

## “Everything else” takes its revenge



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Over the last month, each of the so-called “Magnificent 7” (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) has been falling in price, led by Tesla down 40% from its peak and 32% on the month. That’s been enough to bring all the U.S. large-cap indexes down by somewhere in the mid-to-high single digits. Over the same interval, indexes elsewhere are either up sharply (Europe, the UK, and Hong Kong) or holding their own (Canada, South Korea, Taiwan, and Japan).

This is all the more remarkable, in our view, because much of the “everything else”—e.g., Canada, Europe, Asia, and the UK—looks likely to feel the painful bite of U.S. tariffs. So too will some important segments of U.S. manufacturing—mostly autos—even before retaliatory tariffs are factored in.

This apparent buoyancy in the equity indexes of threatened economies is being read by some market participants as indicating that tariffs will prove to be much more moderate and short-lived than headlines suggest. For our part, we are uncomfortable with an investment approach that starts with the premise that the stock market is an infallible predictor of the future.

### Equity views

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

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

Equity markets are driven in some large part by expectations for the economy—particularly the U.S. economy. RBC Capital Markets Head of U.S. Equity Strategy Lori Calvasina makes an important distinction between moderate U.S. GDP growth of 2.1%–3% per annum and slow growth of 1%–2%. The former allows for solid corporate revenue and profit growth, enough to stimulate capital spending and innovation. Such growth tends to be non-inflationary, not requiring the U.S. Federal Reserve to take action to cool things off. Periods of moderate GDP growth have tended to be good for equities.

However, GDP growth rates below 2% dampen sales and earnings. Equity

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## GLOBAL EQUITY PERSPECTIVE

performance typically falters during periods of slow growth.

The “Goldilocks” zone, between 2.1% and 3% per annum, is where U.S. GDP growth has been running for some time. In Q4 of last year the annualised rate was 2.3%. In the past three calendar years it ran at 2.5%, 2.9%, and 2.8%. That has been a very good stretch for corporate revenues, earnings, and share prices.

Consensus estimates for 2025 U.S. GDP growth have been running in the low-to-mid-2% range and the Q1 pace had been widely expected to come in between 2.2% and 2.5%. However, some recent data is putting both the Q1 forecasts and the conviction around the full-year estimates into question. January foreign trade and consumer spending results were much weaker than the market expected or than quarterly consensus estimates had factored in. Now some are raising the prospect that Q1 GDP growth could be negative: somewhere between minus 1% and minus 2% rather than the plus 2.3% previously pencilled in.

Forecasters on the Street are quick to point out that special factors are to blame: on the international trade front, many U.S. businesses pre-bought foreign-sourced supplies to get ahead of tariffs, which temporarily worsened the trade deficit; while on the consumer front, lingering effects of the Boeing strike, the California wildfires, and cold weather produced not just slower growth in consumer spending but an outright decline. These shortfalls are all expected by most economists to reverse themselves in the coming months.

Maybe. But all of the “special factors” noted above were visible for some time and presumably factored into Q1 estimates but clearly not to anything like a sufficient degree. So, investors can be forgiven if they are now a bit leery of accepting assurances that all this undershooting will be recouped quickly. So far, full-year consensus estimates have not been adjusted or pared back. But uncertainty around

this won't even partially go away until the first estimates of Q2 growth are released by the U.S. Bureau of Economic Analysis in midsummer, if then.

For now, RBC Global Asset Management Chief Economist Eric Lascelles believes the damage to Q1 won't be as great as currently feared. His team estimates full-year 2025 GDP at 2.5%.

But if investors decide to worry that this sudden data confusion is in fact marking a negative change of trend, they may decide to act first and wait for clarity later. Rich price-to-earnings multiples need to have the underlying positive fundamental assumptions constantly and unequivocally reaffirmed.

Confidence in a sufficiently robust growth path for U.S. GDP in 2025 and 2026 has become more elusive in a world where policy uncertainty has soared. And policy uncertainty inevitably has translated into business and consumer uncertainty. CEOs reporting good, often better-than-expected results for Q4 have been reluctant to give guidance for 2025. Plans for hiring and capital expenditure look to have become more fluid, less set in stone.

Even lower growth than we are forecasting could feature sticky, perhaps even higher, inflation. (The “prices paid” component of the February ISM Manufacturing Purchasing Managers' Index soared to a new cycle high.) Manufacturers protected by tariffs are likely to raise prices because they can. Meanwhile, businesses that are hit by rising input costs from tariffs on imported goods have said in surveys they will try to pass on these costs to consumers. Faced with this dynamic, the Fed and other central banks may well stay “on pause” regarding further rate cuts.

All that said, we see plausible scenarios that could reignite the uptrend in North American equities while building on the recent upsurge in the European and UK stock

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markets. One would be a peace treaty, ceasefire, or any other agreed gearing down of the Russia-Ukraine conflict. Recent chaotic developments notwithstanding, that can't be ruled out.

Another, obviously, would be some meaningful scaling back of trade issues. We think hopes for some quick resolution on the trade front are just that—"hopes." Banking on their saving the day in the short run looks to us like a risky stance. But equity markets are known for the propensity to "climb a wall of worry," and to that end any movement in the right direction on trade or the situation in Ukraine might well be all the bulls need to keep control.

And, of course, the distortions in the January trade and consumer spending data could be recouped more rapidly and fully than we expect, restoring credibility and confidence in full-year GDP growth estimates in the market-friendly 2.1%–3% zone.

For now, worries that the world's largest economy could be downshifting into slow-growth mode are weighing on markets. A selective, cautious approach to equities has served us well for some time. In our view, it continues to be the right setting.

## Research resources

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			Count	Percent
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