



## Emerging markets: A ripe climate

Weak U.S. dollar + vaccines =  
constructive outlook on emerging  
markets

Frédérique Carrier | Page 4

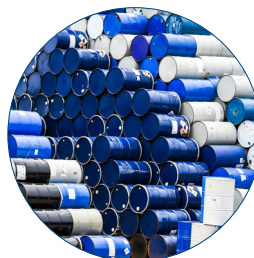
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**Starting from  
square one**



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The pace of economic growth for most economies should slow in early 2021, but we expect equity prices will gain ground as the year progresses. We recommend an Overweight exposure to equities within a global balanced portfolio.

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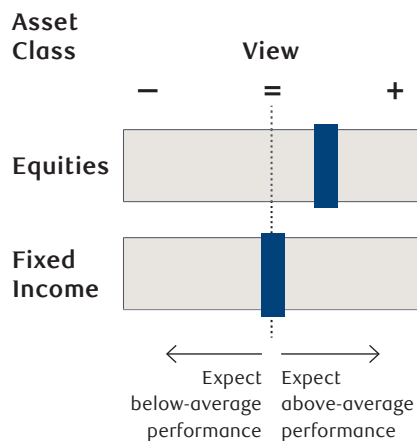
Central banks made many policy shifts in 2020. Are there more to be had?

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## RBC'S INVESTMENT Stance

### Global asset class views



(+/-/=) 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.

Source - RBC Wealth Management

## EQUITIES

- While the end of the COVID-19 pandemic is not yet in sight and shutdowns persist in developed countries, we think its economic fallout will diminish through 2021. This, combined with accommodative monetary and fiscal policies, should support strong corporate profits growth and higher stock prices this year. The persistence of ultralow interest rates should support above-average valuations and make equities the asset class of choice in 2021.
- We recommend holding an Overweight position in equities in portfolios with long-term time horizons. But we think investors should expect some bumps along the way. Many major equity markets have rallied sharply in the past couple months, not to mention since the March 2020 panic lows. It would be normal for markets to take a breather or pull back over the near term.

## FIXED INCOME

- The central banks of most developed countries are likely to only fine-tune policy measures after pulling out all the stops in 2020, but will act if needed. As that intervention wanes, along with an ongoing economic recovery dependent on the path of COVID-19 and the vaccine rollout, we think global yields can move gradually higher—so we stay modestly short on yield curves. In credit markets, valuations are historically rich and corporate bond yields are at fresh record lows, but we still expect credit to outperform government debt in 2021, and maintain a slight Overweight.
- We maintain our Market Weight in global fixed income. Global demand for “safe-haven” assets remains robust and with markets continuing to price a strong economic recovery, along with central bank support, we maintain a broad Overweight to corporate credit, primarily via preferred shares.

## MONTHLY Focus



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# Emerging markets: A ripe climate

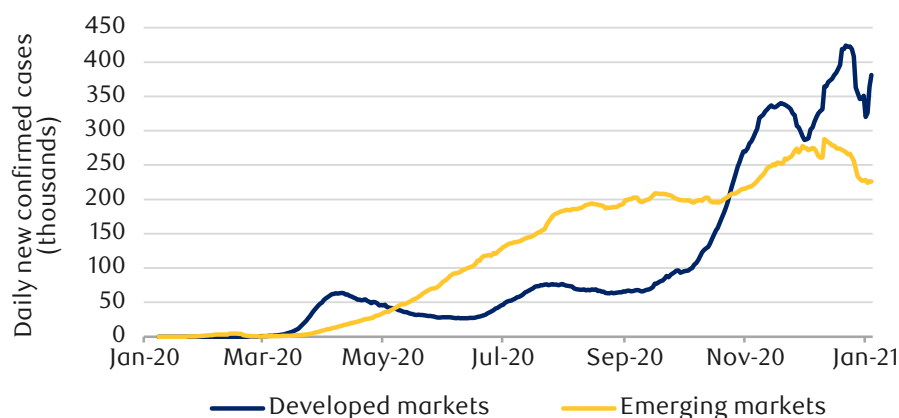
The development of safe, effective vaccines and a weak U.S. dollar solidify our constructive view of emerging market equities, especially Asia (ex-Japan). At the same time, we think Asian bonds provide an attractive yield pickup versus those in developed markets.

After a long, difficult year the development of COVID-19 vaccines allows us to start 2021 on a note of optimism. While much of the vaccine newsflow has focused on the U.S. and Europe, we think it will provide a shot in the arm for emerging markets (EM) as well.

According to the Organisation for Economic Co-operation and Development, emerging market Asia will top the economic growth leaderboard in 2021, thanks to China, which is expected to grow eight percent in 2021, while India should come in just under that at some 7.9 percent. Latin America is likely to lag, with Mexico growing 3.6 percent and Brazil an even more meager 2.6 percent.

### Q4 surge in COVID-19 infection rates more virulent in developed markets than in emerging markets

Seven-day moving average of daily infections



Source - RBC Wealth Management, European Centre for Disease Prevention and Control, Macrobond, RBC Global Asset Management; data through 1/4/21

### Vaccines—Good news for EMs too

One can be forgiven for thinking that as the vaccines are initially rolled out in advanced economies, EMs stand to lose out. But that is not necessarily the case.

Many EMs rely heavily on exports: for Thailand, South Korea, and Turkey, they account for a hefty 60 percent, 40 percent, and 33 percent of GDP, respectively. As the global cycle picks up, these economies should benefit. Thailand, Mexico, and Turkey, which generate 23 percent, 16 percent, and 12 percent of GDP, respectively, from tourism, could enjoy an incremental recovery on the return of freshly vaccinated tourists and the resumption of air travel.

