Wealth Management
& Capital Markets Perspective

Wealth Management Dominion Securities

For the clients of Grimes Handscomb Asset Management of RBC Dominion Securities | Summer 2019

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Europe: Green shoots wilt

By Frédérique Carrier

With trade tensions simmering and the economies of its largest trading partners slowing, the expected European economic recovery in the second half of 2019 will likely prove elusive. In our view, European equity valuations do not reflect political and economic factors including tariff negotiations, a reinvigorated populist Italian government, and Brexit uncertainty. We recently downgraded European equities to underweight.

Fading optimism for new growth

Our thesis on European recovery was two-pronged. We expected the temporary factors that had crimped growth in Q4 2018 and Q1 2019, such as new auto emissions testing standards and the Yellow Vest protests in France, to recede during 2019. We also expected a stabilization in global trade and growth during the second half of this year after a difficult 2018. Together, these developments would have enabled the sturdy roots supporting the Eurozone economy – falling unemployment, healthy loan growth to the private sector (6% for the euro area), and gently supportive fiscal policy in France, Italy, and Germany – to support new growth.

As we move further into the second half of 2019, many of the temporary factors are indeed waning, albeit slowly. But given the recent ratcheting up of trade tensions, it seems unlikely that global trade will indeed stabilize in the near future. Even if relations between the U.S. and its trading partners thaw somewhat in the short term, tariffs will remain in place as negotiations continue. The uncertainty will continue to damage global growth prospects, in our opinion.

Europe's economy depends heavily on trade. Exports represent a high 44.4% of regional GDP, compared to 30.1% for the U.K, 18.6% for Canada and 12.1% for the U.S., according to the World Bank. Of those exports, 39% go to Europe's three largest trading partners: the U.K. (16%), the U.S. (15%) and China (8%), according to European Commission data. Hence, slowdowns in the economic growth of major trading partners due to trade tensions and the spectre of a hard Brexit create substantial headwinds for the region.

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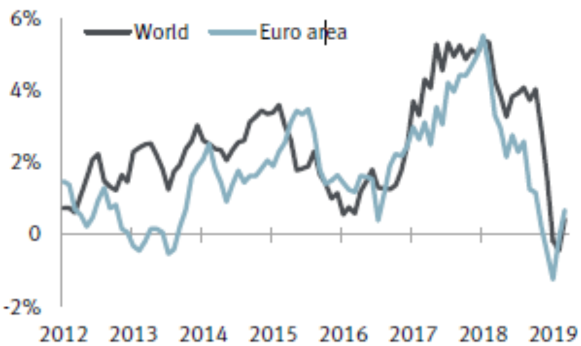
Trade volumes rising, but for how long?
CPB World Trade Monitor 3-month rolling average, y/y



The March uptick may prove short-lived as trade disputes evolve.

Note: last data point is March 31, before the May escalation of the trade war
Source - RBC Capital Markets, Bloomberg, CPB World Trade Monitor

European economic data featured some green shoots in the spring, culminating in Q1 GDP growth of 0.4% quarter over quarter, following a lackluster 0.2% in Q4 2018. However, recent releases have been less encouraging, with most falling short of consensus expectations. Consequently, the European Central Bank (ECB) has pared back its growth projections for fiscal 2020 and fiscal 2021.

ECB staff lowers 2020 and 2021 growth expectations again
ECB growth projections

	Dec 2018	Mar 2019	Jun 2019
2019	1.7%	1.1%	1.2%*
2020	1.7%	1.6%	1.4%
2021	1.5%	1.5%	1.4%

*Given robust Q1 2019 GDP data, the ECB tweaked upwards its 2019 estimates in June, though that estimate remains below the 1.7% it had calculated for 2019 back in December 2018.
Source - RBC Wealth Management

The market's inflation expectations have also fallen from 1.6% at the beginning of the year to 1.1% in mid-June.

We believe consensus corporate earnings growth forecasts will need to be adjusted to reflect this new reality, as they are too high at 8% for this year and 10% for 2020. Slightly negative Q1 earnings-per-share (EPS) growth for the region will make those full-year estimates difficult to achieve, and we believe European equities will struggle to outperform as long as downward earnings revisions prevail.

The ECB has announced it is prepared to take bold steps to prop up inflation and to support the regional economy should it weaken further. Despite interest rates already in negative territory, RBC Capital Markets now expects two 10-basis point rate cuts this year, in September and December. It is also possible that the central bank will relaunch its quantitative easing programme next year.

The ECB's actions are unlikely to remove the key obstacle to the region's growth, in our view: the global trade dispute. The central banks' ability to boost economic expansion through ever-lower interest rates appears limited, at the margin. In a possible sign of things to come, U.S. President Donald Trump lashed out at ECB President Mario Draghi and the ECB for "making it unfairly easier for them to compete against the USA."

Political tensions return

Beyond this, we believe regional political tensions are likely to increase over the course of the next few months in three key areas.

U.S.-EU auto tariffs – The U.S. has postponed a decision on European auto tariffs until the autumn. But if President Trump were to attempt to use auto tariffs as a lever to open up the EU agricultural market, he would likely face stiff opposition from Europeans, who passionately protect their agricultural sector. Should the dispute escalate and the U.S. slap new tariffs on European auto imports, it would significantly impede growth given the importance of auto trade flows, in our view.

