GLOBAL
Insight
WEEKLY

Perspectives from the Global Portfolio Advisory Committee April 25, 2024

Energy booster?

Frédérique Carrier – London

Oil has been rallying lately. And we think that's fueling an intriguing opportunity. We look at what's behind the Energy sector's supply and demand dynamics, focusing on the risk from the Middle East conflict. We contend the global oil sector is benefiting from improved fundamentals and exposure in equity portfolios can act as a hedge to rising geopolitical risk.

Higher for longer?

Oil prices surged to a six-month high in early April, underpinned by both OPEC production cuts and demand being stronger than the market expected thanks to resilient economies, particularly in the U.S. The ongoing conflict in the Middle East has also given rise to a risk premium.

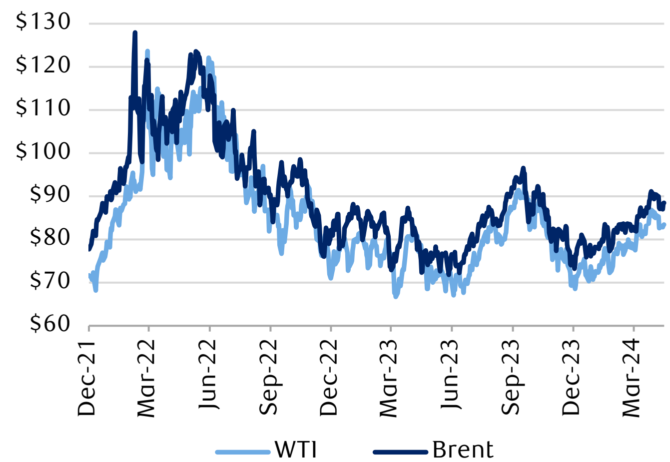
The fundamentals of the oil market today are strong, with the Organisation for Economic Cooperation and Development's oil inventories below their five-year average. The U.S. Energy Information Administration expects that over the summer months, global oil production may not meet consumption, which tends to stay strong due to the driving season and surging air conditioning demand in the Northern Hemisphere.

Going forward, some opposing factors may affect global production, which has already been restrained by the 2.2 million barrels per day production cut OPEC put in effect in January 2024:

- The White House's reimposition of sanctions on Venezuelan oil, as the Biden administration asserts that the Maduro government has failed to make progress on free and fair presidential elections, cracking down on the opposition.

Oil prices on the rise?

Price per barrel of West Texas Intermediate (WTI) and Brent crude oil



Source - Bloomberg; data through 4/24/24

Helima Croft, Middle East expert and RBC Capital Markets, LLC's Head of Global Commodity Strategy, expects the reimposition of sanctions to have limited impact. She believes the U.S. will grant direct licenses on a case-by-case basis to international companies seeking to bring Venezuelan barrels to the U.S.

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 4/24/24 market close (unless otherwise stated). Produced: 4/25/24 14:41 ET; Disseminated: 4/25/24 14:50 ET

- Saudi Arabia may gradually return some of its cuts to the market in the summer, to secure the benefits from higher volume at a favourable price, and perhaps to help key customers. Still, RBC Capital Markets doesn't expect OPEC to make a concerted effort to increase production unless there is a sustained supply outage. The cartel learned a painful lesson in 2018 when it ramped up oil production to offset an expected disruption in Iranian production. That shortage never materialized, and prices retreated, hurting OPEC's profitability.

Sustained supply shortages could, however, result from the recent military actions in the Middle East.

Clear and present danger

Geopolitical risk has been heating up since last autumn, and flared up in April. After decades of clandestine and proxy warfare, Iran and Israel launched direct military strikes on each other's territory. While Israeli and Iranian leadership both seem to have designed their military actions to avoid causing significant civilian casualties and infrastructure damage, Croft contends the underlying regional dynamics remain destabilizing and could take sudden escalatory turns.

She notes that a direct threat to regional oil supplies is possible in an expanded war scenario, through attacks on tankers in the Strait of Hormuz or on critical energy infrastructure in the region by Iran or Yemen's Houthi rebels that it backs. Iran has already threatened to disrupt shipping in the Strait of Hormuz as part of its strategic response to the Israeli strike. In fact, Iran seized a vessel in those critical waters hours before its drone and missile strike on Israel. In 2019, Iran targeted tankers in this crucial maritime passageway that carries the equivalent of 40 percent of OPEC production.

