

# Global Insight

Perspectives from the Global Portfolio Advisory Committee



## As the Brexit clock ticks down, what now?

As the countdown to Brexit ticks ever louder, what's going on and how should investors approach this uncertain and volatile environment?

Frédérique Carrier | Page 4



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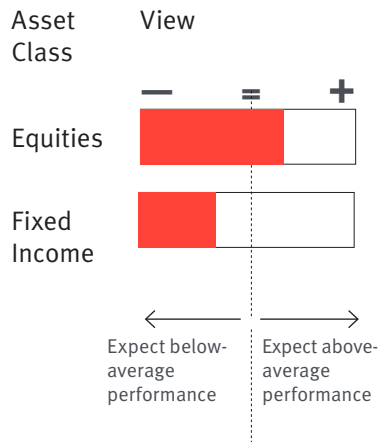
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All values in U.S. dollars and priced as of market close, August 31, 2018, unless otherwise stated.

# RBC's investment stance

## Global asset views



See “Views explanation” below for details

Source - RBC Wealth Management

## Equities

- Persistent U.S. economic strength and relatively steady trends in Europe and Japan keep us constructive on global equities. More importantly, our key leading economic indicators are signaling positive economic momentum into next year, at least, and risks of imminent recession for major economies seem low. These factors make it likely corporate earnings will continue to grow in 2019 at an average to above-average pace, depending on the market.
- While the Chinese economy has yet to fully work through its deleveraging cycle, the process should be manageable. Tariff risks could persist, particularly between the U.S. and China, but the likelihood of an all-out global trade war has diminished. We remain moderately Overweight global equities.

## Fixed income

- Global central bank activity remains in focus, especially while the banks guide their respective economies through myriad challenges including trade disputes, geopolitical risks, and flattening yield curves. These issues could have market impact through year's end, though not to the point they derail plans by the Federal Reserve and Bank of Canada to gradually increase rates. In our view, the slow pace of rate hikes should serve to limit upward pressure on interest rates globally.
- We maintain our Underweight stance on fixed income, but corporate credit remains our favorite sector within the asset class. Quality is still king, and we continue to see single-A rated issues as providing the most compelling opportunities. Given the current flat yield curves, we think shortening portfolio duration is prudent.

## Views explanation

(+ / = / -) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

+ Overweight implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

= Market Weight implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

- Underweight implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.

# As the Brexit clock ticks down, what now?



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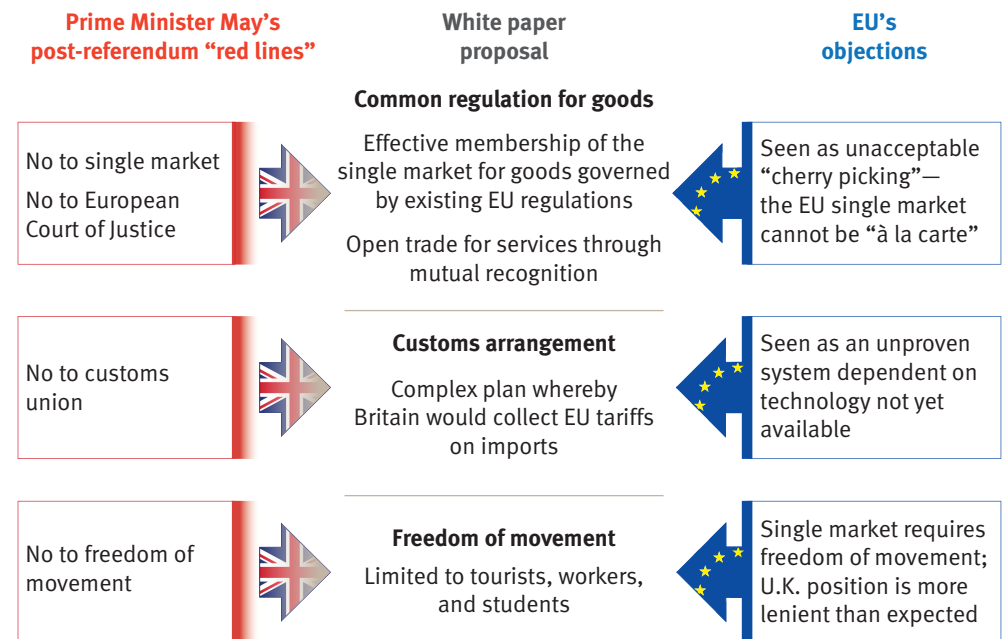
With the Brexit deadline looming, we take the pulse of the negotiations, and assess the wide spectrum of political risks and their potential impact on the economy. We answer investors' key questions, and highlight opportunities and strategies in this uncertain and volatile environment.

## Q. What is the state of play of the negotiations?

**A.** The talks are unfolding along a two-pronged approach. One element relates to the terms of the divorce, the so-called Withdrawal Agreement, covering three issues: the financial settlement the U.K. will pay to the EU, the rights of EU citizens who remain in the U.K., and options to avoid a hard border between Ireland and Northern Ireland. This prong also involves an agreement on a transition period—ensuring the status quo for 21 months after the exit on March 29, 2019—so that the U.K. can prepare itself for life outside the EU.

Most of the Withdrawal Agreement has been negotiated, except for the Irish border issue. The resolution of this depends on the future arrangement between the U.K. and the EU, particularly with respect to the trading of goods.

### May blurs her “red lines”



Source - RBC Wealth Management

# Brexit clock ticks down

The other element of the negotiations deals with the blueprint of the U.K.'s future relationship with the EU. Prime Minister Theresa May laid out her strategy in July in a white paper, the government's first detailed proposal on this topic since the referendum in June 2016.

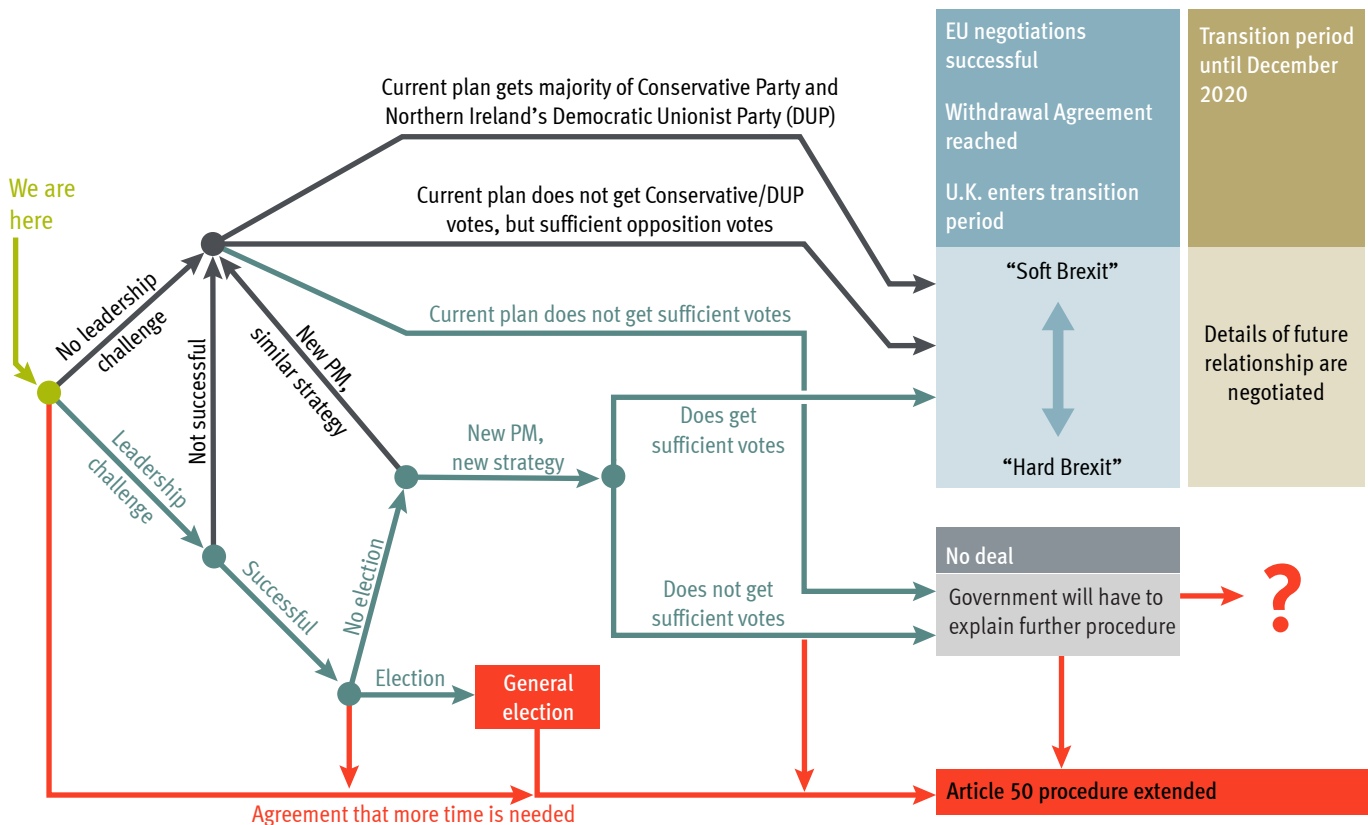
May opted for a "soft Brexit," i.e., the U.K. would maintain close economic ties with the EU by effectively retaining membership within the single market for goods and respecting EU regulations. But this plan means May has changed her previous stance on the "red lines" she had firmly laid out after the Brexit vote (see graphic on the previous page).

