GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

September 7, 2023

Sorry, TINA, looks like you've got company

Kelly Bogdanova – San Francisco

The long-running popularity of stocks over other asset classes has often been chalked up to there simply being no other place for investors to go, or as TINA says, "there is no alternative." But now that the Fed has hiked rates aggressively and bond yields have surged, TINA has competition. What does this mean for the equity market and why should investors consider opportunities in bonds?

For roughly a decade, the U.S. equity market had little-to-no competition from the U.S. bond market.

Bond yields were unusually low largely due to the Fed's ultraloose, near-zero percent interest rate policies which suppressed yields. The S&P 500's dividend yield was either competitive with the 10-year Treasury yield or exceeded it at times—both rare occurrences in history.

As bond yields were declining or suppressed, naturally investors often assessed the dividend yield from the equity market, combined with equities' price appreciation potential, as a more attractive option.

During this period, institutional investors quipped that the stock market was benefiting from the TINA phenomenon—an acronym that stands for "there is no alternative" to equities.

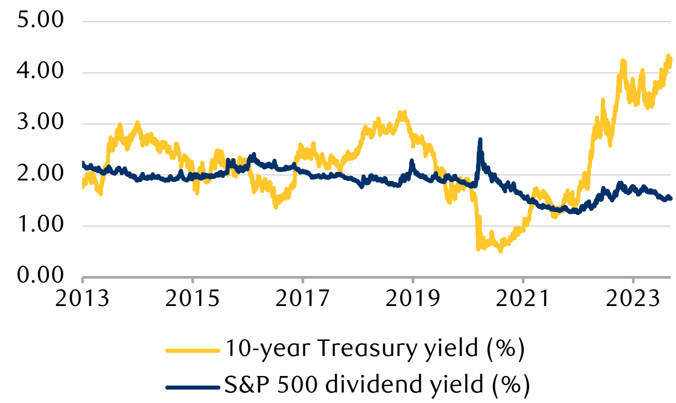
Fast forward to 2023, and suddenly there are alternatives to stocks. TINA has competition.

Heed the yield signs

Now that the Fed has hiked interest rates aggressively, bond prices have sold off and bond yields have surged to their highest levels in many years.

As of this writing, short-term Treasuries possess yields close to and above five percent, and longer-term Treasuries are above four percent. The Bloomberg

The U.S. 10-year Treasury yield has surged while the S&P 500 dividend yield has drifted lower



Source - RBC Wealth Management, Bloomberg; data through 9/6/23

U.S. Aggregate Corporate Bond Index, which measures investment-grade corporate bonds, is yielding 5.76 percent. Even banks are paying rates on money market funds that are higher than the S&P 500 dividend yield.

At the same time, as the S&P 500 has rallied recently, its dividend yield has drifted lower.

The result is that the gap between the benchmark 10-year Treasury yield and the S&P 500 dividend yield is as wide

For perspectives on the week from our regional analysts, please see pages 3–4.

For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.
Priced (in USD) as of 9/6/23 market close (unless otherwise stated). Produced: 9/7/23 4:54 pm ET; Disseminated: 9/7/23 4:58 pm ET

as it has been in the past 10 years, as the chart on the previous page illustrates.

The difference, or the spread, between the 10-year yield of 4.28 percent and the S&P 500 dividend yield of 1.55 percent is 2.73 percent or 273 basis points.

This greatly exceeds the 10-year average of 40 basis points and is approaching the long-term average of 322 basis points that has occurred since 1971.

Furthermore, all 11 S&P 500 sectors now have dividend yields below the 10-year Treasury yield (see chart). This has not occurred in the past 10 years until very recently, but it is the more typical relationship going back decades.

Role reversal?

As long as bond yields remain elevated and higher than the S&P 500's dividend yield, we think investors could be more inclined to allocate a greater share of their incremental cash to bonds instead of equities—the reverse of what has occurred over the past 10 years.

In our view, this factor alone is not enough to jolt the equity market as historical data indicates the trajectory of the economy and corporate earnings play the biggest roles in shaping the equity market's direction and magnitude of gains over the long term. But we think the potentially greater demand for bonds and relatively lower demand for equities could serve as a headwind for the U.S. equity market if this relationship persists over time.