Croft's view is that current oil prices do not reflect the extent of the escalation risk, even though they are elevated and already reflect a risk premium. She believes a sustained de-escalation of tensions in the region is unlikely. In addition to the potential for Israel-Iran clashes to widen, she also cites the potential for escalation in the cross-border conflict between Israel and Iran-backed Hezbollah in Lebanon.

If U.S. prices at the pump surpass the psychological threshold of $4/gallon nationwide, RBC Capital Markets believes the White House may release more oil from the Strategic Petroleum Reserve (SPR) in an attempt to cap prices during the peak summer driving season and ahead of November's presidential election. Also, RBC Capital Markets thinks the SPR's relatively low level of just over 350 million barrels, compared to over 600 million in early 2022 before Russia's invasion of Ukraine, and elevated oil prices may spur the White House to ratchet up diplomatic efforts to effect a reversal of OPEC cuts at the cartel's next meeting in June.

Capital discipline energizes Energy equities

Global energy share prices are up more than 10 percent since the beginning of the year, buoyed not only by surging oil prices but also by underlying fundamentals.

In recent years, faced with the threat of the energy transition, oil companies have become more circumspect in allocating their capital expenditure programmes, focusing only on the most profitable projects—whether they are in the traditional oil industry or renewables. Production from the global oil majors has grown only by low single digits, but overall profitability seems well underpinned, in our view. The return on equity ratio has increased to 14 percent compared to the 44-year median of 12 percent, according to Paul Danis, head of asset allocation at RBC Brewin Dolphin.

Going forward, Canadian oil companies have the additional benefit of the long-awaited Trans Mountain Pipeline Expansion (TMX) coming on stream in Q2 2024. The pipeline system will carry crude and refined products from Alberta to Canada's West Coast, providing oil producers with the ability to reach new markets.

Oil companies' new capital discipline has enabled most producers to focus on improving returns to investors via share buybacks and dividends. The global Energy sector currently possesses a 12-month trailing dividend yield of 3.6 percent, well above the 2.3 percent yield for the MSCI All Country World Index (MSCI ACWI).

Even after the recent rally in Energy stocks, the global sector currently trades at a 36 percent discount to the MSCI ACWI on a 12-month forward price-to-earnings basis. According to Danis, this reflects a challenging structural growth backdrop driven by the shift away from fossil fuels and the rise of clean energy.

Oil companies can provide a hedge against geopolitical risk and a possible supply shock, in our view. The sector strongly outperformed the broad equity market during the three oil supply shocks since the 1970s.

However, investors should be mindful that oil stocks are not very sensitive to interest rates given their low valuation multiples, and have thus done relatively well in the rising inflation and interest rate environment. If, as we believe, bond yields are close to their peak, this performance tailwind may well be removed. Moreover, by realizing substantial profits thanks to prudent investment in their core businesses, oil companies in Canada, the UK, and Europe risk becoming targets again for further windfall taxes. This could affect investor sentiment.

Weighing the opportunities and risks, we suggest portfolios should have a position in Energy stocks at least in line with relevant equity benchmarks given undemanding valuations, ongoing capital discipline, and the elevated risk of an oil supply shock.

UNITED STATES

Alan Robinson – Seattle

- **U.S. stocks' strong start to the week hit a speed bump as economic data and some high-profile earnings misses stymied the recovery.** This marked the busiest week of Q1 2024 earnings season with 42% of S&P 500 companies reporting. Results and company guidance mostly missed expectations, as Technology stocks in particular failed to meet lofty consensus forecasts.

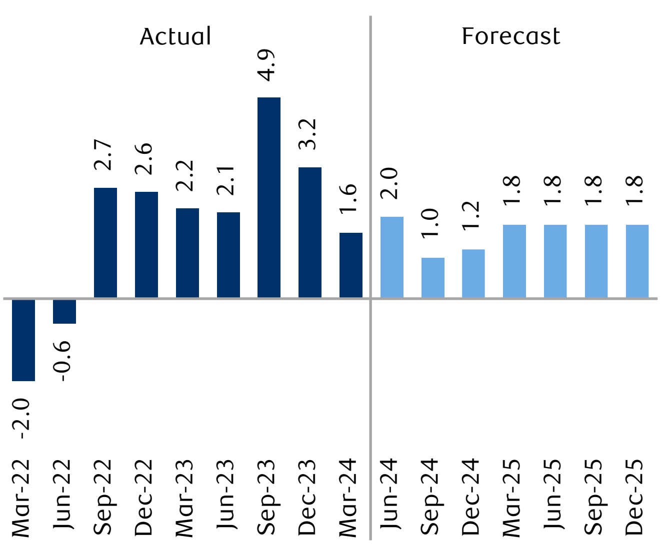
- **The Commerce Department released its first estimate of Q1 2024 GDP growth** on April 25. The headline growth rate of 1.6% q/q on an annualized basis missed the consensus forecast of 2.2% and marked the slowest growth rate in nearly two years (see chart).