The white paper is largely being seen as an opening gambit for negotiations. Parts of it have already been rejected by the EU, whose main motivation is to preserve the union. Accommodating the U.K.'s demands may embolden other countries to seek exceptions and special arrangements as well.

By taking this approach, May has angered the most passionate Brexiteers in the Conservative Party, who are vocal proponents of a clean break with the EU. And in doing so she has become vulnerable given her thin parliamentary majority, and political uncertainty is likely to fester as negotiations heat up in the face of the approaching deadline.

## Possible political scenarios until March 2019

Low visibility is an understatement



Source - RBC Capital Markets



## Q. What are the milestones prior to the exit?

**A.** There is now less than a year before the U.K. leaves the EU. The timeline below is only indicative, as tensions apparent in U.K. politics may well give rise to unforeseen events.

Other than the ongoing negotiations and European Council meetings, the Conservative and Labour Party Conferences in the autumn could very well influence how the divorce takes shape.

## Q. What is the base-case Brexit scenario?

**A.** Our base case is that a soft Brexit deal will be struck. After all, such an outcome is in the interest of both the U.K. and the EU. The U.K. would avoid the turmoil of leaving the EU without any provision as to what the future relationship might bring; and the EU would avoid the potentially destabilising effect of having a trading partner and close neighbour endure significant political and economic upheaval.

If the U.K. cannot adjust the proposals as laid out in the recent white paper closer to the requirements of the EU, we would expect the EU to counter with a “take it or leave it” proposal, with a customs union for goods flexible enough to keep the Irish border open. This would limit the U.K.’s ability to negotiate trade deals with third countries, but also limit the damage to the U.K. economy.

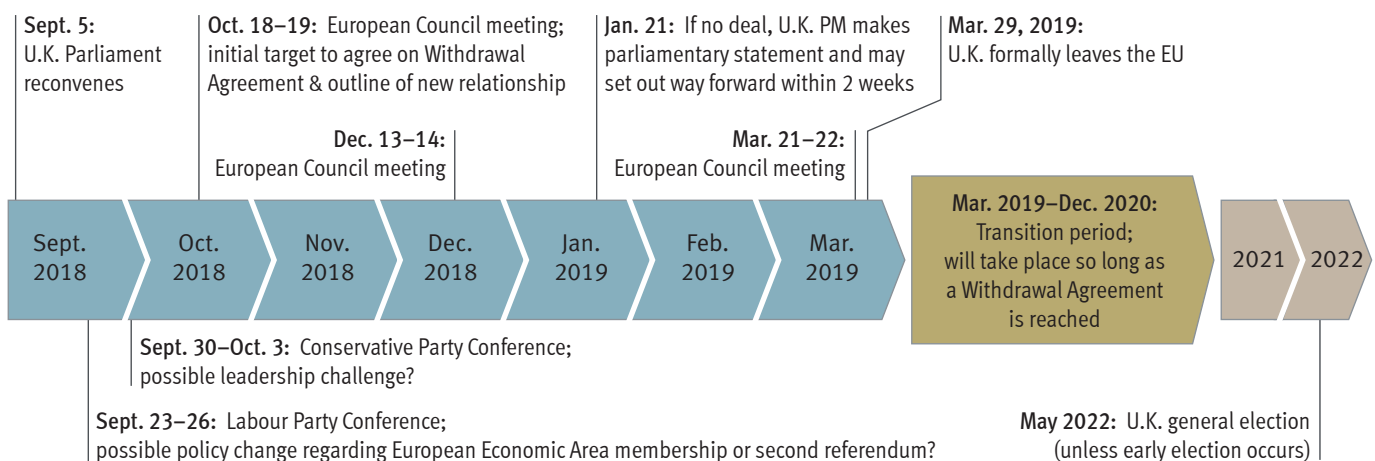
Faced with the choice of a hard, cliff-edge Brexit or fresh elections which could lead to a Labour government, we would expect Conservative Members of Parliament (MPs) to be pragmatic and put their differences aside and accept this deal, propped up by cross-party support.

Eric Lascelles, chief economist at RBC Global Asset Management, expects the hit to GDP from a soft Brexit would be 5% over a number of years, but he points out that 1%–2% of this drag has already materialised, leaving less pain remaining.

Our base case is that a soft Brexit deal will be struck.

### So much to do, so little time

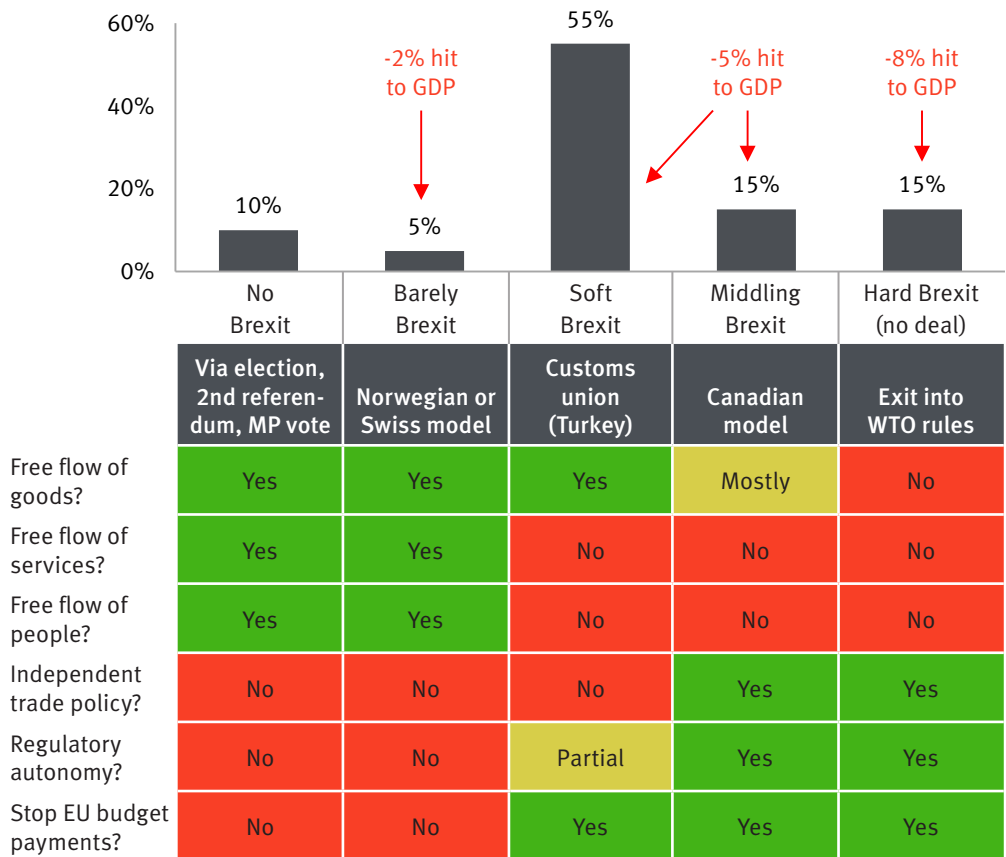
Key upcoming milestones in the Brexit timeline



Source - RBC Wealth Management, RBC Capital Markets

## Brexit probabilities and implications

Base case is soft Brexit, but tail risks should not be dismissed



Source - U.K. Government, RBC Global Asset Management, RBC Wealth Management

### Q. There is a lot of talk about a “no-deal” outcome—what would that entail?

**A.** Some Brexit-backing Conservative MPs believe a no-deal outcome would be advantageous to the U.K., as it would ensure the country regains its sovereignty. They are frustrating May’s soft Brexit efforts as demonstrated by cabinet resignations and close parliamentary votes over the summer.

A no-deal outcome would occur should the U.K. fail to conclude the negotiation of the Withdrawal Agreement—the soft border with Ireland being the sticking point—and talks with the EU break down. This scenario could also materialise if the final deal does not garner enough support in Parliament.

Lascelles assigns a probability of 15% to this outcome whereby the U.K. would then be compelled to trade with the EU on the basis of WTO rules. This probability may well increase somewhat as events unfold. With trade with the EU severely disrupted in this scenario, Lascelles estimates a hit to GDP as high as 8% over a number of years.

A no-deal outcome would occur should the U.K. fail to conclude the negotiation of the Withdrawal Agreement.

### **Q. Is there a chance that Brexit will fall through?**

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**A.** At the other end of the spectrum, the scenarios of “no Brexit” or “barely Brexit” (a solution akin to the Swiss model) are possible, though Lascelles pegs both with low probabilities of 10% and 5%, respectively. Sentiment has not sufficiently turned for the former. For the latter, the EU is unlikely to allow the U.K. adopt a model similar to that of Switzerland, which it now regrets having agreed to.

### **Q. Why are many investors more concerned about a Labour government than about Brexit?**

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**A.** Due to infighting, the Conservative Party has now slid behind Labour in the polls. Mark Dowding of BlueBay, an RBC Group company, assigns a 25% probability of a far-left Labour government led by Jeremy Corbyn.

Elections could be called after a possible leadership challenge this autumn, though with her now-soft Brexit approach, May is likely to have the support of enough MPs—most of whom favour a soft Brexit—to survive. A further test would occur should the deal she brings back to the U.K. be voted down, as this would very likely be followed by a snap election.

A Labour-led government would likely aim for a soft Brexit. As a coalition or a minority government, it would probably soften its stance further, aiming instead to stay in the common market for both goods and services with some control over immigration. A second Brexit referendum would also be more likely under this scenario, given Labour’s increasingly softening stance towards leaving the EU.