## MONTHLY FOCUS

*Emerging markets: A ripe climate*

In early 2020 there was widespread concern the COVID-19 outbreak could spark a new EM financial crisis, producing a wave of defaults and devaluations. These fears have proved overblown. Thanks to aggressive actions of policymakers and the International Monetary Fund, that situation has been avoided. Vaccine rollouts in EMs should further underpin the EM economic recovery, even though those rollouts will happen later than in developed nations. Moreover, RBC Global Asset Management (GAM) points out that emerging markets have as a whole spent less than five percent of GDP on COVID-19-related fiscal stimulus compared to about 30 percent for developed markets (DM), leaving room for further fiscal stimulus should it be required.

### Constructive outlook for EM equities

We are constructive on EM equities, and particularly the Asia ex-Japan region whose weight in the MSCI Emerging Markets Index has grown since the China A shares were included at the end of 2019. China, Korea, and Taiwan now make up more than two-thirds of that index.

A cyclical upturn, strengthening EM currencies, and undemanding equity valuations underpin our stance.

EM equities tend to outperform when global Purchasing Managers' Indexes, gauges of economic activity, increase thanks to companies' high operating leverage or high fixed-cost base, and because of the pronounced exposure to cyclical sectors, which account for some 50 percent of the MSCI Emerging Markets Index.

Moreover, historically, there has been a distinct positive relationship between strong currencies and equities. RBC GAM found that since 1988, EM stocks have generally risen when the U.S. dollar declines and as EM currencies strengthened. The reverse holds true. This occurs because a stronger national currency makes it easier for EMs to cope with heavy external debt loads, which RBC GAM estimates at around \$5.4 trillion (denominated in U.S. dollars and other DM currencies).

EM equities are also undervalued. Our national research correspondent calculates that on a sector-adjusted price-to-earnings basis, EM equities trade at a discount of some 20 percent to DM, close to a 15-year low, with most sectors trading at a discount to their DM equivalent. RBC GAM found that looking at price-to-book (P/B) value shows a similar picture, with EM equities trading at a 30 percent discount to DM.

For China, we believe the current valuation looks fair, with the onshore index, the CSI 300, trading at 14.7x the consensus forward earnings estimate, in line with the five-year average.

### Strong EM currencies + high Asian yields

The prospect of a weaker U.S. dollar is important to our constructive view on EM. Since the peak of the COVID-19-driven financial markets crisis in March, the U.S. Dollar Index has weakened by some 12 percent as fears for the global economy have receded. Dollar weakness could persist into this



## MONTHLY FOCUS

*Emerging markets: A ripe climate*

Emerging-market equities trade at a 30% discount to their developed-market counterparts on a price-to-book value basis



Source - RBC Global Asset Management

year according to consensus forecasts. Ultralow interest rates have made the U.S. dollar less attractive, while more predictable trade policies under a Biden presidency could further reduce the financial world's need for a "safe-haven" currency.

As investors gain confidence in the global economic outlook, they are once again seeking riskier, higher-yielding assets. Q4 2020 looks as though it will have been one of the strongest quarters for inflows into EMs since 2013. According to the Institute of International Finance, non-residents' portfolio flows totaled some \$76 billion in November 2020, significantly over the prior month's \$23 billion, and achieving in only two months a level similar to total Q3 inflows of an already high \$107 billion. These capital flows are likely to continue as EM currencies are undervalued and EM government bond yields are higher.

According to our national research correspondent, EM currencies are nearly as undervalued as they were during the Asian financial crisis of 1998 despite some countries' balance of payments surpluses being close to a 20-year high. In addition, the average interest rate on EM local government debt compared to that of the U.S. is significantly higher, even adjusting for inflation. To illustrate, the JP Morgan Emerging Markets Bond Index Global Diversified, which tracks bonds issued by sovereign and quasi sovereign entities yields some 350 basis points over U.S. Treasuries. This higher-than-normal spread should attract foreign investors.

There is another important development. Chinese government bonds will be included in the FTSE World Government Bond Index as of October 2021. This reflects China's ongoing progress with market reforms and increased access for global investors. China is the world's second-largest bond market with some \$16 trillion outstanding. According to our national research correspondent, foreign investors own only three percent of Chinese government bonds against a benchmark weighting that could potentially rise to approximately 15 percent. It would be reasonable to expect there will be stronger-than-normal institutional buying of Chinese government debt in the months leading up to the index inclusion.

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## MONTHLY FOCUS

*Emerging markets: A ripe climate*

Asian bonds provide what we believe is an attractive yield pickup versus developed markets. For investors willing to withstand higher risk, there are selective opportunities in EM bonds with yields of as much as 6%–8%. We caution, however, that the ride may not be a smooth one and investors need to be nimble and selective given heightened idiosyncratic risks amid COVID-19 challenges, persisting trade tensions, and rising debt burdens.

### Parting thoughts

Risks to this constructive outlook for both EM equities and debt would include a more difficult-than-expected vaccine rollout and/or a take-up that's too low to allow social-distancing measures to be relaxed in both developed nations and EMs. Perhaps less likely would be a decision by the Federal Reserve to tighten policy sooner than expected. Countries that have ratcheted up debt to finance government spending, such as Brazil, would be particularly vulnerable, in our view.

Overall, the prospects for EM equities appear attractive for 2021. They've had a good run recently, surpassing January's 2020's high, and the MSCI Emerging Markets Index is up 67 percent since the March lows, in line with the gains generated by the S&P 500. Better entry points are possible, but on a one-year view, we are positive on the asset class, with a preference for Asia (ex-Japan), and China in particular. Having weathered the COVID-19 crisis more successfully, this region's finances make it less vulnerable to an eventual Fed tightening cycle.

*With contributions from Juan Carlos Cure, RBC Europe Limited.*

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## Not so fast

The V-shaped recovery that began in May for most economies is giving way to a slower and probably bumpier phase of growth. “Second wave” shutdowns, a factor in Q4 2020 for the UK and Europe, will be a Q1 2021 drag for the U.S. and Canada. Nonetheless, the U.S. and Canadian economies should regain their pre-pandemic high ground by late 2021/early 2022. For Europe, the UK, and Japan, it will likely take a couple quarters longer. By the end of Q3 2020, China’s economy had already recovered all the ground lost to the first half’s COVID-19 shutdown.

