RBC Global Asset Management

Asset class commentary

SUMMER 2020

Global Economy

The COVID-19 shock altered the course of the global economy and ravaged financial markets, prompting policymakers to step in quickly and with scale. Unprecedented monetary and fiscal stimulus, combined with signs of an economic recovery as lockdowns eased, triggered a rapid rebound in risk assets.

Global economies were severely impacted by government-imposed lockdowns that shuttered businesses and curtailed consumer activity. As a result, we slashed our growth forecasts and they are now mostly below-consensus. Our base case outlook for the United States is for a 7.1% decline in 2020 GDP, though we recognize a variety of scenarios are possible. As countries ease lockdown measures, the most prominent risk is that the virus regains traction and forces economies into a second closure. The U.S. election in November, an important Brexit deadline and the deterioration of U.S.-China relations could also serve as sources of volatility for economies and financial markets.

Fixed Income

Global bond yields declined sharply as the coronavirus caused massive disruption to people's lives around the globe. The U.S. 10-year government-bond yield fell to an all-time low of 0.31% in early March, and is currently yielding a paltry 0.60%. We expect bond yields to stay near their recent lows as unemployment remains high, inflation low and central banks accommodative. For the next 12 months, the focus of the bond market will be on policymakers' responses to the evolving pandemic.

Bond prices will be bolstered by central-bank efforts to keep policy loose via low rates and large-scale asset purchases. We forecast that 10-year yields in most major markets will be essentially unchanged a year from now unless the economic recovery proceeds at a much faster pace than we expect. As the pandemic subsides longer term, it would be reasonable to expect yields to rise and bond prices to fall from current levels. This pandemic, like all others before it, will eventually fade, and a return to something resembling normalcy, not only for individuals but also the bond market, should follow.

Canada

The S&P/TSX Composite Index tumbled 14.9% in U.S.-dollar terms (9.7% in Canadian-dollar terms) in the five months ended May 31 of this year. Financial markets fell swiftly beginning in late February as economic shutdowns were instituted globally to combat the spread of the new coronavirus. Equity markets then charted a strong rebound from the lows on March 23, supported by a substantial global monetary and fiscal response. Future returns will depend largely on continued progress in managing the virus and the timing of any treatment or vaccine.

The virus-related restrictions are taking a massive toll on jobs, supply chains, consumer purchases and commodity prices, and economists expect Canada's GDP to decline by more than 7% in 2020, the deepest downturn on record. Analysts now expect a 30% decline in earnings for 2020 followed by a 43% rebound next year. The S&P/TSX price-to-earnings multiple is currently 15 times last year's profits, below the long-term average of 16.7. Better relative outperformance of the S&P/TSX Index will require a sustained economic recovery that supports higher commodity prices.

United States

The S&P 500 Index rose 3.6% during the three-month period ended May 31, 2020, as the coronavirus-related sell-off bottomed in late March and stocks staged a remarkable comeback during April and May as a result of enormous fiscal and monetary support.

Estimates anticipate a huge drop in GDP and corporate earnings during the first half of 2020, followed by a sharp rebound beginning in the second half of the year and into 2021. Our read of the market is that investors are optimistic in expecting the virus to remain under control, for government support programs to prevent a solvency crisis and for a vaccine to be widely distributed by the first half of next year. In the meantime, the risk of a second wave of infections from the virus is significant and the ramp-up in anti-Chinese rhetoric by the Trump administration potentially complicates things, particularly as the presidential election approaches this fall.

Europe

The COVID-19 outbreak triggered the fastest bear market in European history and pulled the economy into recession. Macroeconomic data since the start of the pandemic hasn't made for good reading and we know that the numbers will continue to deteriorate, with the European economy having been in almost total suspension during April and May. Company reports corroborate the downturn, which has unleashed emergency measures to bolster liquidity and balance sheets. Peak government and central-bank response is behind us and positive epidemiological indicators have shifted the market's attention to reopening schedules and motivated a substantial rally off the lows.

Assuming that the impact of the virus is short-lived and an earnings recovery conforms to the evolving consensus of a V-shaped recovery, European equities are probably fairly valued after the recent rally. Considering valuation from a yield perspective, European stocks are still attractive relative to fixed income. In the short term, volatility is likely to remain elevated, but we do believe the worst is behind us.

Asia Pacific

Asian stocks posted sharp declines during the three-month period ending May 31, 2020, in line with global markets, as the coronavirus pandemic dealt an unprecedented blow to global economic growth. Regional markets fell 25% in March before rebounding 20% through April and May. Public-health measures appear to have helped contain the spread of the virus, but they have come at a hefty economic price.

Lockdowns currently in place are gradually being loosened, but we expect economic activity to remain weak for the remainder of 2020. Though we anticipate job losses in service industries will be higher than in manufacturing, job losses in both areas mean that unemployment rates are likely to continue rising.

On a regional basis, equity markets in New Zealand, China and Taiwan outperformed, while Australia, Indonesia and the Philippines lagged. Within Asia, the Communication Services, Consumer Staples and Health Care sectors outperformed, while Energy, Real Estate, Industrials and Financials lagged.

Emerging markets

The MSCI Emerging Markets Index fell 6.9% in U.S.-dollar terms during the three months ended May 31, 2020, and has dropped 16.0% since the beginning of the year. Governments are focused on restarting the economy and stocks have rebounded in recent weeks as investors price in an eventual rebound in economic growth.

Emerging-market equities have lagged U.S. stocks during the rebound, as major countries including Brazil and India are behind the curve when it comes to tackling the spread of the coronavirus. The rally has not been a high-conviction one as highlighted by continued growth-stock leadership in the rebound.

Stocks are still undervalued in our view, even after the strong rebound, and we would expect emerging-market equities to outperform overall in the coming months if there is no resurgence in COVID-19 cases. In the near term, however, markets will remain volatile as bad and good news alternate. For a sustained recovery, the market would need to be sure that the worst was over.

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