

## Waiting room



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We have been waiting for the arrival of two things: the U.S. recession that reliable leading indicators have been saying is coming and new all-time highs for the major equity markets.

A recession remains a plausible outcome despite the expectation voiced by many that U.S. GDP will continue along an uninterrupted growth path for this year and next. As for new equity market highs, our wait is mostly over: the S&P 500, the Dow Jones Industrial Average, and Japan's TOPIX have all reached new high-water marks in style; Europe and UK markets have done so in a less dynamic fashion; and the Nasdaq and Canada's TSX are not quite there yet. We expect more to come.

Of course, corrections can arrive anytime and usually do unannounced. But there is no valuation "line in the sand" that triggers one or makes a pullback inevitable. Nor is there any reliable timing measure of "overdone-ness." Rather it's most often a case of buyers leaving the field, sellers coming to dominate, and market averages moving down for a while.

Often, the market reversal to down from up can be abrupt, perhaps triggered by a worrying development—think last spring's bank failures—or a policy shift. We have no idea when the next such

### Equity views

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

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

retrenchment will arrive, but we think one surely will.

However, major tops, those turning points ushering in more prolonged, deeper market declines (bear markets), often present a couple of precursor hallmarks, neither of which are present today. The first is investor sentiment, which typically goes through a stretch of weeks or months at very high levels before a bull market expires. Fear of missing out dominates investor attitudes in those final months. So far, while there are definitely more bulls than bears out there, an overwhelming majority conviction that further new highs lie immediately ahead is missing.

The second concerns market "breadth." Are most stocks moving directionally in sync with the market

For important and required non-U.S. analyst disclosures, see [page 4](#).

All values in U.S. dollars and priced as of market close, Feb. 29, 2024 unless otherwise stated.

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## GLOBAL EQUITY

averages? We think the answer is yes for the important large-cap segment of the stock market. The so-called “advance-decline line” for the S&P 500 stocks moved to a new high in December, followed by the index itself in January.

However, prior to the start of past bear markets a very different sequence of events emerges. The advance-decline line typically rolls over into a downtrend months before the market itself peaks. No such negative divergence is in evidence as of yet.

Over and above these internal market factors, it's the economy that determines where corporate earnings are headed. And share prices are pushed up and down in large part by changes in future consensus earnings expectations. Recessions pressure near-term earnings estimates low enough to shake investors' confidence in long-term corporate earnings power. That in turn can take a temporary heavy toll on share prices.

So, is there a recession in the offing that investors should be wary of? Arguably the answer is yes for Europe, the UK, and Canada where GDP growth has been decidedly weaker than for the U.S. for several quarters running. However, historically it's been U.S. recessions that have been hardest on major global equity markets. As to whether there is one on the way, the majority opinion has swung back and forth repeatedly over the past 18 months.

RBC Global Asset Management Inc. Chief Economist Eric Lascelles recently raised his estimated probability the U.S. economy will experience a soft landing (i.e., no recession) to 60% from 40%, although he notes that both his prior projection and the new one aren't materially different than a coin flip. The door is still open to both outcomes.

We agree with that view but would argue that investor watchfulness is all the more called for. One hurdle the

soft landing argument will need to get past is that there has never been such a benign outcome when Fed tightening has been accompanied by overt raising of lending standards by banks. In this instance the majority of U.S. banks have been doing just that for six consecutive quarters for almost every category of loan.

Many soft landing advocates have been saying for some time that this whole tightening process has gone on too long without a recession arriving, concluding as a result that one won't. However, looking at all the recessions that have played out from the early 1950s onwards, on average each began 25 months after the first Fed interest rate increase. In this case that would target April of this year, keeping in mind that in more than half the instances the wait time was longer than the average. It's premature, in our view, to assert the timing window for a recession is closed.

There is also a widespread view that the good Q4 GDP report and the Atlanta Fed's GDPNow forecast for something close to a 3% annualised growth rate for Q1 make it unlikely a recession could start any time soon. But history doesn't support that notion. Again, looking back at past occurrences, the GDP growth rate delivered in the quarter immediately before each recession began averaged 2.4% but in fact was all over the map, ranging between minus 2.7% and plus 9%.

We remain committed to equities but are watchful. Equity markets are exhibiting sustained upward momentum that may deliver further new highs in the coming weeks and months. Corrections can't be ruled out, but some important precursors of bear markets are not yet in evidence.

We are keeping in mind that the probabilities of a recession arriving remain uncomfortably high and should be reflected in stock selection.

## Research resources

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