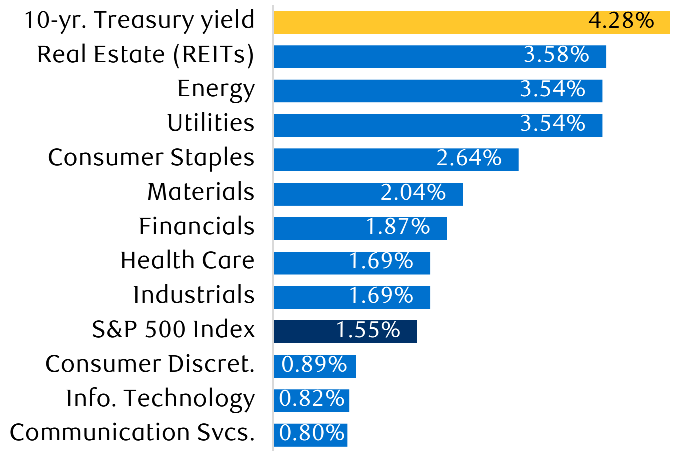
S&P 500 returns have historically been much higher in the rare periods when the index's dividend yield exceeded the 10-year Treasury yield, and also when the reverse extreme happened—when the dividend yield was far below the 10-year yield.

A CFRA study cited by Forbes based on data from 1953 to 2021 illustrates this relationship. It shows that historical S&P 500 returns were highest when the spread between the S&P 500 dividend yield and the 10-year yield was the widest, and returns were second-highest when this spread was very negative. (Note: The CFRA data represents average 12-month forward S&P 500 returns, measured at the end of each quarter.) The data are as follows:

- **Twenty-one percent return** in the S&P 500 when the spread between the index's dividend yield and 10-year Treasury yield was greater than zero percent; this scenario was rare
- **Seven percent return** when the spread was between zero percent and negative two percent
- **Four percent return** when the spread was between negative two percent and negative four percent
- **Thirteen percent return** when the spread was less than negative four percent; in other words, when the dividend yield was much lower than the 10-year yield

All of the 11 S&P 500 sectors have dividend yields below the 10-year Treasury yield

10-year Treasury yield versus S&P 500 sector dividend yields



Source - RBC Wealth Management, Bloomberg; data as of 9/6/23

Currently, the spread is -2.73 percent (-273 basis points), which is in the third category, where historical forward 12-month S&P 500 returns are the lowest. Based on our expectations for bond yields, the dividend yield, and the economy, we think the spread will likely be in one of the two middle categories for the time being.

This historical return relationship between the S&P 500 dividend yield and the 10-year Treasury yield is another reason—in addition to recession risks and related earnings growth vulnerabilities—why we believe U.S. equity returns next year have the potential to undershoot returns for this year.

Thus far in 2023, the S&P 500 price gain is pacing at about 16 percent and we think there is room to tack on additional gains before year-end. But next year the competition factor between stocks and bonds could kick in, and recession risks could reaccelerate.

A complement to stocks

Clearly, equities have an important place in balanced portfolios, and their long-term historical returns have far exceeded returns on bonds (although, admittedly, with higher risk and volatility). We still view the equity dividend growth strategy as the most favorable for the equity side of portfolios; historical returns for this strategy have greatly exceeded those of the S&P 500 over the long term.

But we think the current relationship between the equity market's dividend yield and the 10-year Treasury yield along with the demise of the TINA effect are reasons for investors to take a close look at portfolio allocations and consider opportunities in bonds.

For more information about why we believe bonds are attractive, especially for balanced portfolios, see our recent article "The income is back in fixed income."

