RBC Global Asset Management

Executive summary

SPRING 2021

Eric Savoie, MBA, CFA
Investment Strategist
RBC Global Asset Management Inc.

Daniel E. Chornous, CFA
Chief Investment Officer
RBC Global Asset Management Inc.

The pandemic is entering a new phase with vaccines at hand, case counts in decline and businesses gradually resuming normal operations. Bond yields have surged, stocks have climbed to records and a variety of market signals suggest that economies are on the cusp of a strong recovery.

Virus retreats, economic outlook improves

After a difficult few months, the virus situation has improved significantly across the world's major nations. The number of new infections has plunged in just a few months and global transmission rates have fallen to their lowest level since the pandemic began. Tightened restrictions, vaccinations and seasonal factors have all contributed to curbing the spread of the virus. Containing COVID-19 has been critical to the economic recovery, which is now underway and has much more room to grow supported by significant monetary and fiscal stimulus. In fact, the economy has been incredibly resilient for most of the pandemic and the damage from the second wave of the virus was milder than expected. We look for a significant rebound in economic growth this year, with most economies achieving pre-pandemic levels of output sometime this year or next. Our economic forecasts were mostly upgraded from last quarter and remain above the consensus.

Outlook is less clear with many variables at play

Although our base case scenario is quite constructive, a number of moving parts make the growth outlook less clear than usual. Some of the risks include the unprecedented nature of the pandemic, uncertainties related to the distribution of vaccines and their efficacy against new variants, and the possibility of another virus wave. Uncertainties also exist around the potential for inflation and amount of additional fiscal stimulus on the horizon. Our assessment is that these risks are roughly balanced in terms of their ability to turn out better or worse than expected. The vaccine and the virus represent greater downside risks, but the reverse is true regarding fiscal support.

Inflation concerns mount but upward price pressures are limited

The combination of significant ease in monetary policy, central banks' willingness to accept faster inflation, historically high sovereign-debt loads and a push for local production of medical supplies has investors concerned that inflation could run too hot. Prices are indeed rising, albeit off a low base, and we should recognize that inflation expectations remain in line with levels of the past decade. Expectations in previous crises that significant growth in the money supply would lead to inflation haven't materialized because increases in the supply of money have ended up in savings or been returned to banks as excess reserves. It's also worth keeping in mind that demographics and sector effects related to technology, health care and education are putting downward pressure on inflation. Our view is that the underlying inflation trend will move higher but that it will remain at low levels relative to history.

Expecting further U.S. dollar weakness amid tailwinds for cyclical currencies

The U.S.-dollar bear market is still in its early stages and longer-term factors point to further declines. The recent rise in U.S. bond yields has given the greenback a short-term boost, offering investors a more attractive opportunity to sell the dollar. An environment of stronger global economic growth and higher commodity prices is supportive for cyclical currencies. We expect emerging-market currencies to outperform their developed-market peers and think that the Canadian dollar can outperform among its G10 counterparts.

Bond yields surged, valuation risk recedes

Longer-term bond yields have surged as investors' expectations of faster inflation and better economic growth are offsetting the impact of central-bank efforts to hold rates down. The U.S. 10-year Treasury yield rose roughly 50 basis points over the past quarter, moving above 1.50% for the first time since the pandemic. Part of the increase was due to real, or after-inflation, interest rates rising from unsustainably low levels. We think real rates could rise even higher but structural changes related to demographics, an increased preference for saving versus spending and the maturing of emerging markets will ultimately limit how high they can go. Moreover, the recent surge in global yields has dampened the acute valuation risk that existed in the bond market and we think that bond prices could find near-term support at current levels.

Stocks rise to record levels led by economically sensitive segments

Global equities rose to new highs as the pace of COVID-19 vaccinations progressed, virus counts declined and earnings exceeded expectations. The S&P 500 Index gained 5.6% in the past quarter and has climbed to more than one standard deviation above fair value. We recognize there is froth in some areas of the market and that valuations are elevated, but our modelling suggests the possibility that price-to-earnings ratios could rise even further as fears of the crisis fade and interest rates return to normal levels. While U.S. large-cap technology and momentum stocks are expensive, equity markets in Canada, the U.K., Europe and Japan remain below their fair values and offer compelling upside. Furthermore, the economic recovery has stoked a rotation out of traditional U.S. large-cap leadership into other more economically sensitive areas of the market, driving rallies in small- and mid-cap stocks, financials and industrials, and value stocks overall.