While Labour’s softer position would be beneficial to the economy, in our view, its other economic policies would more than likely offset this.

The party intends to significantly increase fiscal spending. Despite raising the corporate tax rate to 26% from 19% as well as personal taxes by reintroducing the top 50% marginal rate, the Labour programme would likely lead to higher fiscal deficits.

Labour has also proposed amending the Bank of England’s (BoE) charter to mandate the central bank finance infrastructure and social care projects, a measure which would clearly be inflationary.

Overall, these policies would likely result in higher Gilt yields, higher inflation, and possibly a weaker pound should the new policies induce capital flight.

### **Q. How has the economy responded to this uncertainty?**

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**A.** The Brexit vote has already taken a bite out of U.K. economic growth. A cursory look at growth projections made by the Office for Budget Responsibility (OBR) in March 2016 before the referendum compared to the most recent estimates shows the OBR slashed its growth projections by a cumulative 2% over 2016–2019 (inclusive).

The two main culprits have been lower consumption, as disposable incomes have been eroded by higher inflation due to sterling’s downward spiral, and

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# Brexit clock ticks down

## Brexit bites

U.K. growth has been lagging that of other countries since the Brexit vote

	2015	2016	2017	2018E	2019E	2020E
U.K. GDP projections, March 2016	2.2%	2.0%	2.2%	2.1%	2.1%	NA
U.K. GDP projections, May 2018	2.2%	1.9%	1.7%	1.5%	1.3%	1.3%
Differential		-0.1%	-0.5%	-0.6%	-0.8%	
Cumulative impact of Brexit / growth foregone				-2%		

Source - The World Bank, IMF, Office for Budget Responsibility

weaker business investment, which grew at about one-third of the pace initially envisioned since the referendum. The impact on the economy would have been starker still had the government not stepped up its own investment, and the BoE not loosened monetary policy.

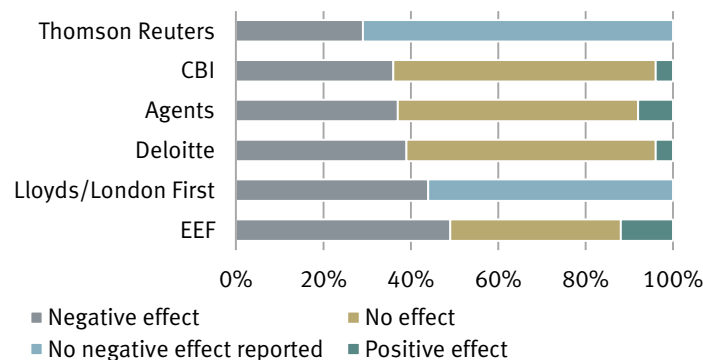
Going forward, it is difficult for us to see how the U.K. can break out of the doldrums.

Going forward, it is difficult for us to see how the U.K. can break out of the doldrums. Consumption is likely to remain underwhelming even as disposable incomes recover, given the tepid increase in real wage growth. High household indebtedness and a low savings ratio below 5% point to an already stretched consumer. Households may well opt to use their slightly higher income to build up savings or pay down debt.

Business investment is unlikely to pick up. The Q2 2018 Deloitte CFO Survey again ranked Brexit as the top risk facing U.K. businesses, with three-quarters of respondents expecting Brexit to lead to a deterioration in the business environment in the long term, the highest proportion since the referendum in 2016. Many companies are worried about their supply chains, and how quickly and reliably they will be able to import components from Europe. Many are freezing their investment plans, or leaving the U.K. as a result.

In a bid to prop up the economy, the U.K. government is loosening its purse strings earlier than planned and has announced wage increases for public sector workers. Fiscal austerity has subtracted some 0.2%–0.3% from growth over each of the last two years.

## Surveys of the impact of Brexit on investment



Business investment is impacted by the uncertainty.

Source - Bank of England February 2018 report

We expect the pound could retest its lows in the event of a hard Brexit; conversely, a soft Brexit could slightly lift the pound.

With this uncertain background, RBC Capital Markets expects GDP growth of 1.3% and 1.4% this year and next, respectively, and for the BoE to increase interest rates twice in 2019, bringing the Bank Rate to 1.25%, though this is contingent on a soft Brexit outcome.

### **Q. What about the currency?**

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**A.** The pound bore the brunt of the adjustment to financial asset pricing in the aftermath of the Brexit vote, falling some 20% against the U.S. dollar, and somewhat less on a trade-weighted basis, in the three months after the referendum.

After clawing back some of its losses, sterling is down 10% against the dollar since its April 2018 move in response to market perceptions about the outcome of Brexit negotiations and its impact on growth.

Renewed political frictions or a possible breakdown of negotiations with the EU could prompt further sterling weakness. We expect the currency could retest its lows in the event of a hard Brexit; conversely, a soft Brexit could slightly lift the pound.

### **Q. After showing resilience during the politically volatile summer, what's next for U.K. equities?**

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**A.** Several factors underpinned the hardy performance of U.K. equities during a summer dominated by political drama.

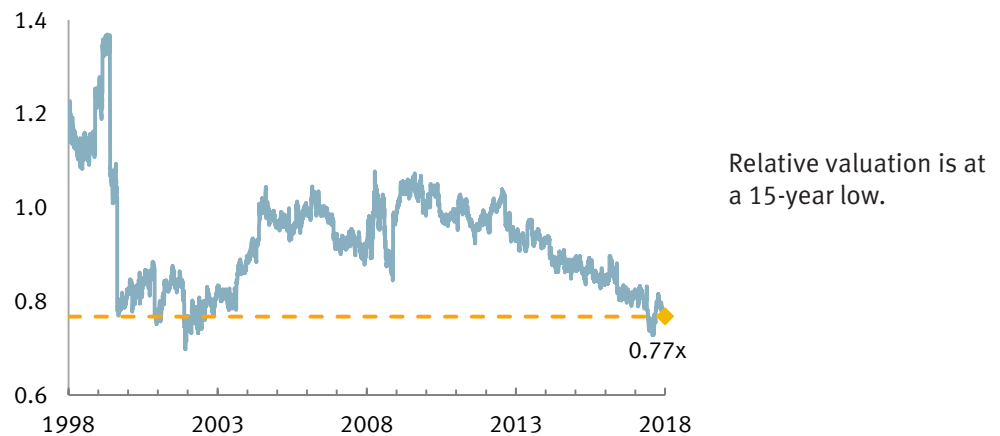
Firstly, the pound's 4% fall relative to the dollar since May supported equities as currency weakness tends to have a positive effect on U.K. indexes, with some 70% of the FTSE 100's revenues generated abroad.

Moreover, the Energy sector, which is heavily represented in U.K. indexes, has benefitted from stronger oil prices and improved cash flows. Further support materialised from the rebound in M&A activity in the U.K. with foreign investors taking advantage of the weaker pound, while share buybacks have increased. Corporate earnings expectations seem to have passed peak pessimism and are now recovering. Finally, relative to other stock markets, the U.K. has seen less of an impact from the ongoing trade disputes than other regions that have a larger exposure to sectors in the tariff crosshairs such as Technology and Autos.

All of this supports our recent upgrade of U.K. equities to Market Weight. After three years of underperformance, valuations are now attractive, in our view. The dividend yield has seldom been so high, exceeding the 4% threshold on only five occasions since the market trough of 2009 and offering some 1.4x the average yield of other developed markets.

U.K. equities trade on a price-to-earnings (P/E) ratio of 13.7x and 12.7x consensus estimates for 2018 and 2019, respectively. On a price-to-book value (P/BV) basis, the FTSE All-Share Index trades close to a 15-year low relative to the MSCI World Index. Barring a systemic shock, we believe value has emerged in the U.K. We maintain our long-standing preference for companies which generate the majority of revenues abroad, and we find particular value in Energy and Financials.

### FTSE All-Share P/BV relative valuation to MSCI World



Source - Bloomberg, RBC Wealth Management

However, the non-negligible probabilities of a no-deal outcome or of early elections that could result in a Labour-led government curb our enthusiasm. In the case of the former, domestic stocks would be hurt the most: the pound would likely weaken, increasing the cost of imported raw materials and squeezing corporates' margins, while consumers' disposable incomes would be eroded by inflation.

A no-deal scenario could also potentially affect companies which export a large proportion of sales to the EU. But many of those also have production facilities abroad, which should somewhat shield them from the negative impact of this scenario.

If there are early elections that produce a Labour government, we believe utility, bus, and railway companies would be threatened by potential changes in regulations (lower fares and prices), a likely higher cost of debt, and the risk of nationalisation. A higher corporate tax rate would particularly hurt small-cap stocks, in our view. Meanwhile, Financials such as investment managers would likely suffer from the high end of their client base facing a more difficult environment for pensions and savings.

### Tune out the noise

We expect significant noise and spells of anxiety will affect financial markets as the Brexit deadline approaches and political uncertainty peaks. Markets will likely react more strongly to headlines which seem to herald the U.K. crashing out of the EU, while being sceptical towards those which point to a smooth exit, until a final deal is reached and ratified by both the U.K. and EU parliaments.

Our base case continues to anticipate a soft Brexit, and barring any shock to the economy, we expect reasonable returns from U.K. equities and maintain our Market Weight stance. We would focus on companies with international exposure until more clarity on the future business model of the country emerges.