A bolstered populist government in Italy – The right-wing Lega is the main political force in Italy's coalition government, and the party's strong showing in the recent European Parliament elections has emboldened its leader, Matteo Salvini. He has resumed talk of breaching EU fiscal rules and issuing a parallel currency. So-called "mini-BOTS," named after the country's ordinary Treasury bonds, would be used to pay public sector bills, in a direct provocation to the ECB.

It is unclear at this stage whether Rome's dispute with Brussels will escalate. Our base case is that rising yields would act as a control mechanism to contain the crisis. Italian banks, which own 8% of the country's bonds, remain fragile due to non-performing loans reaching a high 9% of total loans. They would be weakened further by rising yields, something we believe most governments would prefer to avoid.

The current government might opt for confrontation, and the vicious cycle of rising yields and credit rating downgrades that would likely ensue. Faced with that reality, the country's political leadership could decide to head further into the storm or to change course, much as Greece did in 2015. Either way, we believe the developing situation would weigh on business sentiment and further dampen growth.

Brexit uncertainty – As things stand, the deadline for the U.K. to exit the EU is October 31, 2019. Whilst the EU would prefer to avoid the chaos of a no-deal Brexit, it is far from clear that Brussels would grant the U.K. another extension. Avoiding a no-deal Brexit would require the country's parliament to finally accept the Withdrawal Agreement negotiated by former Prime Minister Theresa May, which it has thrice rejected. In our view, the probability of a no-deal Brexit is not inconsiderable, at around 30%.

Naming your executor – seven common pitfalls and how to avoid them

If asked by a family member or friend to serve as their executor, most of us would consider it an honour. However, it can be a complicated, sometimes overwhelming undertaking.

An executor is often responsible for a long and detailed task list to ensure your last wishes are carried out. To settle even a simple estate, it can take about 18 months. Your executor must complete numerous tasks and duties, including:

- Finding and, if necessary, probating the Will
- Protecting, selling or distributing assets
- Reviewing insurance and pension benefits
- Paying outstanding debts and taxes
- Preparing a final accounting for the beneficiaries of the estate

That's why it's important to carefully consider your choice as executor. Following are seven issues you should be aware of when naming your executor:

1. Not considering your executor's age and health

Many people choose someone close to their own age to act as their executor, such as their spouse, a sibling or a close friend. That may be fine when everyone is younger and in good health. However, when the time comes to act, the person you have named may no longer be up to the task due to their age or health. It's also possible that they will predecease you. Make sure you review your choice of executor as time goes on, and consider naming someone from the next generation.

2. Overlooking family conflict

Let's face it, family can be complicated. That's why it's important to select an executor who is able to manage potential family discord and balance conflicting interests. To help your executor, consider talking with your beneficiaries in advance, so they clearly understand your final wishes and the reasons for your decisions.

3. Selecting someone too busy

It can take one to two years to settle a basic estate, and longer if you have a more complex estate. If you are establishing trusts in your Will, your executor's responsibilities could stretch into many years or even decades. This can be challenging for your executor if they have a busy life, so think about naming someone who will likely have the time to carry out their duties, or arranging professional assistance to help them.

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4. Choosing someone too far away

Your executor will be responsible for many tasks that are much easier to do if they are closer to where you live.

5. Naming an expat executor

When a non-resident of Canada acts as the sole executor of a Canadian estate, the estate may be considered a non-resident of Canada. This could result in the loss of tax advantages enjoyed by Canadian-resident estates.

6. Putting honour before duty

You may feel like you have to name someone in particular as your executor – someone who may "expect" the honour. However, your executor will have duties that require a certain level of technical expertise, such as filing tax returns. What's more, your executor could potentially face personal legal liability if they don't properly carry out their duties. As a result, you should carefully consider your executor's level of expertise.

7. Not getting professional assistance when you need it

Ultimately, you may find it difficult to find someone ideally qualified to act as your executor. Avoid naming someone just because you have to name someone. Give some thought to either hiring a professional to act as your executor, or to support your executor in carrying out their duties.

For information about choosing an executor, please contact us.

Introducing Laurie Christensen

Prior to joining RBC Dominion Securities over 14 years ago, Laurie had excelled in a diverse range of roles, from Project Coordinator to an entrepreneurial stint as a business owner. Her tenure at RBC Dominion Securities has seen her amass experience in the financial services industry as an Associate, Branch Administrator and presently a Senior Associate with Grimes Handscomb Asset Management of RBC Dominion Securities. This year, Laurie took on the new challenge of becoming a mentor through a joint partnership with RBC and the Toronto Region Immigrant Employment Council (TRIEC). The RBC-TRIEC program pairs skilled immigrants with experienced professionals in their field, helping them grow their network and better understand the Canadian job market and work culture. As Laurie would tell you, mentors have a lot to gain too. She has thoroughly enjoyed expanding her cultural awareness and practising her leadership skills in such a rewarding way.

Benchmarks

Equity market 12-month trailing return (for month ending June 30, 2019)	
S&P/TSX composite total return index	3.9%
S&P 500 total return (C$)	10.1%
S&P 500 total return (U$)	10.4%
DJIA total return (C$)	11.9%
DJIA total return (U$)	12.2%
Nasdaq composite price return (C$)	6.3%
Nasdaq composite price return (U$)	6.6%

RBC Capital Markets Canadian Bond Market indexes 12-month trailing return (for month ending June 30, 2019)	
Short-term index	4.1%
Intermediate-term	7.7%
Three-month T-Bill (C$)	1.5%
Three-month T-Bill (U$)	2.3%

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