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Global equity perspective
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Offense still on the field; defense ready for the call

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Equity markets backed off sharply in less than a week. The spark that ignited this was a much weaker-than-consensus U.S. employment report. At the least it would appear the market is in a correction that probably has weeks or months to run. At the worst, this may be the opening frame of an outright bear market. There are arguments that support both outcomes. However, what seems most probable is that the relentless march to new highs is over for now.

The most compelling factor supporting the idea that this will play out as a correction rather than the start of a bear market has been market breadth—the majority of stocks in most major global equity indexes have been moving in sync with their respective indexes. That is to say, to take the S&P 500 as an example, when the index has been moving higher, measures of breadth have also been rising. Both have also moved in tandem when the market was pulling back. The turning points, whenever the trend changed, have been within a couple of days of each other.

Breadth is an important market factor to monitor because measures such as advance-decline lines and unweighted indexes usually break down and start moving lower several months before the more closely watched capitalisation-weighted indexes, such as the S&P 500, set their final peak for the cycle. So far, no such negative divergence has appeared, suggesting that once this correction has played out the bull market could have further to run.

Equity views

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

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

Earnings are also on the positive side of the ledger. So far, the consensus estimate for this year's S&P 500 earnings has hovered around $242 per share with next year's at $277, as measured by FactSet. The current-year estimate usually erodes from the beginning of the year through the first half and further into the fourth quarter. However, uncharacteristically, it has risen slightly since the start of the

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All values in U.S. dollars and priced as of market close, July 31, 2024 unless otherwise stated.

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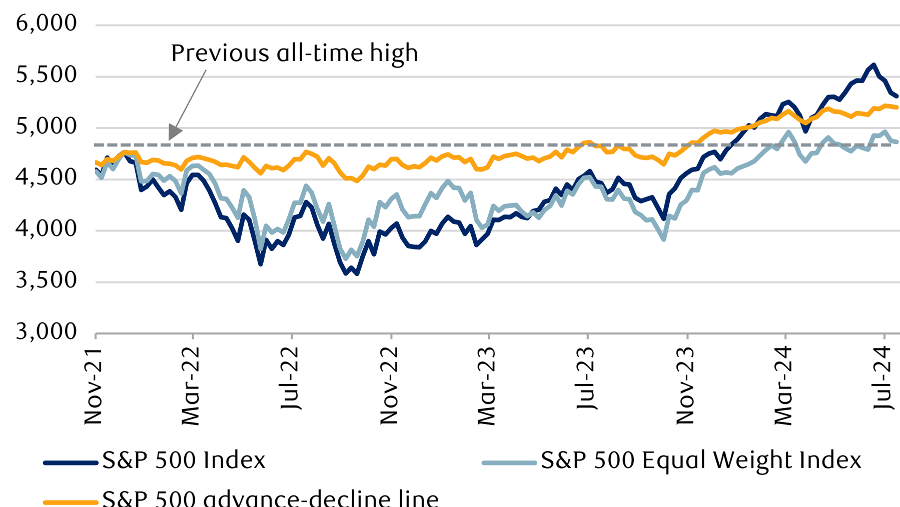
GLOBAL EQUITY PERSPECTIVE

All together now

It's not just the "Magnificent 7"; the majority of the stocks in the S&P 500 were moving higher for most of the past 21 months. This broad-based advance is not yet showing any internal signs of weakness.



Source - RBC Wealth Management, FactSet, Bloomberg; data through 8/6/24

year. Historically, investors would have expected a drop of about 3% in estimated 2024 earnings over that stretch.

On the momentum front, our proprietary weekly Quadrant Balance measure that tracks the percentage of S&P 500 stocks with rising momentum looks to have peaked and is coming down but is nowhere yet near levels that would rate as oversold.

There are a number of factors that bear watching:

Weakening employment metrics: While employment data has been repeatedly characterised as "stronger-than-expected" and "resilient," a closer look reveals a picture that has steadily weakened over the past 18 months.

