


Source - Bloomberg; data through 8/31/20

Key forecasts

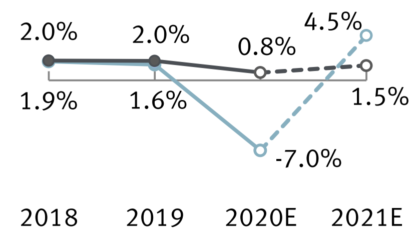
United States – Worst GDP drop in modern history

As expected, Q2 GDP worst in modern history at down 31.7%. Jobless claims edged back above 1 million. Drying-up of government business support, coupled with expiring benefits, presents further risk. Housing data astonishingly strong as people opt for less crowded suburbs. Fed's new policy approach will let inflation run higher, likely keeping interest rates low for years to come.



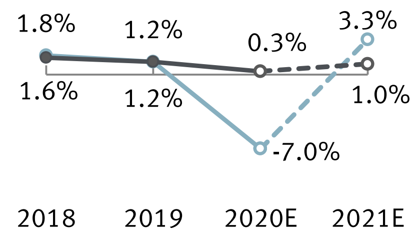
Canada – Broad data recovery

Among broadly stronger data, retail sales growth posted a second record monthly high despite touching an all-time low in April. The unemployment rate at 10.9% is off its 13.7% high, though still double pre-pandemic levels. Manufacturing sales grew strongly in May and June but remained 9% below peak levels. The BoC will seek public input for first time on the 2% inflation targeting framework it uses to set monetary policy.



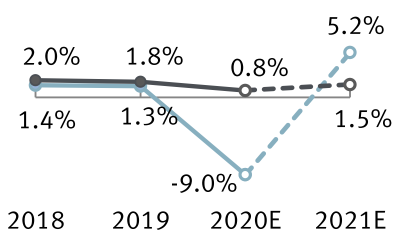
Eurozone – ECB on standby

Manufacturing data recovered to the best level since late 2018 amid a reopening economy. The unemployment rate sticking near lows at 7.8%. Exports strengthening. Renewed increase in virus case count may slow the domestic recovery. ECB signaled the policy committee is standing by to provide additional monetary stimulus should it be needed, adding that they have considerable room for action.



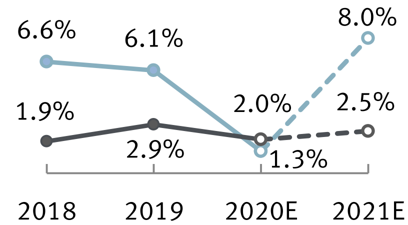
UK – Businesses remain pessimistic

Consumer sentiment improved slightly as some restrictions have been lifted, but business confidence sagged. With more than half of UK businesses fully operational, many believe a recovery will be sluggish at best, according to Lloyds, which also reported that just 16% of firms surveyed indicated they were planning on retaining all their furloughed staff. Brexit negotiations going nowhere, dampening sentiment further.



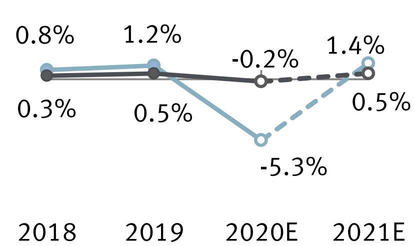
China – Manufacturing rebound slower than expected

It remains clear that China's manufacturing rebound is well underway but has slowed somewhat. Industrial production growing slowly, capital spending more quickly. Electricity production surging. Consumer spending continues to grow but confidence has ebbed in recent months. Exports are growing, helped by reopening of overseas economies.



Japan – Q3 starts weak

Japan's economy began Q3 on a weaker economic footing. Industrial production and exports are both growing but still below pre-COVID-19 levels. The crisis is weighing on consumption and investment. The prime minister stepping down may leave policy questions hanging for now. Japan's economy is expected to contract 4.8% in 2020, down slightly from the prior forecast, and recover by 2.6% in 2021.



Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management (RBC GAM), Bloomberg consensus estimates