The earnings recovery in Q3 was stronger than expected. Profit indications for Q4 point to further improvement. Earnings in 2021 and 2022 could surprise to the upside as some sectors and groups, crippled by the pandemic, return to life. The extension through December of the equity market rebound off the deep spring lows suggests to us that investors have already paid in advance for some of that expected return to “normal.” However, indexes

in Europe, the UK, and Canada have not yet made it back to their 2019 highs. Japan’s TOPIX is still below its 2018 high water mark.

Once the developed economies and China are fully re-opened, which we expect in H2 2021, we look for GDP and earnings growth to settle in at a more sedate pace, similar to that which prevailed in the long, post-financial crisis expansion.

We expect equity prices will appreciate further from today’s levels through 2021, although not by as much as earnings advance, bringing price-to-earnings ratios down modestly.

Our Overweight (above-benchmark) recommended exposure to equities in a global balanced portfolio reflects our view that the driving force behind earnings growth and equity valuations is rapidly shifting away from the outsized volatility risks presented by the pandemic back toward the long-term expectations for sustainable economic growth.

## REGIONAL HIGHLIGHTS

### United States

■ The domestic economic recovery is persisting, albeit at a two steps forward, one step back pace due to renewed COVID-19 shutdowns. The S&P 500 has risen almost 15% since early November. Small-capitalization stocks have fared even better, with the Russell 2000 rallying 28% during the same period. These strong rallies raise questions about the sustainability of the moves. Technical indicators point to an increased risk of a near-term pullback, in our view.

■ Even if the market takes a much-needed rest, we think the major indexes have the potential to deliver worthwhile all-in returns for the year. We expect corporate profits to gain more ground as the economic

foundation becomes sturdier with the help of ongoing ultraloose monetary policies, another round of fiscal stimulus, and the ultimate taming of COVID-19 headwinds. The S&P 500 consensus earnings forecast of \$167 per share for 2021 seems reasonable to us, and would represent roughly 20% y/y growth after the final 2020 results shake out. If this is achieved, it would push profits to a record level, beyond the pre-COVID-19 high of \$163 per share reached in 2019.

■ The S&P 500’s valuation of 22.5x the forward consensus earnings estimate is uncomfortably above average, but should not prohibit the index from advancing given that interest rates are likely to remain extraordinarily low.

### Equity views

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

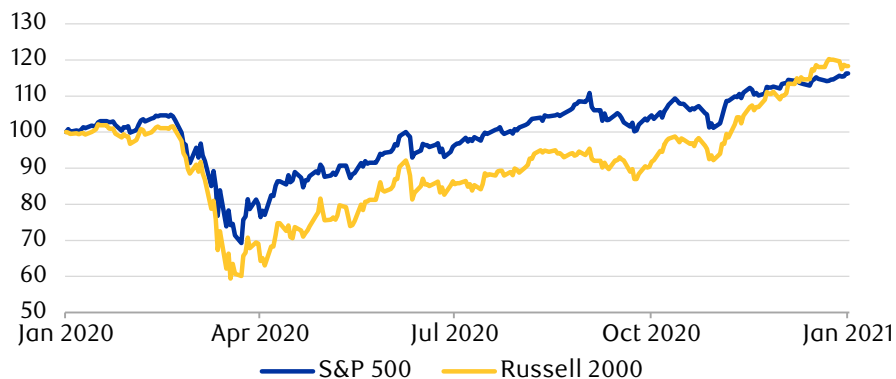
+ Overweight; = Market Weight; – Underweight  
Source - RBC Wealth Management



## GLOBAL EQUITY

### Regional highlights

#### Large-cap and small-cap performance in 2020, indexed to 100



Source - RBC Wealth Management, FactSet; data through 1/1/21

■ As of this writing, and due to the preliminary outcomes of the Georgia Senate races, the Democratic Party is positioned to take control of the U.S. Senate upon the swearing in of Joe Biden as president and Kamala Harris as vice president. The market's knee-jerk reaction following the Georgia elections was positive due to the perception that greater fiscal spending on COVID-19 relief and other federal initiatives could be in the offing and would support economic growth. Thus far, risks of tax increases are not at the forefront. We think this is because razor-thin Democratic control in the Senate (and the party's narrow majority in the House of Representatives) makes passing sweeping, substantial tax hikes difficult to achieve. Also, in our view, many market participants recognize that raising taxes in the early stages of a fragile economic recovery and amid persistent COVID-19 economic challenges would be ill-advised, and this effectively reduces the risk of substantial tax increases—at least in 2021.

■ To start the year, we would position equity portfolios with a mix of cyclical (economically sensitive) and defensive dividend-paying sectors. We would Overweight U.S. equities.

#### Canada

■ A greater return to normalcy such as that afforded by a successful COVID-19 vaccine could be a powerful tonic for Canadian equity market performance in 2021. The S&P/

TSX Composite trades at a marked valuation discount relative to some developed markets. An improvement in the perceived durability of the economic recovery could boost sentiment toward key sectors of the domestic market and help shrink its relative discount.

■ Big Six banks collectively amassed CA\$24 billion in credit loss provisions during fiscal 2020. If the economic outlook brightens, actual credit losses could prove to be less than feared, and we could see a portion of these provisions released back into future earnings. This is not our base case but is illustrative of what further evidence of sustained economic growth could provide to Canada's largest industry group.

■ Energy's weight in the benchmark has eroded in recent years, but improved performance could further propel Canadian equities. RBC Capital Markets forecasts higher crude prices in 2021, which we believe is reasonable if a sustainable improvement in demand helps drain both oil and refined product inventories. We recommend a Market Weight position in Canadian equities.