- **This kind of weaker-than-expected report would typically trigger a "risk-on" reaction** in markets, with stocks rallying on hopes that slower growth would open the door to a faster pace of interest rate cuts from the Federal Reserve. **But the opposite happened, with stocks and bonds both under pressure**. What was behind this apparent disconnect?

- The answer lies in the details of the report. **The biggest detractor from growth was the trade balance**, with imports up 7.2% q/q (annualized) and exports up only 0.9% due to weak global demand and a strong dollar. We think the solid demand for imports, combined with a 6.1% surge in domestic sales and slightly higher inflation, indicates the consumer is unfazed by higher interest rates—although a drop in the consumer savings rate to 3.7% suggests a slowdown may be around the corner.

U.S. Q1 growth hit by a weakening trade balance

Real GDP growth (%) and RBC forecasts



Note: Shows quarter-over-quarter annualized growth as of 4/25/24.

Source - U.S. Commerce Department, RBC Capital Markets estimates

- **Internet bellwether Meta Platforms Inc.'s (META) earnings report poured cold water on the Technology sector.** Q1 2024 earnings beat consensus forecasts, but guidance for a 12% increase in capital expenditures was much higher than forecasts for 4% growth. Management justified the increase by citing an urgent need to incorporate AI into the platform. While we believe this makes sense for the long term, we note these investments may take time to yield bottom-line results.

CANADA

Nguyen Dang, CFA & Claudia Humbert, CFA – Toronto

- **Canada's retail sales edged lower in February, marking a second consecutive month of declines.** According to Statistics Canada, retail sales decreased by 0.1% m/m, after contracting 0.3% in January. Preliminary data for March suggests no change in retail activity. February's data came in below consensus expectations that had anticipated a modest 0.1% m/m increase. Sales fell in five of nine subsectors, led by decreases from gasoline stations and fuel vendors, while increased sales at motor vehicle and parts dealers helped offset some of the broader contraction. Core retail sales, which exclude volatile fuel and motor vehicle figures, were unchanged from January. **We think the data underscores the challenges facing Canadian consumers amid higher living and borrowing costs**, particularly as Canadian households tend to be more sensitive to changes in interest rates. Bank of Canada (BoC) officials will likely take the data into consideration as they deliberate when to start cutting interest rates. Financial markets are currently pricing in a greater than 50% prospect of a rate cut in June.

- **BoC policymakers acknowledged recent progress on inflation but noted the need for further evidence of price growth stabilizing towards the BoC's 2% target before easing rates**, as detailed in the latest meeting minutes. Views on the timing and desired conditions for rate reductions varied among policymakers. Some pointed to a pickup in Q1 GDP growth as alleviating the risks of maintaining high policy rates, emphasizing potential inflationary pressures from strong U.S. growth and domestic labour market conditions. Other officials focused on easing the inflation pressures that materialized over the past 12 months, which could support a pivot towards rate cuts. **All agreed, however, that rate reductions would proceed gradually to mitigate the risk of reigniting inflation.** Since the April policy meeting, we have seen more signs of inflation in Canada moving in the right direction, with headline (all items) inflation registering at 2.9% y/y in March, aligning with the consensus forecast. The interest rate decision at the BoC's next meeting in early June will hinge on forthcoming data, in our view, including the April Consumer Price Index report, GDP figures, and employment.