UNITED STATES

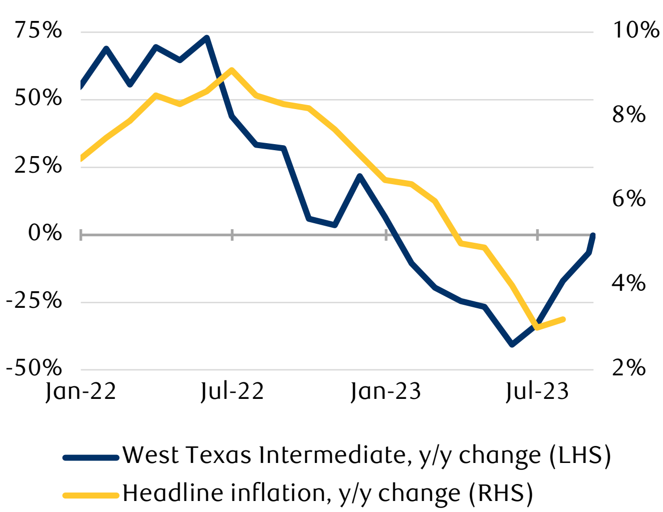
Tyler Frawley, CFA – Minneapolis

- **U.S. equities appear on track for losses this week** as Treasury yields have moved markedly higher—with the 10-year yield back near its highest levels since 2007. While all major indexes are lower this week, the Dow Jones Industrial Average has been the best relative performer, down 1.05%, while the S&P 500 and Nasdaq Composite have lagged, falling 1.55% and 2.28%, respectively. Energy has been the best-performing sector on the week, up 0.62%, as oil prices soared to 10-month highs following Saudi Arabia's decision to extend its 1.3 million barrel per day production cuts through the end of the year.

- **Rising oil prices could threaten inflation progress in the coming months**. After peaking at 9.1% in June 2022, headline inflation moved lower for 12 straight months to 3.0% in June 2023. However, that streak was broken the following month when it rose to 3.2%, as energy costs began transitioning to a headwind from a tailwind for inflation. As the chart shows, the year-over-year percentage change in West Texas Intermediate (WTI) crude oil prices had been trending lower since May 2022 (one month before headline inflation peaked) before bottoming in May 2023, down 41% y/y (one month before headline inflation bottomed). However, this year-over-year comparison has been trending higher since that time and is now down just 0.2% y/y. Given our belief that oil prices are likely to remain elevated in the near term due, in part, to Saudi Arabia's production decision, there is likely to be upward pressure on headline inflation in the months ahead—which could embolden the Fed to continue its hiking cycle for longer than the market anticipates.

- **The U.S. Labor Department reported initial jobless claims fell for the fourth consecutive week to 216,000 during the week ending Sept. 2**, the lowest level since February and well below the Bloomberg consensus expectation of 234,000. Continuing jobless claims of 1.679 million also came in below the 1.719 million consensus expectation. We think these reports highlight the continued strength of labor in the face of what has been an unprecedented Fed tightening cycle.

Rising oil prices may threaten inflation progress



Source - RBC Wealth Management, Bloomberg; WTI oil data through 9/5/23, headline inflation data through July 2023

CANADA

Estefani Ayazo, CFA & Matt Altro – Toronto

- **The Bank of Canada (BoC) held its benchmark rate steady at 5.0%**, as widely expected given mounting evidence the economy has begun to soften in recent months. With inflation risk remaining the main source of concern, BoC policymakers reiterated their willingness to raise interest rates further if necessary to bring underlying price pressures under control. Despite an above-target headline Consumer Price Index increase of 3.3% y/y in July, the combination of softer economic growth data for Q2 and preliminary estimates signaling continued weakness in Q3 gave policymakers the confidence to move to the sidelines. A pause in rate hikes also allows the BoC more time to assess the economic outlook, as incoming data over the next few months could help determine whether the underlying economic weakness in the second quarter was transitory. According to RBC Capital Markets, the BoC could leave rates unchanged for a prolonged period and possibly shift towards easing monetary policy in H2 2024, especially in a scenario where excess demand and labour market conditions continue to ease gradually.

- **Canadian GDP declined by an annualized rate of 0.2% in Q2, meaningfully worse than last month's early estimate of a 1% increase**, according to RBC Economics. Consumer spending continued to decelerate, with the 0.2% rise in Q2 being the smallest increase since the pandemic lockdowns in Q2 2021. Business investments also rose, in part due to a surge in aircraft purchases, but the GDP was dragged lower by a drop in output in June as well as other temporary factors including the federal workers strike. This GDP data, released before the BoC's meeting this week, had reinforced expectations that the central bank would pause rate hikes; as RBC Economics noted, headwinds to economic growth from higher interest rates have been building under the surface and the lagged effects of earlier rate hikes are beginning to be felt.

EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- **German macroeconomic data continues to disappoint**. Industrial production declined 0.8% m/m in July, the third monthly drop in a row, and is now 7% below the pre-pandemic level. Exports were similarly weak in July, declining 0.9% m/m.

- **Germany's exports have stagnated for much of this year** due to a combination of supply chain frictions, deglobalization trends, China's increased ability to produce goods it used to import from Germany, and intense competition in other markets.

- **German Chancellor Olaf Scholz on Sept. 6 called for a pact among government, federal states and municipalities, and the political opposition to tackle economic challenges**. The appeal for cooperation comes after last week's announcement of a small program to encourage corporate investment in digitization and the energy transition. Though details are still lacking, it seems complacency and disbelief are finally being replaced by a sense of urgency.