#### Europe & UK

■ We would hold a Market Weight position in both Europe and UK equities. Both economies face a difficult winter due to COVID-19, but based on a 12-month outlook, they should recover as infection rates subside and monetary and fiscal support work their way through.

## GLOBAL EQUITY

### Regional highlights

■ For Europe, the landmark €750 billion rescue package backed by joint EU debt should ensure aid is available in H1 2021. We believe an improving economic outlook would favour cyclical, such as select Industrials companies underpinned by secular trends, and luxury and sporting goods categories where long-term fundamentals appear structurally attractive. Long term, we favour Health Care, a sector supported by demographics and rising global health care expenditures, and renewables-focused companies in the Utilities sector as governments target green and sustainable investments.

■ The UK is continuing to adjust to leaving the EU single market, and we believe its economy will adapt to these challenging times.

■ The FTSE All-Share Index has been a perennial underperformer since the 2016 Brexit referendum, and valuations are attractive relative to those of other developed markets. Moreover, we expect a notable rebound in dividends this year as many companies are likely to reinstate their payouts as the outlook improves.

■ We prefer UK companies that are well positioned to benefit from long-term structural growth tailwinds or possess internal levers to grow, particularly in the Consumer Staples, Health Care, and Industrials sectors.

### Asia-Pacific

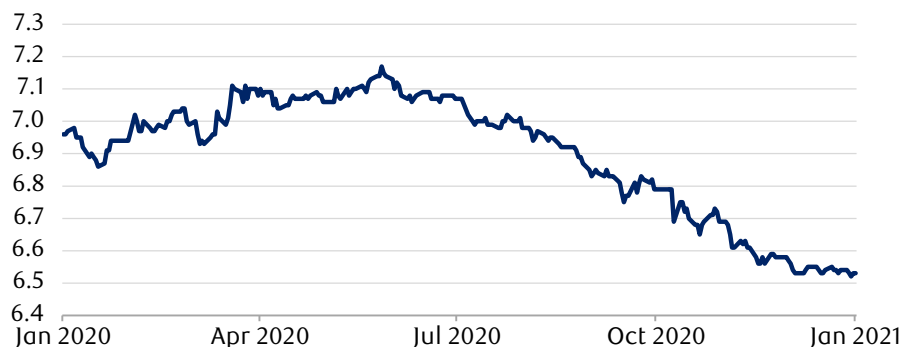
■ We remain Overweight on China equities. We believe the Chinese economy and corporate earnings are

likely to record stronger growth in H1 2021 than in H2 2021 due to easy comparisons to 2020. The liquidity situation could be tighter compared to 2020 as the economy continues to recover. The renminbi may continue to strengthen versus the U.S. dollar, which could benefit sectors with large U.S. dollar debt exposure or whose raw materials costs are settled in dollars.

■ The market generally believes the U.S.-China relationship would marginally improve under a Biden presidency. On the positive side, Biden views China as a “serious competitor” instead of a rival, and he believes imposing extra tariffs on Chinese goods is unwarranted. However, curbing Chinese tech firms could remain a key U.S. strategy, but this may be undertaken via a more traditional approach.

■ For Japan, we expect economic growth to recover moderately in 2021 after a weak 2020 (the Bank of Japan estimates GDP for FY2020–21 at -5.5% and +3.6% y/y, respectively). With the global economy recovering, we expect the downward revisions to Japan’s corporate earnings to reverse. The term of Japan’s House of Representatives will expire in October 2021, and we expect the current administration to call a snap election. A strong mandate for Prime Minister Yoshihide Suga could be a catalyst for Japan’s equity market. We expect the stronger yen to persist, which would weigh on Japan’s key export sector. All in, we are neutral on Japan equities in 2021.

### China renminbi per U.S. dollar in 2020 (CNY/USD)



Source - RBC Wealth Management, FactSet; data through 1/1/21

## GLOBAL Fixed income

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## Starting from square one

After central banks pulled out all the stops and then some in 2020, many investors have asked if there is anything left the banks can do. While we believe there remains plenty of scope for them to provide further accommodation, if needed, the question for central banks this year is likely to be more along the lines of what more needs to be done.

For the Fed, the focus will be on its asset purchase program with rate hikes still nowhere on the horizon. The Fed retains the option of increasing the size of its purchases, and/or extending the maturities of those purchases in order to anchor yields, though passed on the opportunity to do so at its December 2020 meeting. While it will keep that policy pivot on the table, we think 2021 is more likely to see the Fed begin the process of dialing back its asset purchase programs later in the year. The European Central Bank delivered another round of stimulus measures at the end of 2020, so policy should largely be on autopilot in coming months as policymakers assess the economic impact. The Bank of England will not only have

to stand at the ready in the face of the COVID-19 pandemic, but will also have to contend with providing economic support amidst heightened uncertainty as the UK's exit from the EU has now taken effect.

With the policy foundation set, global yields will likely remain well-anchored around current levels, but we see the trajectory as moving gradually higher throughout the year for most developed economies.

All told, we believe 2021 will undoubtedly be a challenging year for fixed income investors. Sovereign yields around the globe open the year at or near historical lows, while optimism around the economic outlook has driven credit spreads, or the yield compensation beyond sovereign yields for credit risk, also back toward historical lows. Although we think income and total returns will be modest at best this year, fixed income should still be looked to as a source of portfolio stability and capital preservation. We would maintain a bias toward credit, and modestly short positioning on yield curves as the economic recovery takes hold.

## REGIONAL HIGHLIGHTS

### United States

■ Despite prospects for additional fiscal stimulus, progress on COVID-19 vaccine rollouts, and improved expectations around the pace of the economic recovery, the Fed signaled again at the December Federal Open Market Committee meeting that policy rates are likely to remain at 0% through at least 2023. Asset purchases are likely to continue as comprised, but we don't see any major shifts in monetary policy unless economic conditions deteriorate, whereby the Fed would likely increase and/or extend the maturities of its asset purchase program.