We expect significant noise and spells of anxiety will affect financial markets as the Brexit deadline approaches and political uncertainty peaks.

**Q. How should U.K. individuals subject to U.K. tax and pensions approach personal financial planning in light of Brexit uncertainty?**

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*A. Dean Moore, head of Wealth Planning at RBC Wealth Management in London, U.K., points out that with U.K. tax revenues expected to fall following Brexit, an emergency budget would likely see the U.K. Treasury look to raise additional revenues. There may be pressure to reduce the current annual pension allowance of £40,000 for individuals eligible for U.K. pensions, or lower their £150,000 earnings threshold where the allowance begins to decline. The rate of U.K. tax relief may also be restricted and it would be worth considering maximising contributions to pensions and individual savings accounts, and carrying forward unused U.K. pension relief where possible.*

*U.K. expats living in the European Economic Area (EEA) currently benefit from the “triple lock” guarantee, which mandates that their basic state pension increases every year by the higher of the rate of inflation, average earnings growth, or a minimum of 2.5%. There is some speculation as to whether Brexit could change the status of EEA pensioners, as pensioners living in other countries, such as Australia, do not benefit from any such increase. Should this change occur, it will be necessary for U.K. expats living in the EEA to consider an increase to savings in order to offset the impact of inflation on a fixed basic state pension.*

# Does the “late cycle” have an expiration date?



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While it’s true the U.S. economic expansion is getting long in the tooth, “late cycle” doesn’t necessarily mean “end of cycle,” and in fact the economy is still exhibiting some mid-cycle characteristics. So while it’s always appropriate to be prepared for an inevitable downturn, we are of the view time isn’t running out on the expansion just yet.

The U.S. economy is now in its tenth year of expansion and, at 36 quarters, is within two quarters of being the second-longest on record. “Late cycle” is a term heard frequently these days to suggest the end of this amazing streak is near. Late cycle carries a negative connotation, suggesting a recession is approaching, bringing with it dire consequences for investors.

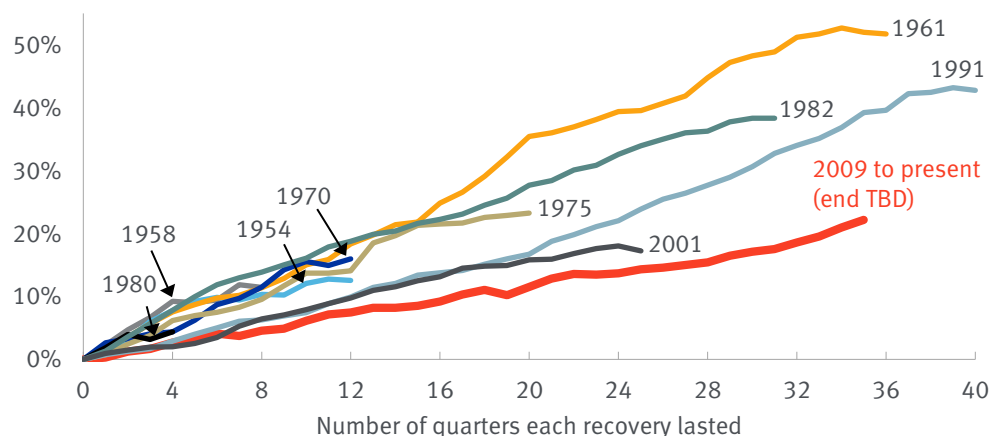
In our view, a sole focus on the time elapsed for this expansion is misplaced. Economic cycles don’t simply die of old age. And, based upon the key indicators we monitor, the current cycle likely has room to run—at least several quarters, perhaps even years.

## Darkest before the dawn

The current expansion began as the Great Recession ended; the official start date was June 2009. The Fed had lowered interest rates to 0% the previous December, 10-year Treasury yields were close to 4%, and the S&P 500 was sitting at 926.12. In hindsight, it is easy to see how the start of the current extended cycle might have been missed as most investors were intently preoccupied with aftershocks from the global financial crisis.

## This is a long-lasting but slow-growing recovery

% U.S. cumulative GDP growth during each recovery cycle since WWII  
(years represent beginning of recovery)



Source - RBC Wealth Management, Federal Reserve Bank of St. Louis; quarterly data through 7/27/18

## “Late cycle”: Expiration date?

Furthermore, over the past 10 years economic growth has been far from robust, averaging just 2.2%—well below the 3.3% long-term average—hardly enough to make anyone overly exuberant. In retrospect, though, this long period of slow growth may have been just what was needed following the carnage wrought by the Great Recession and the unwinding of the unsustainable imbalances that led up to it.

### Where do we stand?

Of the four phases of an economic cycle—early, middle, late, and recession—each brings its own implications for markets and investment portfolios.

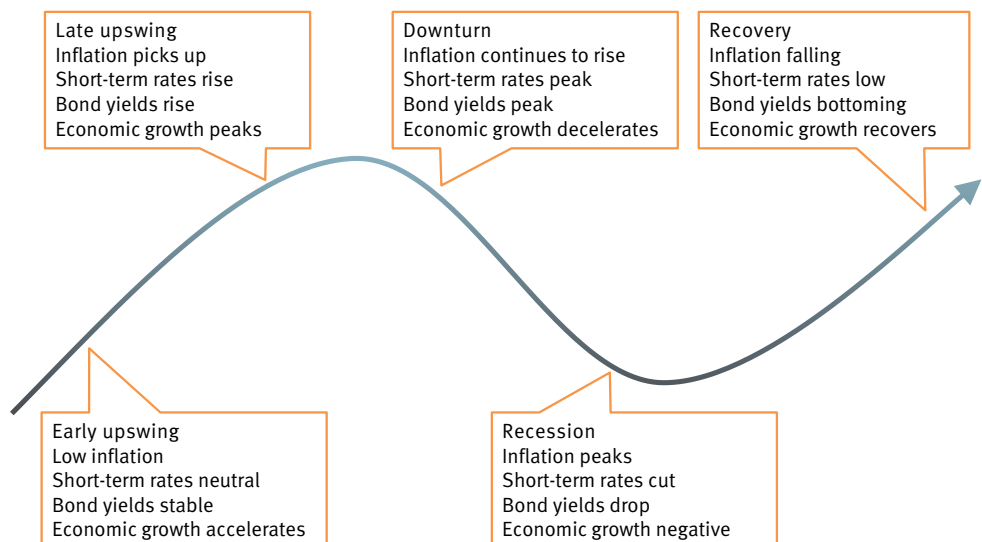
Clearly the economy has moved past the early stage, which is typically characterized by a change from negative to positive growth, sometimes very rapidly as an economy rebounds from a recession, usually propelled by both monetary and fiscal stimulus as well as pent-up demand. Furthermore, it is safe to say the economy isn't in recession today, even though throughout the nine years of this expansion a recession has been the bogeyman many have felt was always lurking just around the corner.

So that leaves us with trying to determine whether we are in the middle or late stage of the current cycle, with the former meaning that risky assets, like equities and corporate bonds, have more time to run, and the latter that rallies in risky assets should be more closely monitored for signs of deterioration.

As mentioned earlier, the easy, consensus call is “late cycle,” but as with many things it may not be as clear-cut as that. Analysts have been making the late-cycle call for at least two years, even though this is a stage in the economic cycle that has a typical lifespan of approximately 18 months.

Many of the late-cycle calls that abound today seem to be more dependent upon “elapsed time” than on supporting economic data. For perspective, it is generally assumed that in the middle phase of a cycle the economy gathers momentum

### Phases of the economic cycle



Source - RBC Wealth Management

The easy, consensus call is “late cycle,” but it may not be as clear-cut as that.



## “Late cycle”: Expiration date?

assisted by an accommodative monetary policy stance. This phase is typically the longest. Once the economy actually rolls into the late-cycle stage, signs of overheating are becoming apparent, inflation pressures are building, and monetary policy can be characterized as tight or restrictive.

It appears the economy is currently straddling two stages of the economic cycle, which makes the analysis more challenging.

### Two “mids” before a recession?

The broad characteristics for the middle and late stages of a cycle are both evident today. This expansion has been characterized by long periods of slow growth. Yet GDP for the just-completed Q2 came in at a brisk 4.2%, the fastest pace in four years, largely a result of the fiscal stimulus provided by tax reform measures passed in late 2017. Whether this is a “one and done” result remains to be seen, but as things stand, RBC Capital Markets forecasts annual growth for this year and next to average 3%—above the sluggish trend rate but still not overheated by most measures.

The broad characteristics for the middle and late stages of a cycle are both evident today.

We know the Fed has a 2% target for inflation, but only recently has its favored measure, core personal consumption expenditures (PCE), matched this number. Meanwhile, policymakers have yet to express any concerns about building price pressures. Unemployment recently touched 3.8%, its lowest level since the 1960s, but at the same time has failed to produce a surge in wage pressure. Finally, even after seven rate hikes since December 2015, Fed policy still cannot be classified as restrictive. The idea of a “neutral rate” for fed funds, where policy would be deemed neither tight nor loose, is a topic of debate by the Federal Open Market Committee. Policymakers are uncertain as to the exact level of the neutral rate; estimates vary across a range from 2.25%–3.00%, but most Fed officials believe it to be around 2.75%. Hence, at current levels, fed funds are only three quarter-point rate hikes away from neutral.

The point to be made here is that by looking at these measures it is hard to say with confidence in which stage the economy is currently positioned—it still exhibits both mid- *and* late-cycle characteristics.