- **Further signs of economic momentum weakening in the region weighed on European equities**, with the STOXX Europe 600 falling for seven consecutive days.

- **In addition to growing worries about regional stagflation, companies with China exposure came under pressure due to a weaker-than-expected August reading from the Caixin China General Services PMI**. Luxury goods stocks were impacted, with the large publicly listed European players down between 5% and 7% during the week, as worries grew that the combination of a slowdown in China and the prospect of stagflation in Europe would increasingly impact consumer demand for high-end luxury items. We acknowledge these risks, but we believe long-term investors should seek to add to positions in high-quality luxury stocks, which have pulled back in the 15%–20% range in recent months.

- **Energy stocks continued to outperform, aided by Brent crude oil prices rising above $90/bbl after OPEC+ announced it would extend output cuts through to the end of 2023**. The tight supply side dynamics are helping to underpin oil prices; if these levels are sustained, we believe upgrades to consensus earnings expectations across the sector are likely. Having lagged year to date, we think the Energy sector has catch-up potential in the remainder of 2023.

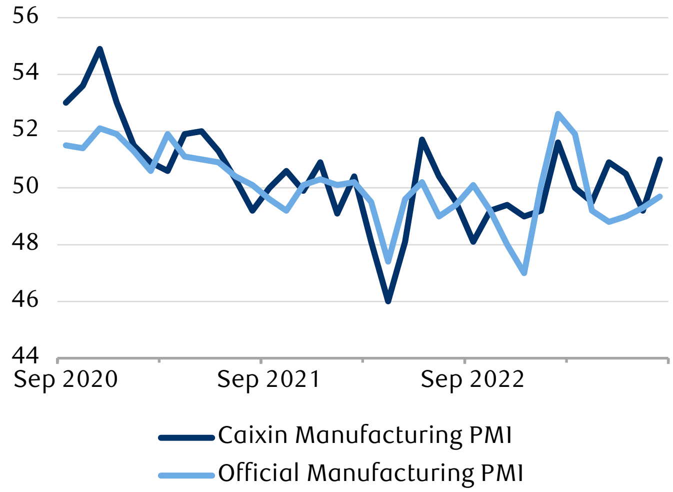
ASIA PACIFIC

Jasmine Duan – Hong Kong

- **Chinese policymakers have announced a series of stimulus policies over the past two weeks**, some of which exceeded market expectations. **Many of the policies target the real estate sector**. China's central bank announced nationwide mortgage requirements will be eased for both first- and second-time homebuyers for the first time since 2015, lowering the floor for down payment ratios and mortgage rates. All Tier-1 cities (including Beijing, Shanghai, Guangzhou, and Shenzhen) eased criteria for identifying first-time homebuyers to allow more people to enjoy preferential mortgage terms.

- Other policies cover monetary, fiscal, and capital markets activities. **We believe this series of announcements signifies that the government is**

China's official and Caixin Manufacturing PMI improved in August



Source - RBC Wealth Management, Bloomberg; monthly data through 8/31/23

cognizant of the economic challenges at hand and is resolved to address them. Collectively, we think the stimulus measures could have a significant impact on China's economy.

- **Some of China's August economic data is showing signs of improvement**. The official Manufacturing Purchasing Managers' Index (PMI) rose to 49.7 from 49.3, and the Caixin Manufacturing PMI climbed to 51.0 from 49.2. Meanwhile, the value of both Chinese exports and imports improved sequentially in August.

- **Huawei launched its Mate 60 and Mate 60 Pro smartphones last week**. The company didn't reveal details of the chips used; but according to an analysis by TechInsights, a semiconductor industry information provider, **the phones are powered by Huawei's proprietary 5G chip and manufactured domestically by Chinese chipmaker SMIC (981 HK) using 7-nanometer technology**. This is notable because the U.S. has blocked Huawei's access to 5G chips since May 2019. The U.S. has also imposed measures to restrict SMIC from obtaining extreme ultraviolet lithography—essential equipment in making advanced chips—from Dutch firm ASML, one of the world's top manufacturers of machines that make semiconductors. The launch of Huawei's new smartphones could mark a breakthrough for the Chinese semiconductor industry as the company managed to overcome U.S. technology restrictions. **This development could also potentially remove one of the major overhangs—U.S. technology restrictions—on Chinese equities**. The Huawei news underscores a key point in our [recent article](#) that China has demonstrated an ability to overcome the impact of technological restrictions in the past, and the country's vast manufacturing scale and well-established supply chains should lay a foundation for future technological innovation.