■ Though Fed policies should act as an anchor on Treasury yields, we still see yields rising and curves steepening on improving growth and inflation expectations over the course of 2021, though at a shallow and glacial pace, meaning the 10-year Treasury yield is likely to hold below approximately 1.25% for the balance of 2021.

■ We believe credit markets will remain well-supported throughout the year as the pace of new corporate bond issuance slows, with additional support provided by high equity market valuations and an ongoing economic recovery. However, current

### Fixed income views

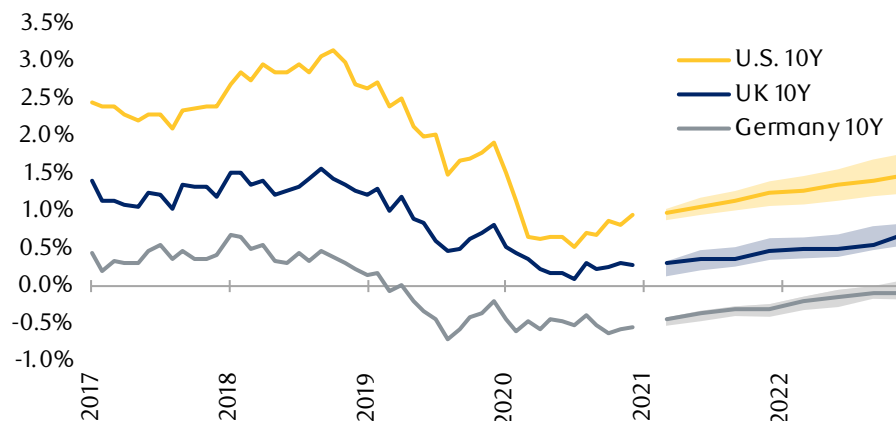
Region	Gov't bonds	Corp. credit	Duration
Global	=	+	5–7 yr
United States	=	+	5–7 yr
Canada	=	+	3–5 yr
Continental Europe	=	=	5–7 yr
United Kingdom	–	=	3–5 yr

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

## GLOBAL FIXED INCOME

## Regional highlights

## Yield forecasts still signal a long road to recovery



Source - RBC Wealth Management, December Bloomberg Survey; forecast period Q1 2021 to Q4 2022 shows median estimates with shaded regions representing central range of forecasts

fixed income valuations already reflect this as credit spreads—or the additional yield compensation for credit risks over Treasuries—are well below historical averages and near pre-pandemic levels. With little threat of sharply higher Treasury yields, we think investors should look to preferred shares for additional income within portfolios in a low-yield environment.

## Canada

■ Canadian sovereign short-term yields remain at record lows due to central bank policy rates while yields further out the maturity spectrum fluctuated more as 2020 progressed. In an unappealing yield environment like this, we recommend traditional Government of Canada bonds for their liquidity characteristics in portfolios but look elsewhere for income generation. We maintain a focus on Real Return Bonds given the cost of inflation protection remains relatively cheap in Canada, therefore the bar to outperform traditional Canadian government bonds is fairly low.

■ Corporate bonds became less appealing for investors as 2020 evolved. The Bloomberg Barclays Corporate Bond Index in Canada has a sub-2% yield and an average maturity of approximately nine years, which is better than is available from government bonds, but leaves us less

enthused about this segment as we head into 2021.

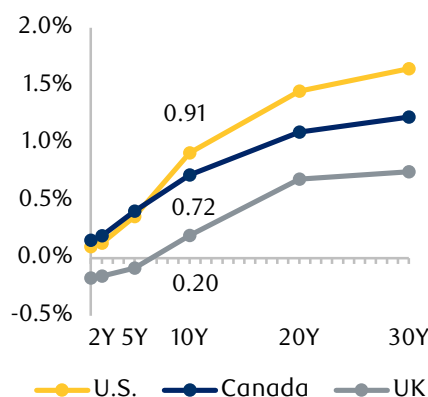
■ Preferred shares remain one of the few areas of the Canadian fixed income space where investors can find 4%–6% yields. We believe the combination of a steady demand for income and a reduced supply of preferred shares due to refinancing will support prices over 2021. However, our excitement must be tempered with the knowledge that preferred shares are highly sensitive to changes in market sentiment. A higher-than-normal allocation to preferred shares should be combined with defensive securities to produce a portfolio generating both income and safety.

## Europe &amp; UK

■ Substantial action by the European Central Bank (ECB) and Bank of England (BoE), with corresponding strong fiscal support from national governments and at the EU level, has been effective at anchoring interest rate expectations while supporting government spending, corporate refinancing, and households during 2020.

■ Europe still has to contend with the uneven recovery and re-opening of some countries' economies over the months ahead. However, the outlook is constructive given the considerable joint fiscal and monetary stimulus across the

## Sovereign yield curves

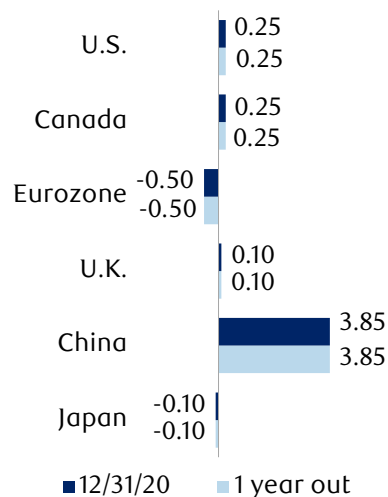


Source - Bloomberg; data through 12/31/20

## GLOBAL FIXED INCOME

### Regional highlights

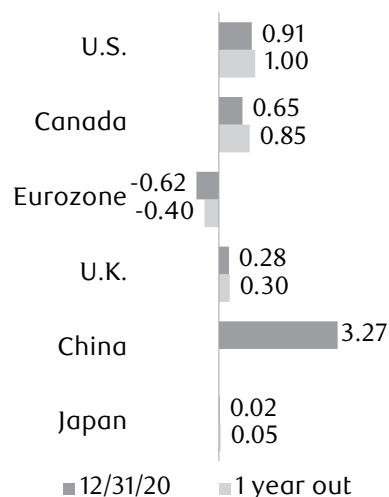
#### Central bank rate (%)



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

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

#### 10-year rate (%)



Note: Eurozone utilizes German Bunds.