So, arguing for the mid-cycle assessment, growth has been speeding up to an above-trend pace closer to 3%; inflation seems contained and, in any case, isn’t yet bothering the Fed; while monetary policy remains accommodative and credit conditions benign.

Turning to the late-cycle side of the ledger, growth may be peaking—most forecasts (including our own) have it subsiding somewhat next year and further in 2020; inflation has been moving up, not down, and extreme tightness in the labor market together with very little excess capacity left in the economy suggest price pressures could build from here; and, finally, the Fed is committed to further rate hikes, and its own “dot plot” (which captures the Fed’s forecasts for the path of future rate hikes) suggests the fed funds rate will reach or surpass the neutral rate next year.

# “Late cycle”: Expiration date?

## Global Portfolio Advisory Committee economic indicator scorecard

Indicator	Status		
	✓	-	-
Yield curve (1 year vs. 10 years)	✓	-	-
Unemployment claims	✓	-	-
Unemployment rate	✓	-	-
Conference Board Leading Index	✓	-	-
ISM new orders minus inventories	✓	-	-
Fed funds vs. nominal GDP growth	✓	-	-

Expansion

Neutral

Recessionary

Unanimous readings consistent with the economic expansion having further to run.

Source - RBC Global Portfolio Advisory Committee

### There must be more

With so much noise surrounding this issue, it would be useful to have some guideposts to mark the economy’s transition from one phase of the cycle to the next.

Eric Lascelles, chief economist for RBC Global Asset Management, recently released his latest quarterly business cycle review, which tracks 17 different factors that exhibit different behaviors at different stages of the cycle. His assessment is that the U.S. economy is displaying late-cycle characteristics that suggest the economy has one to two years before the current business cycle ends. His analysis cites the “absence of economic slack, big job gains, a long run up in equities, a high level of confidence, and a few wobbles in the credit space.”

Our scorecard of a half-dozen forward-looking economic indicators, shown in the table above, gives unanimous readings consistent with the economic expansion having further to run. So all in, even though mid- to late-cycle indicators are elevated, recession risks remain low for now. This is notable because recessions have always been associated with equity bear markets and a challenging time for some parts of the fixed income market.

### Global wildcards

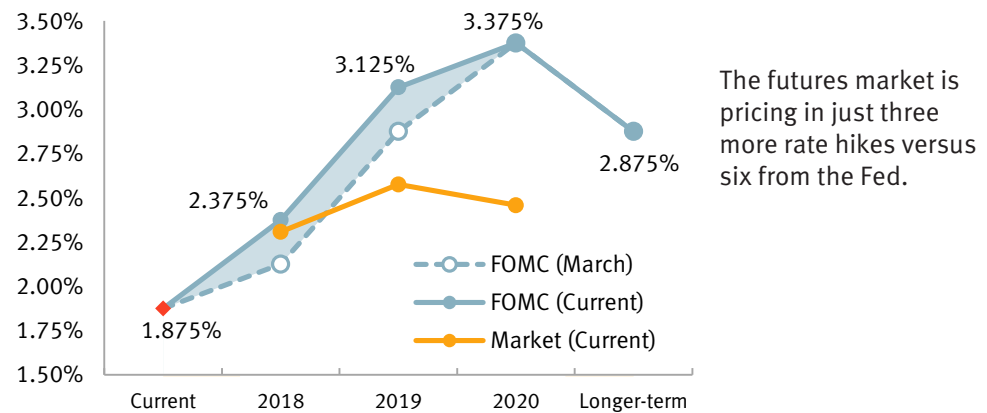
The current environment, which features fast-changing trade disputes, the imposition of tariffs, uneven growth across various regions, and geopolitical concerns, poses a number of challenges for the global economy. The question, in our view, is not so much whether any one or all of these would cause the U.S. economy to dip into a recession, but whether they might accelerate the economy’s path through the cycle lifespan.

So far, the answer has been “no.” The U.S. economy has displayed a high degree of resiliency in recent years as economic performance was unaffected by events in China in late 2015 and Brexit in 2016. For the most part, the same can be said for all the developed economies and many emerging ones as well.

It is likely the U.S. economy will be able to withstand the challenges posed by trade disputes, but these could, depending upon their duration, push the U.S. economic data more decisively into the late-cycle column. Unresolved, these disputes could make the next recession more challenging when it eventually arrives.

## “Late cycle”: Expiration date?

### End of tightening cycle in sight according to market pricing



Source - RBC Wealth Management, Bloomberg, Federal Reserve; data through 8/27/18

### The Fed could tip the scale

The timing of any economic downturn puts the focus squarely on Fed policy. Credit that is more difficult to come by and too expensive has typically been the factor that has tipped the U.S. economy into a slowdown and recession.

To date, the Fed's policy actions have been referred to as “normalization” or “quantitative tightening,” essentially removing the excess stimulus put in place in response to the Great Recession, not restrictive monetary policy. However, in our view, policy could be nearing an inflection point: after seven rate hikes the Fed's “dots” suggest policymakers are only halfway through the current tightening cycle, while market expectations—with which we agree—suggest only three more hikes are warranted.

If the Fed pursues the more aggressive path it laid out in the spring, this could turn policy restrictive sometime next year, driving the weight of the evidence even more fully into the late-cycle column. It would also legitimize, for the first time in this cycle, discussions about a recession being on the horizon.

### Timing is always everything

As has been the case for some considerable time, the U.S. economy is exhibiting both mid- and late-cycle characteristics. Gradually the evidence for a late-cycle interpretation has become predominant. We think that will go on being the case until credit conditions become restrictive enough to make a recession inevitable, but it is important to remember that “late cycle” doesn't mean “end of cycle.”

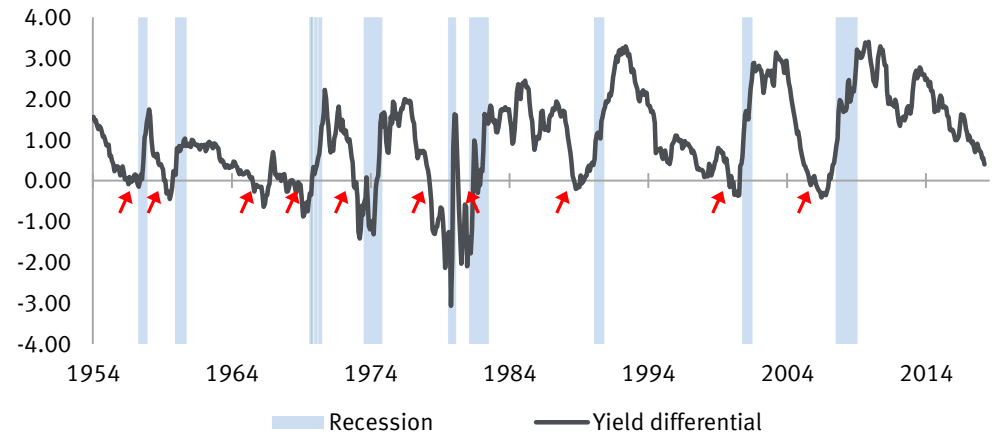
So far, monetary conditions have not reached that level of tightness and are unlikely to reach such a point before next year, perhaps beyond. Once “tight money” arrives it is typically a year or so before a recession gets underway. But so-called risk assets can begin to suffer well ahead of the recession start date.

It is likely the U.S. economy will be able to withstand the challenges posed by trade disputes.

## “Late cycle”: Expiration date?

### Yield differential between the U.S. 10-year Treasury note and the 1-year note

Arrows indicate points where the yield curve inverted



Source - RBC Wealth Management, Federal Reserve Bank of St. Louis; data through 8/1/18

In our view, it is too early to become aggressively defensive with respect to either equities or fixed income. But thinking ahead of time about what such eventual defensive positioning would look like is always appropriate and highly recommended.

# Earning confidence

Global Purchasing Managers' Indexes (economic activity indexes) rolled over in the spring and have declined for six of the past seven months. While they remain comfortably at levels consistent with economies that are still expanding (above 50), the weakening readings suggest that momentum has peaked and that global GDP growth rates will soften in the second half, and perhaps further in 2019.

That looks reasonable to us. It also appears the U.S. economy is better positioned than most to buck that trend. In the current year, fiscal stimulus (tax cuts and new spending) will have added about 1% to U.S. GDP. Next year it will likely be closer to 2%, before subsiding to nothing in 2020. That should be more than enough to overcome weaker exports stemming from slower growth abroad, trade frictions, and the stronger dollar. However, we believe it will be tougher to overcome the growing drag from higher interest rates, which has already put a damper on house sales and home buying intentions, as well as auto sales.

To some extent, equity markets have been pricing in the “higher earnings but slower growth” prognosis facing

## Equity views

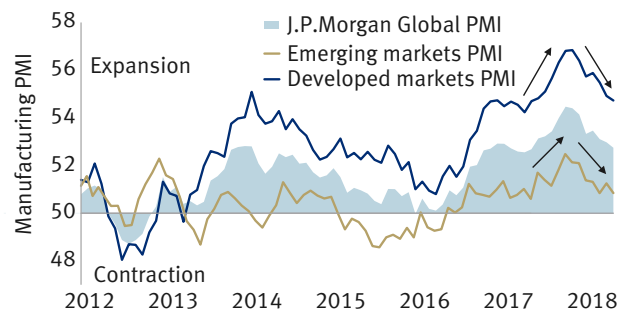
Region	Current
Global	+
United States	=
Canada	=
Continental Europe	=
United Kingdom	=
Asia (ex-Japan)	=
Japan	=

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

most major economies in 2019. Price-to-earnings ratios range from “fullish” in the U.S. where even the slower growth rate we expect would qualify as robust, to “inexpensive” in Europe and Japan where growth prospects are more subdued and less certain.