The nonfarm payroll report has repeatedly been the source of employment optimism, but almost every month's data has been revised lower the following month. That picture looks even softer when government is excluded to give just the jobs added in the private sector.

And when one looks at the Business Employment Dynamics data prepared by the Bureau of Labor Statistics (BLS), with a six-month lag, which adds in the jobs created by newly formed businesses after deducting those lost to business closures, "strong" is no longer the correct adjective to use. By the BLS' estimate, the private sector added about 850,000 fewer jobs in 2023 than the 2.3 million that the monthly payroll data suggested.

And the household survey, which includes the self-employed, has consistently tracked lower than the nonfarm payroll data. Meanwhile, monthly unemployment claims have risen three of the past four months. The unemployment rate is up five of the past six and now sits at 4.3% for the first time since October 2021.

The number of unemployed persons in the U.S. is now 21% higher than it was 12 months ago. Rising unemployment goes beyond the loss of spending power for those who have lost jobs. The larger impact comes from the increase in precautionary savings on the part of employed people who take the worsening unemployment rate as a signal to prepare for a rainy day.

GLOBAL EQUITY PERSPECTIVE

Federal Reserve cuts may not prove to be a panacea: For several quarters, investors have been expecting the first Fed rate cut to be just around the corner. September is now viewed as the most likely kick-off month. At its peak just a few weeks ago the S&P 500 was up a startling 38% from the fall lows. Even the less tech-supercharged Equal-Weighted version of the index was ahead by 33%. It would seem the market had prepaid for that hoped-for rate cut, perhaps more than once.

What happens when the rate cut arrives? There is always the possibility investors will greet the Fed cut enthusiastically and push share prices higher in anticipation of more rate cuts to come. However, in our view, there is a greater chance that investors will decide the glass is more than half empty and that the Fed is cutting because it sees economic and, therefore, earnings weakness looming ahead. History favours the second interpretation: in eight of the past 10 recessions the first Fed rate cut arrived before or just as the economic downturn was getting underway. An equity bull should be hoping the expected Fed rate cut comes off the table because the economy turns out to be too strong to permit one.

That is not how some other central banks are feeling. The Bank of Canada just implemented its second cut and telegraphed a third for September because inflation is falling while the Canadian economy is threatening to weaken further. The European Central Bank looks like it may be on a similar path for similar reasons.

Investors have been expecting higher share prices: Investor sentiment prior to the pullback was ranging between euphoric and merely bullish. Complacency may be justified if the consensus earnings outlook—$242 per share for the S&P 500 this year and $277 for next—holds together. So far, with most of Q2 reported, this year's estimate looks makeable. But we would find it easier to be constructive about the market's near-term ability to shake off the current downturn if investor sentiment readings were much more pessimistic. Worthwhile market uplegs that carry the indexes sustainably into new high ground usually begin from deeply depressed readings for both momentum and sentiment. We are not there yet.

Committed, but…

Corrections can and do arrive unannounced from time to time—we've already had two notable ones come and go since the 2020 pandemic market low. A price-to-earnings multiple north of 20x, monetary and fiscal policy uncertainty, and dramatic political curve balls are just some of the potential catalysts that could trigger a further pullback. So too could collateral damage from yen volatility or any Q3 corporate pre-announcements which pointed to a weakening U.S. consumer spending outlook.

It's already the case, in our view, that the steady rise in the unemployment rate, at a time when consumer confidence is low and the excess household savings built up during COVID fully depleted, removes important bricks from the wall that had been supporting the idea of a "soft landing" for the U.S. economy.

We continue to recommend a defensive posture in equity portfolios, with an emphasis on high-quality dividend-paying shares. While we don't think there is enough evidence to conclude that a recession is a fait accompli, we think core equity holdings should be confined to stocks that can better withstand further economic deterioration or a recession, with valuations supported by prospects for earnings growth.

We are closely monitoring market breadth and sentiment for any signs that a more defensive posture should be considered. Until then, we think a watchful commitment to equities in a global balanced portfolio is called for.

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As of June 30, 2024

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
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Sell [Underperform]	47	3.15	5	10.64

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