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

euro area, with a further extension expected from the ECB.

■ In the UK, the end of the transition period means the country leaving the EU single market for good, even though an agreement has been reached. This heralds a challenging growth outlook which could see the BoE potentially doing more to support the economy. At best, we would expect range-bound market moves; however, we could see the low yields of 2020 being revisited.

■ This leaves investors in an environment of low yields and flat yield curves at the beginning of 2021. Given this backdrop, we continue to favour corporate credit over government bonds, and adopt a flexible and tactical approach in our credit selection. We see cyclical sectors benefiting from the recovery, which we believe will slowly start to gain momentum during the first half of 2021. However, the more defensive sectors that performed well throughout the pandemic may start to lag.

#### Asia-Pacific

■ Asian bonds look attractive for 2021 given their balance between reward and risk. Asia's economic recovery has been led by China, where an impressive V-shaped

rebound is underway thanks to strong measures to control COVID-19. As a result, GDP rose sharply by 3.2% y/y and 4.9% y/y in Q2 and Q3 2020, respectively, after a contraction of 6.8% in Q1. At the Fifth Plenum of the 19th Party Congress held at the end of October 2020, the Chinese government emphasized its aim of sustaining quality growth under its 2021–2025 national economic and social development plan.

■ In the current zero interest rate environment, we think the search for yield is here to stay. Asian bonds continue to provide what we believe is an attractive yield pickup versus developed markets. At the same time, Asia is economically better positioned compared to the other emerging market regions of Latin America and Central and Eastern Europe Middle East and Africa.

■ In Asia, we prefer high-yield over investment-grade bonds. The 6%–8% yield in the high-yield segment is attractive but we caution clients the ride may not be a smooth one. Investors need to be nimble and selective as heightened idiosyncratic risks amid COVID-19 challenges, trade tensions, and debt burdens may linger. However, overall, we believe the risks should be contained.



# Commodities

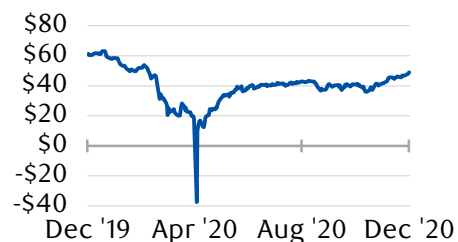
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## WTI: Fueling the economy

Global lockdowns led to sharp double-digit losses for West Texas Intermediate crude in 2020. While vaccine news is positive for crude, RBC Capital Markets suggests further upside would require a resurgence in consumer demand and an improvement in refining margins. We expect further volatility but also upside participation alongside an economic recovery in 2021.



## Natural gas: Economic drawdown

Natural gas surprised to the upside in 2020, and RBC Capital Markets believes the supply-demand dynamic should improve heading into 2021 driven by moderating gas production and increased liquefied natural gas export activity. Inventories remain elevated due to government shutdowns, and we expect drawdowns to pick up as restrictions are lifted.



## Gold: Resetting expectations

Gold has pulled back from its 2020 high, driven by news of vaccines and therefore improved risk appetite. While a “normalized” economy may be a headwind for assets considered to be “safe havens,” we believe the environment remains conducive for gold due to low real rates and political/economic uncertainties going into 2021.



## Copper: Surplus position

Copper experienced a V-shaped recovery, bouncing 70%+ off its 2020 lows and is trading at the top end of its 18-month range. As China consumes roughly 50% of global demand, swift action by its government to curb the pandemic has benefited copper. Going into 2021, we expect the copper market to remain in a surplus position.



## Soybeans: Soy-ing higher

Soybean prices rallied to an 18-month high on the back of growing Chinese demand and lower global production as a result of unfavourable weather conditions. Global ending stock for the 2020/21 season is well below the previous two seasons. We would expect a rebound in production and prices to normalize.



## Wheat: Another record

Wheat prices have benefited from sustained purchases from China as part of the U.S.-China Phase 1 trade agreement and were up about 9% in 2020. The U.S. Department of Agriculture expects global ending stock to reach another record high in the 2020/21 season.



## Commodity forecasts

Commodity	2021E	2022E
Oil (WTI \$/bbl)	\$51.52	\$56.90
Natural gas (\$/mmBtu)	\$2.75	\$2.55
Gold (\$/oz)	\$1,810	\$1,785
Copper (\$/lb)	\$3.25	\$3.00
Soybean (\$/bu)	\$11.87	\$10.48
Wheat (\$/bu)	\$6.12	\$6.13

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (soybean and wheat)

Chart source - RBC Wealth Management, Bloomberg; date range: 12/18/19–12/18/20

# Currencies

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## Currency forecasts

Currency pair	Current rate	Forecast Dec 2021	Change
Major currencies			
USD Index	89.93	95.15	6%
CAD/USD	0.78	0.77	-1%
USD/CAD	1.27	1.30	2%
EUR/USD	1.22	1.14	-7%
GBP/USD	1.36	1.19	-13%
USD/CHF	0.88	0.95	8%
USD/JPY	103.25	98.0	-5%
AUD/USD	0.76	0.69	-9%
NZD/USD	0.71	0.66	-7%
EUR/JPY	126.18	112.0	-11%
EUR/GBP	0.89	0.96	8%
EUR/CHF	1.08	1.08	0%
Emerging currencies			
USD/CNY	6.52	6.35	-3%
USD/INR	73.06	71.50	-2%
USD/SGD	1.32	1.31	-1%

Change is defined as the implied appreciation or depreciation of the first currency in the pair quote. Examples of how to interpret currency data can be found in the Market Scorecard.