EUROPE

Rufaro Chiriseri, CFA & Thomas McGarrity, CFA – London

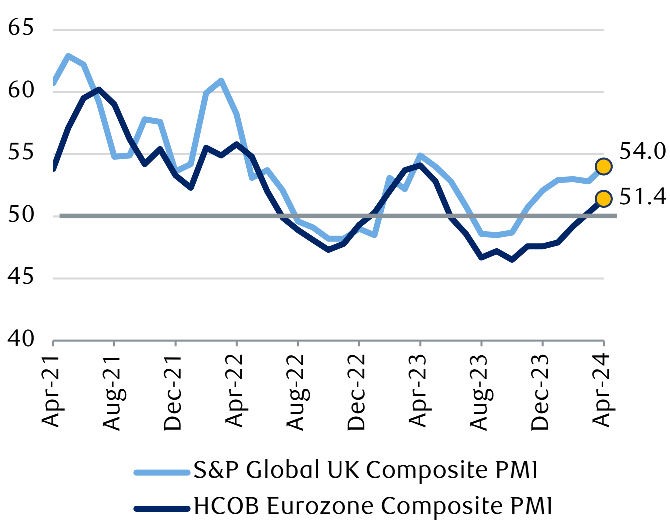
- **The share price of global diversified miner Anglo American jumped over 16% on Thursday, April 25, after the company confirmed it had received "an unsolicited, non-binding and highly conditional combination proposal" from BHP Group, the world's biggest listed mining company.** BHP stated that the offer comprises 0.7097 BHP shares for each ordinary share in Anglo American, plus the company's shareholdings in Anglo American Platinum Limited and Kumba Iron Ore Limited being distributed to shareholders. In total, the offer values Anglo American at £31.1 billion (about US$38.9 billion), or about £25.08 per share. While this represents an almost 14% premium to the share price prior to the announcement, BHP stated that the premium on the implied market value of Anglo American's unlisted assets is approximately 31%.

- **A successful deal would be the most significant one in the mining industry in over a decade, in our opinion.** Moreover, it would represent the biggest takeover of a UK-listed company amid the recent wave of UK companies being acquired by international peers as they seek to take advantage of the lowly valuations on offer.

- **There were further signs that the euro area economic outlook appears to be improving.** The preliminary HCOB Eurozone Composite Purchasing Managers' Index (PMI) rose to 51.4 in April from 50.3 in March—the highest level since May 2023. This was driven by an improvement in the services sector in France and Germany; however, the manufacturing sector slipped further into contractionary territory for the second consecutive month.

Economic recovery in eurozone & UK gathering pace

Regional purchasing managers' indexes (PMIs)



Note: Index level above 50 indicates expansionary conditions.

Source - Bloomberg

- **The preliminary S&P Global UK Composite PMI strengthened to an 11-month high of 54 in April, from 52.8 in March.** The services sector was the largest contributor to overall activity, while manufacturing detracted and slipped from the prior reading. More notably, the data showed a pickup in employment and indicated higher input prices due to wage growth pressures. While pay growth is showing signs of decelerating, it remains uncomfortably high. Consequently, the potential for stronger economic expansion and wage growth led the market to lower its expectations for 2024 rate cuts to slightly below two.

ASIA PACIFIC

Jasmine Duan – Hong Kong

- **Hong Kong's benchmark Hang Seng Index has soared 6.4% so far this week, outperforming its regional peers, and is on track for its best week since November 2022.** We think the rally is mainly due to a more attractive risk-reward profile compared to other major markets such as the U.S. and Japan, in which many investors have overweight positions. We have noticed a slight shift in investor sentiment towards Chinese equities: investors have started to view China's data from a glass-half-full perspective, which is quite a change from the past two years.

- **Several index constituents, including Hong Kong Exchanges (388 HK) and Ping An Insurance (2318 HK), reported better-than-expected Q1 2024 results.** As many of the negatives for the stocks have been priced in, we think the earnings beats could extend the Hang Seng rally given its undemanding valuation.

- **Ping An Insurance, one of the major life insurance providers in China, saw its weak performance in the asset management and technology segments offset by solid results in the life insurance and banking segments.** The value of new business continued to recover, increasing by 20.7% y/y to RMB 12.9 billion and beating consensus estimates of high-single-digit growth. Its share price rebounded by more than 10% after the Q1 earnings announcement as the results were better than feared.

- **SK Hynix (000660 KS), the world's second-largest memory chipmaker, reported a net profit of 1.92 trillion South Korean won (US$1.39 billion) in Q1 2024, reversing a loss of 2.58 trillion won from the previous year.** The company had posted net losses for five consecutive quarters due to a slump in the memory chip market. It now expects a full recovery in the memory market, driven by surging AI-related demand. It also announced a plan to invest more than 20 trillion won to expand capacity in response to strong AI semiconductor demand.

MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	5,071.63	-3.5%	6.3%	22.6%	18.7%
Dow Industrials (DJIA)	38,460.92	-3.4%	2.0%	13.5%	13.8%
Nasdaq	15,712.75	-4.1%	4.7%	30.5%	22.4%
Russell 2000	1,995.43	-6.1%	-1.6%	11.5%	2.8%
S&P/TSX Comp	21,873.72	-1.3%	4.4%	5.8%	3.2%
FTSE All-Share	4,374.06	0.8%	3.4%	1.8%	4.6%
STOXX Europe 600	505.61	-1.4%	5.6%	7.8%	11.5%
EURO STOXX 50	4,989.88	-1.8%	10.4%	13.4%	29.9%
Hang Seng	17,201.27	4.0%	0.9%	-13.8%	-16.7%
Shanghai Comp	3,044.82	0.1%	2.3%	-7.0%	-1.4%
Nikkei 225	38,460.08	-4.7%	14.9%	34.5%	41.9%
India Sensex	73,852.94	0.3%	2.2%	23.0%	29.1%
Singapore Straits Times	3,293.13	2.1%	1.6%	-0.9%	-2.0%
Brazil Ibovespa	124,740.69	-2.6%	-7.0%	20.0%	12.3%
Mexican Bolsa IPC	56,520.48	-1.5%	-1.5%	3.3%	6.3%
Gov't bonds (bps change)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. 10-Yr Treasury	4.646%	44.6	76.7	115.6	174.7
Canada 10-Yr	3.796%	32.8	68.6	88.8	92.8
UK 10-Yr	4.334%	40.1	79.7	55.3	237.1
Germany 10-Yr	2.588%	29.0	56.4	8.0	161.6
Fixed income (returns)	**Yield**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Aggregate	5.22%	-2.1%	-2.9%	-0.7%	-1.5%
U.S. Investment-Grade Corp	5.66%	-2.3%	-2.6%	1.7%	1.6%
U.S. High-Yield Corp	8.09%	-1.0%	0.5%	9.3%	9.3%
Commodities (USD)	**Price**	**MTD**	**YTD**	**1 yr**	**2 yr**
Gold (spot $/oz)	2,315.07	3.8%	12.2%	16.4%	19.9%
Silver (spot $/oz)	27.16	8.8%	14.1%	7.9%	12.5%
Copper ($/metric ton)	9,602.05	9.5%	13.4%	10.2%	-5.1%
Oil (WTI spot/bbl)	84.66	1.8%	18.2%	7.5%	-17.8%
Oil (Brent spot/bbl)	87.98	0.6%	14.2%	6.3%	-17.5%
Natural Gas ($/mmBtu)	1.65	-6.4%	-34.4%	-27.4%	-74.7%
Currencies	**Rate**	**MTD**	**YTD**	**1 yr**	**2 yr**
U.S. Dollar Index	105.8220	1.3%	4.4%	4.4%	4.5%
CAD/USD	0.7298	-1.2%	-3.4%	-1.2%	-7.2%
USD/CAD	1.3703	1.2%	3.5%	1.2%	7.8%
EUR/USD	1.0698	-0.9%	-3.1%	-3.2%	-0.9%
GBP/USD	1.2463	-1.3%	-2.1%	-0.2%	-2.9%
AUD/USD	0.6497	-0.4%	-4.6%	-3.0%	-10.3%
USD/JPY	155.3500	2.6%	10.1%	15.7%	20.9%
EUR/JPY	166.2000	1.8%	6.7%	12.1%	19.7%
EUR/GBP	0.8584	0.4%	-1.0%	-3.0%	2.1%
EUR/CHF	0.9790	0.6%	5.4%	-0.2%	-5.3%
USD/SGD	1.3619	0.9%	3.2%	2.1%	-0.7%
USD/CNY	7.2460	0.3%	2.1%	5.1%	11.5%
USD/MXN	17.0736	3.1%	0.6%	-5.1%	-15.6%
USD/BRL	5.1494	2.7%	6.0%	2.3%	7.4%

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 Tuesday'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 0.72 means 1 Canadian dollar will buy 0.72 U.S. dollar. CAD/USD -3.4% return means the Canadian dollar fell 3.4% vs. the U.S. dollar year to date. USD/JPY 155.35 means 1 U.S. dollar will buy 155.35 yen. USD/JPY 10.1% return means the U.S. dollar rose 10.1% vs. the yen year to date.

Source - Bloomberg; data as of 4/24/24

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As of March 31, 2024

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Rating	Count	Percent	Count	Percent
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Sell [Underperform]	46	3.15	4	8.70

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