As long as the economic data continues to support confidence in next year's earnings estimates and in the idea that the next downturn/recession lies in 2020 or beyond (see the “GPAC economic indicator scorecard” on page 16), then global equity portfolios should be able to deliver worthwhile, all-in returns in the coming 12 months. That view stands behind our recommended moderate Overweight commitment to equities.

Global Purchasing Managers' Indexes (PMIs)



Global growth momentum has peaked as trade worries mount.

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Note: PMI refers to Purchasing Managers' Index for manufacturing sector, a measure for economic activity. Source - Haver Analytics, RBC Global Asset Management

## Regional highlights

### United States

- The U.S. equity market remains laser-focused on bread-and-butter issues like economic momentum and earnings growth rather than on political drama, tweets, and tariff tiffs that dominate headlines. The S&P 500 climbed to a new all-time high in August as forward-looking indicators continued to point to sturdy economic activity in the next year.
- While trade spats pose risks and could generate market volatility or cause a pullback—especially the disputes with China—we believe the U.S. economy is strong enough to withstand the challenges given the worst-case scenario of a full-on global trade war seems unlikely.
- The earnings growth rate likely peaked earlier in the year, although S&P 500 profits surged 24.9% y/y in Q2 and should also top 20% in Q3. We estimate corporate tax cuts represent roughly eight percentage points of growth in both quarters. The tax cut boost will drop out of the year-over-year growth calculation in Q1 2019, although indirect benefits of the tax cuts will continue to boost earnings at least through next year. S&P 500 earnings should rise in the high single-digit to low double-digit range

in 2019, depending on the strength of the economy. We remain constructive on U.S. equities.

### Canada

- The S&P/TSX has underperformed the S&P 500 in 2018 as returns in Canadian Energy and Financials have been modest, while the Materials sector has declined. In our view, the S&P/TSX's multiple discount—15.6x forward earnings relative to the S&P 500 at 17.9x—is appropriate given domestic-specific headwinds such as the impact of higher interest rates on consumers and the housing market, trade policy uncertainty, and economic competitiveness challenges. We remain Market Weight on Canadian equities.
- The consensus S&P/TSX earnings estimate for 2019 is up 6% since the start of the year. That would be a 13% advance on the 2018 estimate. The improvement reflects better growth from the Energy sector. RBC Capital Markets forecasts an average WTI price of \$76 per barrel in 2019. The primary risk comes from the threat that trade conflagrations could dent global growth and erode estimated consumption.
- Bilateral trade talks between the U.S. and Mexico have yielded an agreement that bridges the divide

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### S&P 500 2018 return decomposition

	Forward P/E ratio	x	Forward EPS	=	S&P 500 Index level
Year-end 2017	18.2x	x	\$147.23	=	2,673
August 31, 2018	17.2x	x	\$169.12	=	2,901
<b>Change</b>	<b>-5.5%</b>		<b>14.9%</b>		<b>8.5%</b>

Source - RBC Wealth Management, Thomson Reuters I/B/E/S; data through 8/31/18; Note: Forward refers to next twelve-month figures

As EPS growth surges in 2018, valuations become more reasonable while U.S. equity markets still manage to deliver slightly better-than-average gains at the same time.



over auto rules in a revised trade pact. It is generally accepted that Canada is aligned with the U.S. on autos and it has rejoined talks now that the U.S. and Mexico have settled their differences. We caution that even if auto rules are settled, several contentious issues remain unresolved including a potential sunset clause and dispute resolution procedures.

- According to Bloomberg, Finance Minister Morneau will introduce measures to address Canadian competitiveness in his fall update. Given deficit considerations, any changes may provide accelerated capital cost deductions rather than a reduction in the corporate tax rate.

### Continental Europe & U.K.

- We maintain our Market Weight view on European equities. European economic growth remains solid, while the factors that have supported the domestic recovery persist, including an improving labour market and accommodative European Central Bank policy.
- On a relative P/E basis, European equities look fairly valued compared to global equities. In absolute terms, trading on a forward P/E of 13.4x is reasonable, in our view, given

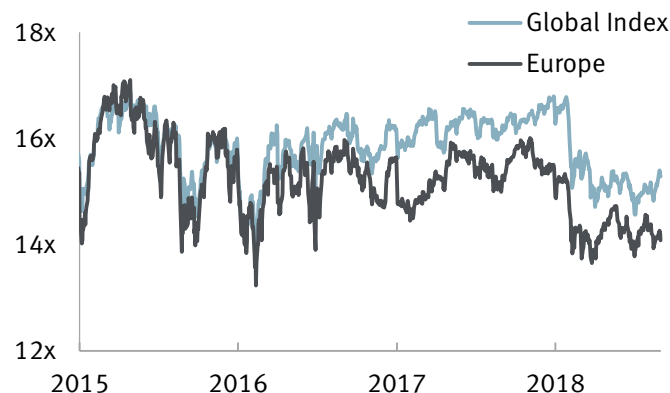
consensus forecasts call for high single-digit earnings growth for 2018 and 2019.

- The Italian political situation remains a risk. The ruling populist government may take a confrontational stance during approval of the country's budget with the European Commission in October. Although we believe that the government is likely to compromise on its budget demands eventually, markets may focus on the risk of an Italian debt crisis. Elevated political risk could hold back investor flows into European equities in a relative context.
- We continue to have a bias towards high-quality companies with global franchises and strong competitive positions.
- For our perspective on U.K. equities, where we remain Market Weight, see [As the Brexit clock ticks down, what now?](#)

### Asia

- The MSCI Asia Pacific Index is down 4.7% in 2018. The trade dispute rumbles on between the U.S. and China, impacting market sentiment in Asia. We see little chance of a favourable resolution in the short

### Next 12-month P/E ratios



European valuations appear reasonable relative to global peers in light of expectations for corporate earnings growth and European economies.

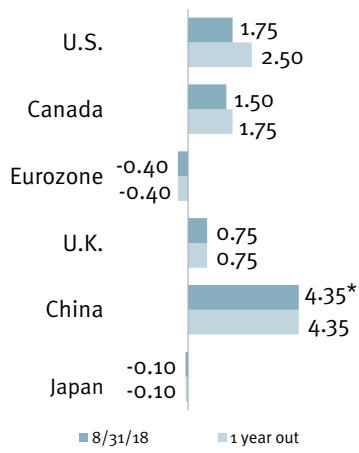
Source - RBC Wealth Management, Bloomberg; Global Index is MSCI ACWI Index, Europe is the MSCI Europe Index; data through 8/31/18

term as the U.S. is effectively demanding that China change its laws, regulations, and behaviours with respect to accessing U.S. technology. See [\*In the trenches of the China and U.S. trade dispute.\*](#)

- Mainland China equities have been notably weak since May as the trade dispute has escalated. The Shanghai Composite reached its lowest level since early 2016 and the Shenzhen Composite its lowest since January 2015. Efforts to curtail credit growth in certain areas, known as “financial deleveraging,” are also having an impact, in our view.
- We continue to have a preference for Japanese equities among the major Asian markets. The TOPIX Index is down 4.5% in 2018, also feeling the heat of the trade dispute. However, the most recent quarterly results from Japanese companies generally beat consensus estimates. TOPIX earnings growth was robust at nearly 9% y/y. The yen has been steady against the dollar. Japanese equity valuations remain undemanding. A win for Prime Minister Shinzo Abe in September’s Liberal Democratic Party leadership election, held every three years, would be viewed positively by investors.

# A pause that refreshes

Central bank rate (%)



\*1-yr base lending rate for working capital, PBoC  
 Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

Since its first rate hike in December 2015 the Federal Reserve has paved the way for other central banks to normalize monetary policy. To date, the Fed has raised rates seven times and is poised to move again later this month. As for others, it is now a “three-horse race” with the Bank of Canada (BoC) and the Bank of England (BoE) joining the Fed. But just as the Fed jump-started the process, it could also be the first to pause, setting the stage for others to follow.

The August meeting of the Fed’s policy-setting Federal Open Market Committee all but confirmed a September rate hike. Similarly, the BoC is expected to soon add another, likely in October, its fifth since July 2017. The BoE moved in August, its second hike since rates bottomed in 2017, but indications are its pace could be much slower—one rate increase per year through 2020. The European Central Bank, on the other hand, has signaled its first hike likely won’t occur before the second half of 2019.

The Fed’s policy plans past September are less clear. Fed Chair Jerome Powell’s language in a July speech, confirmed at the Jackson Hole symposium, was seen as introducing the possibility the Fed might end the current tightening cycle sooner than many expect (see the U.S. section below). Given the Fed’s lead role, this could usher in an earlier-than-anticipated pause by other central banks as well.