Source - RBC Capital Markets forecasts, Bloomberg

## U.S. dollar: Mixed performance

Market consensus looks for further dollar weakness heading into 2021, citing the greenback's anti-cyclical characteristics, ultraloose monetary policy from the Fed, and structural weaknesses (twin deficits). However, RBC Capital Markets suggests consensus may be too bearish on the dollar and forecasts more mixed performance through 2021, in part underpinned by the view that growth expectations favour the U.S. relative to the rest of the world.

## Euro: Limited upside

The outlook for the euro has turned more constructive with the passing of the EU recovery fund and joint fiscal-monetary response to COVID-19. However, with positive catalysts largely priced in and concerns of slowing growth momentum amid the latest COVID-19-related lockdowns, gains could be limited for the euro in 2021. Inflation expectations well below the European Central Bank's target suggest the central bank could keep policy accommodative and rates negative for some time, which could be a longer-term headwind for the currency.

## Canadian dollar: Supportive risk backdrop

Although the Canadian dollar faces challenges with the growth rebound stalling, new fiscal stimulus measures

and the extension of existing programs should help to offset near-term risks. We expect risk sentiment will continue to be the primary driver of the currency heading into 2021. A more positive risk backdrop and increased demand for commodities could keep the Canadian dollar supported.

## British pound: After Brexit

After the Brexit transition process, we still have reason to be cautious on the British pound through 2021. Some degree of economic and trade disruption is likely to result as the UK adjusts to its new relationship with the EU. This, combined with the UK's weak financial position, challenging domestic growth outlook, and the possibility of negative rates could point to sterling underperformance.

## Japanese yen: Domestic flows

Alongside risk appetite catalysts, the yen will likely be driven by flows from Japanese investors. Due to low global rates, Japanese investors are repatriating foreign investments and adding hedges to foreign holdings, keeping domestic demand strong for the yen. These flows could provide support regardless of risk appetite.

## Strong equity markets and a weak U.S. dollar sent USD/CAD to 2018 lows

A global economic recovery and supportive risk backdrop could keep the Canadian dollar supported in 2021

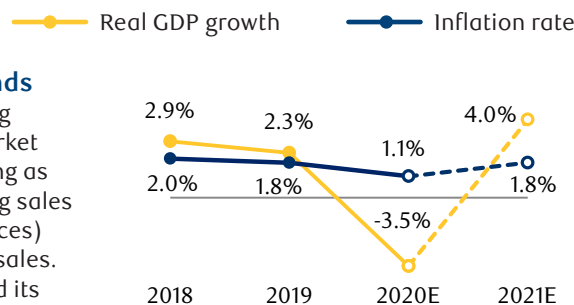


Source - Bloomberg, RBC Wealth Management, data through 12/29/20

## KEY Forecasts

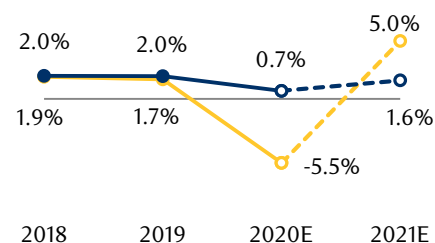
### United States: Labor market headwinds

Unemployment has trended lower, but rising COVID-19 cases have limited the labour market recovery. Jobless claims have stopped falling as second-wave closures bite. Following strong sales through October, retail sales (ex-food services) dipped amid weaker-than-expected online sales. At the last meeting of 2020, the Fed updated its forward guidance and economic projections with no major policy changes. A fiscal package is still pending.



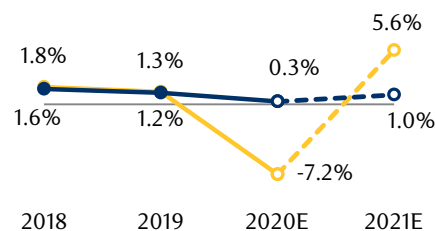
### Canada: Fiscal stimulus supports optimism

The unemployment rate fell to 8.5% in November, due in part to fiscal support and relative success in controlling COVID-19 cases over the summer. Consumer attitudes and spending remain positive. However, renewed restrictions in response to an autumn second wave will likely weaken the December jobs report. The BoC left its key interest rate unchanged at 0.25% and said it would maintain its current policy of quantitative easing.



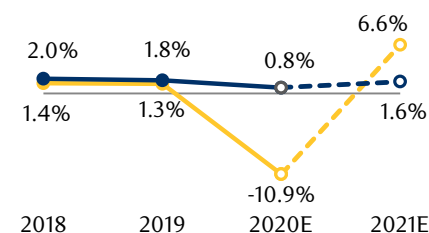
### Eurozone: ECB lifts bank dividends ban

The ECB is encouraging banks to wait on paying dividends until September. With 75% of employment being service-based, unemployment is likely to increase in the wake of restrictive lockdowns. Consumer confidence remains weak, but retail sales have come in better than expected. The Brexit trade deal will ensure that most goods traded between the two regions won't face new tariffs or quotas.



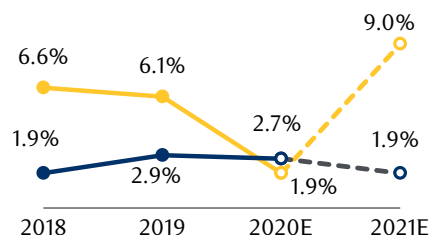
### UK: Brexit deal with EU takes effect

We prefer UK companies positioned to benefit from structural growth tailwinds or possessing internal levers to grow, particularly within Consumer Staples, Health Care, and Industrials. A new COVID-19 virus strain has forced a new round of pandemic restrictions. Positivity surrounding the Brexit deal may be tempered by the UK's rising unemployment rate and COVID-19-driven weak economic recovery.