MARKET
Scorecard

Data as of September 6, 2023

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	4,465.48	-0.9%	16.3%	14.3%	-1.5%
Dow Industrials (DJIA)	34,443.19	-0.8%	3.9%	10.6%	-2.6%
Nasdaq	13,872.47	-1.2%	32.5%	20.2%	-9.7%
Russell 2000	1,874.28	-1.3%	6.4%	4.6%	-18.2%
S&P/TSX Comp	20,226.96	-0.3%	4.3%	6.0%	-2.9%
FTSE All-Share	4,048.70	-0.3%	-0.6%	1.1%	-2.3%
STOXX Europe 600	454.30	-0.8%	6.9%	9.6%	-4.4%
EURO STOXX 50	4,238.26	-1.4%	11.7%	21.1%	-0.2%
Hang Seng	18,449.98	0.4%	-6.7%	-3.9%	-29.5%
Shanghai Comp	3,158.08	1.2%	2.2%	-2.6%	-12.8%
Nikkei 225	33,241.02	1.9%	27.4%	20.3%	12.1%
India Sensex	65,880.52	1.6%	8.3%	11.3%	13.0%
Singapore Straits Times	3,222.88	-0.3%	-0.9%	0.0%	3.9%
Brazil Ibovespa	115,985.34	0.2%	5.7%	5.7%	-1.6%
Mexican Bolsa IPC	52,971.19	-0.1%	9.3%	15.4%	1.3%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	4.280%	17.2	40.5	93.1	295.7
Canada 10-Yr	3.688%	12.4	38.8	49.3	249.9
UK 10-Yr	4.533%	17.3	86.1	143.2	383.9
Germany 10-Yr	2.653%	18.7	8.2	101.5	302.0
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	5.12%	-1.0%	0.4%	-1.1%	-13.4%
U.S. Investment-Grade Corp	5.76%	-1.1%	1.6%	1.3%	-15.0%
U.S. High-Yield Corp	8.51%	-0.3%	6.8%	7.3%	-4.6%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	1,916.57	-1.2%	5.1%	12.6%	5.1%
Silver (spot $/oz)	23.17	-5.2%	-3.3%	28.6%	-6.1%
Copper ($/metric ton)	8,482.50	0.9%	1.4%	9.4%	-10.2%
Oil (WTI spot/bbl)	87.54	4.7%	9.1%	0.8%	26.3%
Oil (Brent spot/bbl)	90.67	4.4%	5.5%	-2.3%	25.5%
Natural Gas ($/mmBtu)	2.52	-8.9%	-43.6%	-69.0%	-46.5%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	104.8450	1.2%	1.3%	-4.9%	13.9%
CAD/USD	0.7333	-0.9%	-0.6%	-3.6%	-8.1%
USD/CAD	1.3637	1.0%	0.6%	3.7%	8.8%
EUR/USD	1.0724	-1.1%	0.2%	8.3%	-9.7%
GBP/USD	1.2504	-1.3%	3.5%	8.5%	-9.6%
AUD/USD	0.6379	-1.6%	-6.4%	-5.3%	-14.2%
USD/JPY	147.6800	1.5%	12.6%	3.4%	34.4%
EUR/JPY	158.3600	0.3%	12.8%	12.0%	21.5%
EUR/GBP	0.8577	0.3%	-3.1%	-0.2%	0.0%
EUR/CHF	0.9564	-0.2%	-3.3%	-1.9%	-12.0%
USD/SGD	1.3626	0.8%	1.7%	-3.1%	1.5%
USD/CNY	7.3180	0.8%	6.1%	5.2%	13.3%
USD/MXN	17.5779	3.2%	-9.9%	-12.7%	-11.7%
USD/BRL	4.9787	0.5%	-5.7%	-5.2%	-3.7%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. 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 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD -0.6% return means the Canadian dollar fell 0.6% vs. the U.S. dollar year to date. USD/JPY 147.68 means 1 U.S. dollar will buy 147.68 yen. USD/JPY 12.6% return means the U.S. dollar rose 12.6% vs. the yen year to date.

Source - Bloomberg; data as of 9/6/23

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As of June 30, 2023

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Hold [Sector Perform]	573	39.41	138	24.08
Sell [Underperform]	49	3.37	3	6.12

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