## Regional highlights

### United States

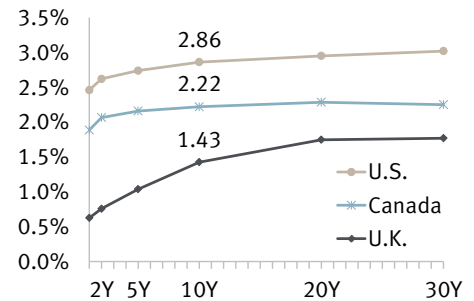
- Federal Reserve August meeting minutes provided clues regarding monetary policy *after* the September

## Fixed income views

Region	Gov’t Bonds	Corp. Credit	Duration
Global	–	+	5–7 yr
United States	–	+	7–10 yr
Canada	=	=	3–5 yr
Continental Europe	=	+	5–7 yr
United Kingdom	=	=	5–7 yr

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

## Sovereign yield curves



Source - Bloomberg

meeting, when a rate hike is widely expected. The minutes noted that in the “not too distant future” existing language stating that policy remains accommodative may no longer be appropriate. To us, this is a sign we are nearing the end of the tightening cycle. Our expectation is that Fed officials will raise rates at the September meeting and subsequently modify language to note that policy remains only “moderately” accommodative. We expect no rate hike in December, and just one or two in 2019 before the Fed pauses, as rates will have

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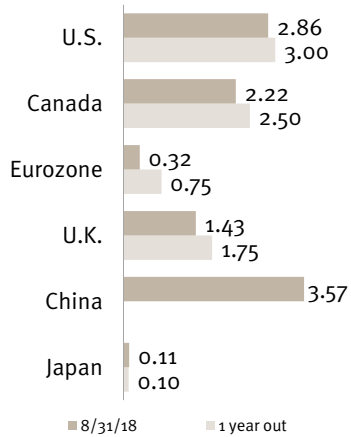
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# Global fixed income

## 10-year rate (%)



Note: Eurozone utilizes German Bunds.  
 Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

reached levels that we think will be consistent with “neutral,” the point where monetary policy is neither accommodative nor restrictive to economic growth.

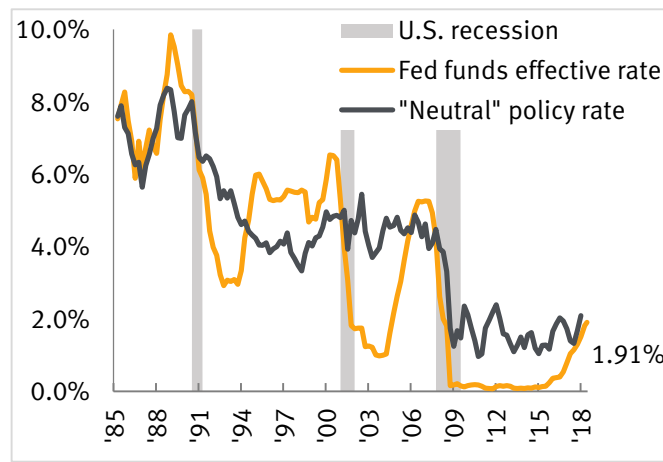
- Investment-grade corporate bond yields compressed toward Treasury yields during August after widening for much of the year as the sector fell out of favor. The 10-year Treasury yield fell 10 basis points, driving the more interest-rate-sensitive investment-grade sector to outperform speculative-grade corporates. After losing 3.3% in the first half of the year, investment-grade bonds have returned 1.33% since then, with 0.49% of that coming in August. We expect stable long-term Treasury yields and softening supply to support investment-grade corporate bonds for the remainder of the year.
- Municipal investors continued to crowd the front end of the yield curve, keeping the ratio of municipal yields to comparable Treasury yields at just 65% and 74% for 2- and 5-year bonds, respectively. This leaves the

value in the muni market in the long end of the curve, where investors can capture over 101% of the 30-year Treasury yield.

## Canada

- Market speculation has increased that the Bank of Canada (BoC) might raise interest rates again, as early as September, after a string of better-than-expected data that has increased Q2 growth forecasts. The headline Consumer Price Index also topped 3% in July, the highest level in seven years, although this was largely driven by temporary factors including energy and airfares. Core inflation remains around the central bank’s target rate of 2% and with the output gap (the difference between actual economic output and what could be achieved) largely closed, we think the BoC will be of the opinion that higher interest rates are warranted over time. With that said, we think an October rate hike is more likely given the BoC is mindful of the impact that higher interest rates are having on highly leveraged Canadian households.

## Fed policy rate on verge of no longer being accommodative



In our view, the Fed is near the end of its tightening cycle, with policy near “neutral.”

Note: Policy is restrictive when fed funds rate is above the neutral rate, accommodative when below.  
 Source - RBC Wealth Management, Bloomberg, Lauchbach Williams Estimate of the Natural Rate of Interest + Core PCE inflation y/y through 3/31/18; fed funds effective rate through 8/22/18

- The yield curve continues to flatten in Canada, but we think the bond market is not fully pricing in the inflation risks, which we view as more tilted towards the upside. Adding in our expectation that the BoC will likely remain in a slow and gradual hiking path creates a risk that longer-dated yields may push higher in Canada. Our focus remains on short-to-intermediate-maturity federal bonds, with a bias towards discounted issues.
- Investment-grade credit spreads were a touch wider in August, leading Canadian corporates to underperform their U.S. equivalents for which spreads tightened. With a number of risks continuing to circle, volatility across global risk assets has picked up over the summer months and while spreads remain tight and corporate paper is in demand, we think this provides an opportunity to upgrade quality.

### Continental Europe & U.K.

#### Europe

- Monetary policy remains accommodative in Europe. We expect the European Central Bank (ECB) to keep the deposit rate unchanged, in

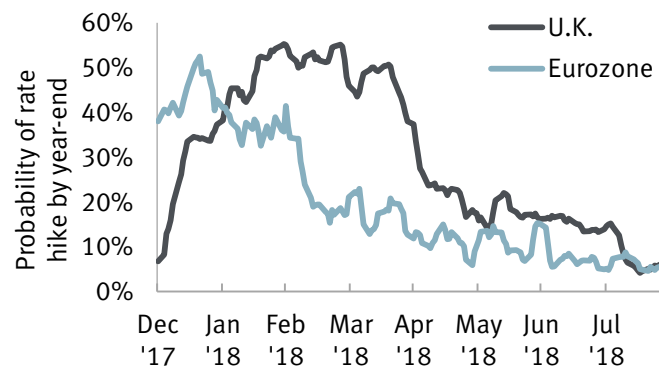
line with its stated policy, “at least through the summer of 2019.”

- Although Q2 eurozone wage growth suggests a potential uptick in inflation, much of this has been driven by the German economy. German growth is expected to ease slightly over the coming months; hence, the feedthrough of wage growth into higher inflation could be a slow process. We don’t anticipate a rate hike before the ECB’s expected time frame of late next year.
- We prefer European corporate bonds to government bonds given leading economic indicators suggest GDP growth should remain sufficiently strong, above 2% y/y.
- Our preference remains for economically sensitive industries including cyclicals and financials, which should benefit from positive economic momentum.

#### U.K.

- In early August, the Bank of England (BoE) increased the Bank Rate to 0.75% from 0.50% as we anticipated, with a unanimous vote. However, there are no expectations for a steep series of rate hikes. Brexit dominates economic and political

### European central banks expected to keep rates steady through year-end



Easing growth estimates and continued Brexit uncertainty should keep central banks on hold in 2018.

Source - RBC Wealth Management, Bloomberg; probabilities of rate hikes at December Central Bank meetings implied by OIS rates; data through 8/30/18

considerations and we expect the BoE to stick to one increase each year through 2020.

- Gilts have performed well against other developed markets' government bonds so far this year and we see this trend persisting. Further economic weakness in the U.K. from Brexit may lead to a prolonged flight to quality and safer assets, in our view. With this possibility in mind, we are upgrading our view on Gilts to Market Weight while maintaining our preferred part of the yield curve to between five and seven years, with a bias towards the shorter end of the range.
- While we continue to see compelling valuations for corporate credit, with spreads 120bp higher than government bond yields, we prefer bonds issued by companies with global revenue bases and good earnings visibility.

## Asia

- Asian credit continued to buck the downward trend in August on the back of stable U.S. Treasury yields and spread tightening, together with easier credit policy from the Chinese government. Since the China Banking Regulatory Commission issued a statement in July emphasizing the importance of banks providing financing to private enterprises, the market has experienced some temporary corporate refinancing relief. However, we believe China will ultimately resume its deleveraging efforts in order to support long-term economic reform goals. Large-cap companies with access to a variety of financing channels should see some relief, while small-cap companies that rely heavily on the bond market may remain under pressure.
- For the second half of 2018, we remain cautious on Asian credit due to a higher maturity wall in the Chinese onshore bond market. According to Standard Chartered research, onshore bonds with put options are projected to rise to north of RMB 800B in the second half of the year, which is roughly 1.5 times the value in the first half of 2018. While issuers have the option to step up the coupon in an effort to persuade investors to stay on, investors seem more focused on credit risk and more inclined to exercise put options, in our view.
- Looking past the domestic financing challenges, Sino-U.S. trade tensions have been quickly ratcheting up and may continue to linger. However, if we take a closer look, CLSA research estimates that tariffs on \$50B of Chinese goods will only reduce China's gross export receipts by \$6B, an insignificant number for a \$13T economy. As such, we believe credit fundamentals should not be impacted at the current stage.



## Peak lumber

### Commodity forecasts

	2018E	2019E
Oil (WTI \$/bbl)	67.77	75.91
Natural Gas (\$/mmBtu)	3.00	2.85
Gold (\$/oz)	1,309	1,300
Copper (\$/lb)	3.22	3.25
Corn (\$/bu)	3.80	4.00
Wheat (\$/bu)	4.95	4.90

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (corn and wheat)

Lumber soared by almost 200% from fall 2015 to an all-time high in the spring of this year. Then came an abrupt decline—down 30% to \$440 per thousand board feet in just three months.