Market scorecard

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	3,505.20	7.0%	8.3%	19.6%
Dow Industrials (DJIA)	28,465.78	7.6%	-0.4%	7.7%
Nasdaq	11,815.09	9.6%	31.2%	47.9%
Russell 2000	1,569.21	5.5%	-6.4%	4.5%
S&P/TSX Comp	16,547.59	2.1%	-3.2%	0.4%
FTSE All-Share	3,342.44	1.8%	-20.4%	-15.4%
STOXX Europe 600	366.51	2.9%	-11.9%	-3.4%
EURO STOXX 50	3,272.51	3.1%	-12.6%	-4.5%
Hang Seng	25,177.05	2.4%	-10.7%	-2.1%
Shanghai Comp	3,395.68	2.6%	11.3%	17.7%
Nikkei 225	23,139.76	6.6%	-2.2%	11.8%
India Sensex	38,628.29	2.7%	-6.4%	3.5%
Singapore Straits Times	2,532.51	0.1%	-21.4%	-18.5%
Brazil Ibovespa	100,462.40	-3.4%	-14.1%	-1.7%
Mexican Bolsa IPC	36,977.05	-0.5%	-15.4%	-13.6%
Bond yields	**8/31/20**	**7/31/20**	**8/30/19**	**12 mo. chg**
US 2-Yr Tsy	0.131%	0.105%	1.504%	-1.37%
US 10-Yr Tsy	0.713%	0.528%	1.496%	-0.78%
Canada 2-Yr	0.279%	0.268%	1.354%	-1.08%
Canada 10-Yr	0.644%	0.467%	1.164%	-0.52%
UK 2-Yr	-0.057%	-0.067%	0.401%	-0.46%
UK 10-Yr	0.311%	0.104%	0.479%	-0.17%
Germany 2-Yr	-0.652%	-0.601%	-0.927%	0.28%
Germany 10-Yr	-0.397%	-0.185%	-0.700%	0.30%
Commodities (USD)	**Price**	**1 month**	**YTD**	**12 month**
Gold (spot $/oz)	1,969.60	-0.4%	29.7%	29.4%
Silver (spot $/oz)	28.25	15.4%	57.6%	53.2%
Copper ($/metric ton)	6,486.50	4.3%	8.9%	18.4%
Uranium ($/lb)	20.90	-0.5%	-12.6%	-7.7%
Oil (WTI spot/bbl)	42.74	5.8%	-30.2%	-22.7%
Oil (Brent spot/bbl)	45.47	4.6%	-31.4%	-25.1%
Natural Gas ($/mmBtu)	2.63	46.2%	20.1%	15.1%
Agriculture Index	273.20	7.3%	-3.6%	9.8%
Currencies	**Rate**	**1 month**	**YTD**	**12 month**
US Dollar Index	92.1350	-1.3%	-4.4%	-6.8%
CAD/USD	0.7678	2.8%	-0.4%	2.0%
USD/CAD	1.3026	-2.7%	0.4%	-2.0%
EUR/USD	1.1938	1.3%	6.4%	8.7%
GBP/USD	1.3375	2.2%	0.9%	10.0%
AUD/USD	0.7389	3.3%	5.1%	9.6%
USD/JPY	105.8500	0.1%	-2.5%	-0.3%
EUR/JPY	126.3700	1.3%	3.8%	8.2%
EUR/GBP	0.8925	-0.8%	5.5%	-1.3%
EUR/CHF	1.0783	0.3%	-0.6%	-0.9%
USD/SGD	1.3600	-1.0%	1.1%	-1.9%
USD/CNY	6.8485	-1.8%	-1.6%	-4.3%
USD/MXN	21.8875	-1.7%	15.6%	9.1%
USD/BRL	5.4666	5.2%	36.3%	32.5%

U.S. equity markets rallied, with the S&P 500 and Nasdaq breaking records while the DJIA neared record levels.

Yields on U.S. 2-year and 10-year Treasuries rose m/m as they lost their appeal in a zero-rate world yield environment.

Gold prices retreated in August while silver and copper prices jumped m/m.

The U.S. Dollar Index fell as the dollar weakened against most major currencies including CAD, EUR, and GBP.

Equity returns do not include dividends, except for the Brazilian Ibovespa. Equity performance and bond yields in local currencies. U.S. 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 0.76 means 1 Canadian dollar will buy 0.76 U.S. dollar. CAD/USD -0.4% return means the Canadian dollar has fallen 0.4% vs. the U.S. dollar during the past 12 months. USD/JPY 105.85 means 1 U.S. dollar will buy 105.85 yen. USD/JPY -2.5% return means the U.S. dollar has fallen 2.5% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 8/31/20.

Research resources

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Thomas Garretson, CFA – Fixed Income Senior Portfolio Strategist, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Christopher Girdler, CFA – Fixed Income Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group, RBC Dominion Securities Inc.

Patrick McAllister, CFA – Manager, Equity Advisory & Portfolio Management, Portfolio Advisory Group, RBC Dominion Securities Inc.

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Hold [Sector Perform]	635	42.25	130	20.47
Sell [Underperform]	92	6.12	12	13.04

Outperform (O): Expected to materially outperform sector average over 12 months. **Sector Perform (SP):** Returns expected to be in line with sector average over 12 months. **Underperform (U):** Returns expected to be materially below sector average over 12 months. **Restricted (R):** RBC policy precludes certain types of communications, including an investment recommendation, when RBC is acting as an advisor in certain merger or other strategic transactions and in certain other circumstances. **Not Rated (NR):** The rating, price targets and estimates have been removed due to applicable legal, regulatory or policy constraints which may include when RBC Capital Markets is acting in an advisory capacity involving the company.

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