Asset Mix – maintaining overweight in stocks, underweight in bonds

In our base case scenario, the economy enjoys a powerful rebound in 2021 as virus threats fade and normalcy draws closer. We've seen a substantial jump in fixed-income yields, and, for the first time since early 2020, we now expect slightly positive returns for sovereign bonds over the year ahead. Given the expectation of a solid cyclicals recovery in economic growth and corporate profits, we believe a bias toward risk taking remains appropriate. Although the advantage of stocks over bonds has diminished somewhat as a result of rising yields, equities continue to offer an attractive risk premium versus fixed income. As a result, we are maintaining our overweight position in stocks and underweight in bonds. For a balanced, global investor, we currently recommend an asset mix of 64.5 percent equities (strategic neutral position: 60 percent) and 34.5 percent fixed income (strategic neutral position: 38 percent), with the balance in cash.

Disclosure

This document is provided by RBC Global Asset Management (RBC GAM) for informational purposes only and may not be reproduced, distributed or published without the written consent of RBC GAM or its affiliated entities listed herein. This document does not constitute an offer or a solicitation to buy or to sell any security, product or service in any jurisdiction; nor is it intended to provide investment, financial, legal, accounting, tax, or other advice and such information should not be relied or acted upon for providing such advice. This document is not available for distribution to investors in jurisdictions where such distribution would be prohibited.

RBC GAM is the asset management division of Royal Bank of Canada (RBC) which includes RBC Global Asset Management Inc., RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management (UK) Limited, RBC Global Asset Management (Asia) Limited, and BlueBay Asset Management LLP, which are separate, but affiliated subsidiaries of RBC.

In Canada, this document is provided by RBC Global Asset Management Inc. (including PH&N Institutional) which is regulated by each provincial and territorial securities commission with which it is registered. In the United States, this document is provided by RBC Global Asset Management (U.S.) Inc., a federally registered investment adviser. In Europe this document is provided by RBC Global Asset Management (UK) Limited, which is authorised and regulated by the UK Financial Conduct Authority. In Asia, this document is provided by RBC Global Asset Management (Asia) Limited, which is registered with the Securities and Futures Commission (SFC) in Hong Kong.

Additional information about RBC GAM may be found at www.rbcgam.com.

This document has not been reviewed by, and is not registered with any securities or other regulatory authority, and may, where appropriate and permissible, be distributed by the above-listed entities in their respective jurisdictions.

Any investment and economic outlook information contained in this document has been compiled by RBC GAM from various sources. Information obtained from third parties is believed to be reliable, but no representation or warranty, express or implied, is made by RBC GAM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC GAM and its affiliates assume no responsibility for any errors or omissions.

Opinions contained herein reflect the judgment and thought leadership of RBC GAM and are subject to change at any time. Such opinions are for informational purposes only and are not intended to be investment or financial advice and should not be relied or acted upon for providing such advice. RBC GAM does not undertake any obligation or responsibility to update such opinions.

RBC GAM reserves the right at any time and without notice to change, amend or cease publication of this information.

Past performance is not indicative of future results. With all investments there is a risk of loss of all or a portion of the amount invested. Where return estimates are shown, these are provided for illustrative purposes only and should not be construed as a prediction of returns; actual returns may be higher or lower than those shown and may vary substantially, especially over shorter time periods. It is not possible to invest directly in an index.

Some of the statements contained in this document may be considered forward-looking statements which provide current expectations or forecasts of future results or events. Forward-looking statements are not guarantees of future performance or events and involve risks and uncertainties. Do not place undue reliance on these statements because actual results or events may differ materially from those described in such forward-looking statements as a result of various factors. Before making any investment decisions, we encourage you to consider all relevant factors carefully.

Publication date: March 15, 2021

32467 (03/2021)
EXECUTIVE SUMMARY_SPRING 2021_E 03/12/2021