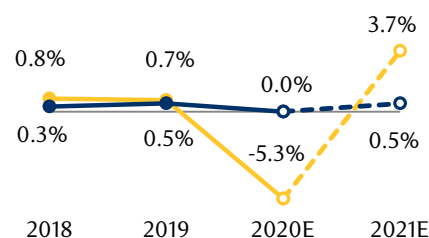
### China: Expansion intact

China January PMIs indicate economic expansion remained intact into year-end. CEO surveys suggest the recovery will take several more months to reach all of the economy as some components still struggle. Slow recovery in the retail sector has tightened credit access for smaller companies with retail exposure. Larger companies continue to have easier access to capital.



### Japan: Industrial output flat

After five months of growth, Japan's industrial production was unchanged in November. After eight months of inventory declines, manufacturers can manage through weaker domestic and overseas demand without having to significantly cut output. A record rise in COVID-19 cases has forced the Japanese government to impose new travel restrictions, which could further dampen overall economic activity into Q1.



## MARKET Scorecard

Data as of December 31, 2020

### Equity indexes

Equity markets climbed higher across the board in December amid positive vaccine news.

### Bond yields

The U.S. 10Y has found a range of about 0.90% after hitting a record low of roughly 0.51% just four months ago.

### Commodities

Oil posted positive gains in December, but remained dramatically lower for the year as the pandemic sharply reduced demand.

### Currencies

The U.S. dollar continues to tumble as rising COVID-19 cases and subsequent business activity restrictions have offset any optimism surrounding widespread vaccine distribution.

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 0.78 means 1 Canadian dollar will buy 0.78 U.S. dollar. CAD/USD 2.0% return means the Canadian dollar has risen 2.0% vs. the U.S. dollar during the past 12 months. USD/JPY 103.25 means 1 U.S. dollar will buy 103.25 yen. USD/JPY -4.9% return means the U.S. dollar has fallen 4.9% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 12/31/20.

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	3,756.07	3.7%	16.3%	16.3%
Dow Industrials (DJIA)	30,606.48	3.3%	7.2%	7.2%
Nasdaq	12,888.28	5.7%	43.6%	43.6%
Russell 2000	1,974.86	8.5%	18.4%	18.4%
S&P/TSX Comp	17,433.36	1.4%	2.2%	2.2%
FTSE All-Share	3,673.63	3.7%	-12.5%	-12.5%
STOXX Europe 600	399.03	2.5%	-4.0%	-4.0%
EURO STOXX 50	3,552.64	1.7%	-5.1%	-5.1%
Hang Seng	27,231.13	3.4%	-3.4%	-3.4%
Shanghai Comp	3,473.07	2.4%	13.9%	13.9%
Nikkei 225	27,444.17	3.8%	16.0%	16.0%
India Sensex	47,751.33	8.2%	15.8%	15.8%
Singapore Straits Times	2,843.81	1.3%	-11.8%	-11.8%
Brazil Ibovespa	119,017.20	9.3%	2.9%	2.9%
Mexican Bolsa IPC	44,066.88	5.5%	1.2%	1.2%

Bond yields	12/31/20	11/30/20	12/31/19	12 mo. chg
U.S. 2-Yr Tsy	0.121%	0.149%	1.569%	-1.45%
U.S. 10-Yr Tsy	0.913%	0.839%	1.918%	-1.00%
Canada 2-Yr	0.201%	0.251%	1.697%	-1.50%
Canada 10-Yr	0.677%	0.671%	1.702%	-1.03%
UK 2-Yr	-0.160%	-0.022%	0.545%	-0.71%
UK 10-Yr	0.197%	0.305%	0.822%	-0.63%
Germany 2-Yr	-0.700%	-0.743%	-0.601%	-0.10%
Germany 10-Yr	-0.569%	-0.571%	-0.185%	-0.38%

Commodities (USD)	Price	1 month	YTD	12 month
Gold (spot \$/oz)	1,898.36	6.8%	25.1%	25.1%
Silver (spot \$/oz)	26.40	16.6%	47.9%	47.9%
Copper (\$/metric ton)	6,486.50	2.4%	26.0%	26.0%
Uranium (\$/lb)	20.90	-0.5%	-12.6%	-7.7%
Oil (WTI spot/bbl)	48.52	7.0%	-20.5%	-20.5%
Oil (Brent spot/bbl)	51.80	8.8%	-21.5%	-21.5%
Natural Gas (\$/mmBtu)	2.54	-11.9%	16.0%	16.0%
Agriculture Index	273.20	10.5%	21.8%	21.8%

Currencies	Rate	1 month	YTD	12 month
U.S. Dollar Index	89.9370	-2.1%	-6.7%	-6.7%
CAD/USD	0.7853	2.2%	2.0%	2.0%
USD/CAD	1.2725	-2.1%	-2.0%	-2.0%
EUR/USD	1.2216	2.4%	8.9%	8.9%
GBP/USD	1.3670	2.6%	3.1%	3.1%
AUD/USD	0.7694	4.8%	9.6%	9.6%
USD/JPY	103.2500	-1.0%	-4.9%	-4.9%
EUR/JPY	126.1800	1.4%	3.6%	3.6%
EUR/GBP	0.8937	-0.2%	5.7%	5.7%
EUR/CHF	1.0812	-0.3%	-0.4%	-0.4%
USD/SGD	1.3221	-1.5%	-1.8%	-1.8%
USD/CNY	6.5272	-0.8%	-6.3%	-6.3%
USD/MXN	19.9143	-1.3%	5.2%	5.2%
USD/BRL	5.1985	-3.0%	29.0%	29.0%

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			Count	Percent
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Sell [Underperform]	67	4.44	12	17.91

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