The blowout record high price was posted during a period of comparatively anemic new house construction. Yes, U.S. housing starts, 1.3 million units in May, were up a long way from the ultra-depressed 480,000 unit low in the Great Recession. But every housing peak back to the 1950s has typically been either side of 2 million units. Why this unprecedented surge in lumber prices in a period of cyclically disappointing housing starts?

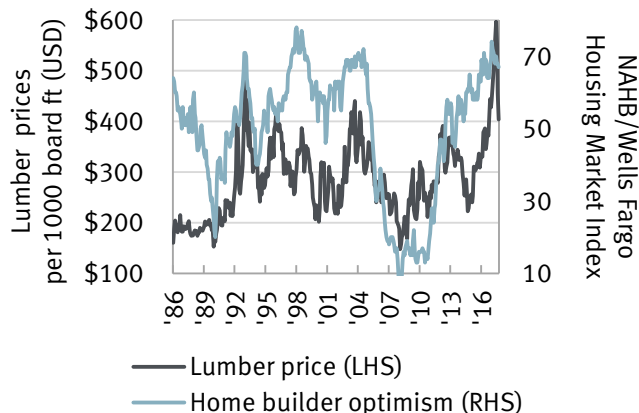
At least three factors are not visible in the housing start data. Because the square footage of the average home has been rising steadily, 1.3 million starts today might consume as much lumber as, say, 1.6 million starts 20 years ago. Second, because affordability has worsened with rising home prices, spending on upgrading existing dwellings has risen sharply. Lumber used in repair and remodeling, a big part of lumber demand, has surged independent of new house construction.

Supplies of timber have also become constrained and more expensive. The annual allowable cut in British Columbia, a very large source of lumber for the U.S. market, has been permanently reduced. And finally, the tariff imposed on Canadian softwood lumber sold into the U.S., in a period of relatively tight supply, allowed all producers to raise prices by the amount of the duties.

Now the sales of homes are well off their peaks of last year. Inventories of unsold homes are up, while housing starts and permits have rolled over as has home builder optimism. Meanwhile, surging lumber prices brought smaller, less efficient sawmillers back into production.

Lower prices plus time will eventually right-size the supply of lumber, in our opinion. But falling lumber prices won't improve home affordability, which is worsening as mortgage rates rise. Lumber prices should establish some new equilibrium range. But it looks like the May peak, which itself was almost 50% higher than any prior peak in at least 30 years, will stand as the high water mark for this cycle.

### Lumber prices vs. home builder optimism



Has the cyclical peak come and gone?

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Source - RBC Wealth Management, Bloomberg and National Association of Home Builders; data through 8/30/18

# Currencies

## Currency forecasts

Currency pair	Current rate	Forecast Jun 2019	Change*
<b>Major currencies</b>			
USD Index	95.14	95.94	1%
CAD/USD	0.76	0.79	4%
USD/CAD	1.30	1.26	-3%
EUR/USD	1.16	1.16	0%
GBP/USD	1.29	1.25	-3%
USD/CHF	0.96	1.07	11%
USD/JPY	111.03	119.00	7%
AUD/USD	0.71	0.72	1%
NZD/USD	0.66	0.71	7%
EUR/JPY	126.18	138.00	9%
EUR/GBP	0.89	0.93	4%
EUR/CHF	1.12	1.24	11%
<b>Emerging currencies</b>			
USD/CNY	6.83	7.20	5%
USD/INR	70.99	69.00	-3%
USD/SGD	1.37	1.37	0%

\* Defined as the implied appreciation or depreciation of the first currency in the pair quote.

Examples of how to interpret data found in the Market Scorecard.

Source - RBC Capital Markets, Bloomberg

### U.S. dollar: Upswing intact –

Investors seeking safe assets amidst emerging market turmoil pushed the dollar to its highest level against a basket of currencies in more than a year in August. The rally was further abetted by strong consumer demand, a pass-through of import tariffs that underpinned firm price growth, and signs the Fed will tighten monetary policy further. Widening rate spreads in favour of the U.S. should continue to support the dollar through year-end.

**Euro: Under pressure –** Fears of European banks' exposure to escalating turmoil in Turkey sent the euro tumbling in August, extending its decline against the dollar seen since April. Protracted volatility in Turkey could keep the euro vulnerable, in our view; but it will likely be growing uncertainty leading up to the mid-October Italian budget deadline alongside widening rate spreads in favour of the dollar that could see euro weakness prevail over coming months.

### British pound: All about Brexit –

Downward pressure on the pound accelerated in August with the currency slipping to year-long lows against both the dollar and euro. Investors' concerns over the prospect of a less-than-smooth Brexit transition outweighed confirmation that the U.K.

economy rebounded from a slowdown earlier in the year. Given domestic political frictions and still challenging negotiations around the U.K.'s exit from the EU, we see scope for further pound weakness throughout 2018.

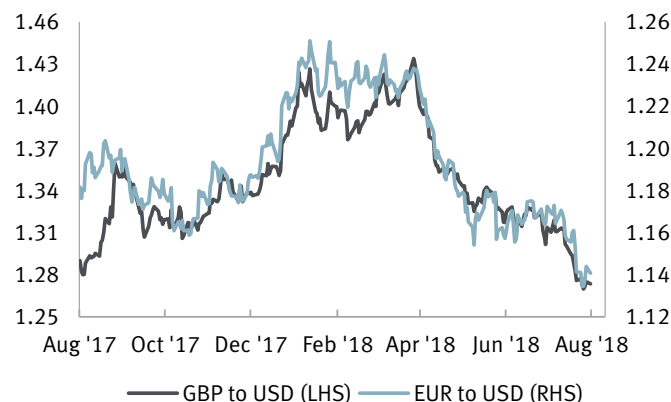
### Canadian dollar: Hikes in the pipeline –

Evidence of price pressures building alongside reports of solid economic activity is bolstering investor confidence on the health of the Canadian economy, with knock-on effects to the currency. An economy running close to capacity positions the Bank of Canada to further raise interest rates through early 2019, in our view. This should help to support the currency trending broadly sideways through year-end 2018, barring an about-turn in US-Canada trade relations.

### Japanese yen: Benign policy for now –

The Bank of Japan's (BoJ) announcement that it will commit to keeping monetary policy rates at "extremely" low levels for an "extended" period of time points to highly accommodative policy persisting. Accordingly, with the currency showing a lack of its risk-aversion properties to rising geopolitical tensions and the BoJ reiterating a cautious stance, we see little need to adjust our neutral outlook for the yen.

### Pressure builds against the pound and euro



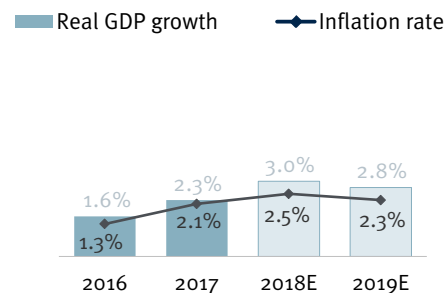
The U.S. dollar gathered momentum against the euro and pound in August as political risks weighed on investor sentiment.

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Source - Bloomberg, RBC Wealth Management; data through 8/18/18

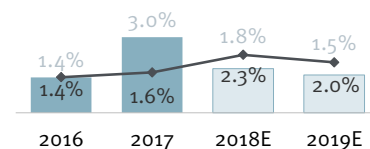
## United States — Another rate hike

- Q2 GDP was revised higher to 4.2% q/q, and another 25 bp rate hike is expected from the Fed in September. Hiring slowed to 157k in July, weighed down by 32k retail jobs lost in the Toys “R” Us bankruptcy. Housing is expected to be a net detractor to economic growth in H2, with elevated prices and higher mortgage rates weighing on affordability and sales.



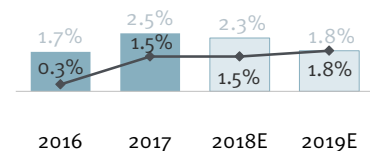
## Canada — BoC to hold

- Hiring reaccelerated at a 54.1k pace, pushing the unemployment rate down to 5.8%, lowest since 2007. Q2 GDP remained robust at 2.9% q/q with stronger-than-expected oil production. While trade disputes don’t appear to be materially impacting activity, trade uncertainty weighs on business and consumer confidence. The BoC is expected to hold rates in September at 1.50%.



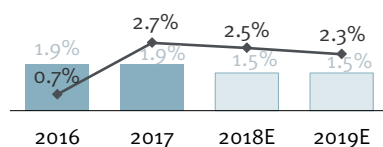
## Eurozone — Trade dispute continues

- The EU’s trade “truce” with the U.S. was short-lived, with President Trump calling the EU a currency manipulator. Eurozone manufacturing PMI increased despite auto tariffs, while services PMI fell, dragging the composite lower. The ECB plans to cap its bond-buying program in December at €2.6 trillion (\$3T), and keep interest rates low through summer 2019. Italian bond yields rose as Italy’s economy continues to lag euro-area peers.



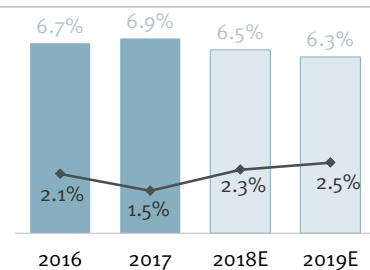
## United Kingdom — Brexit outcome weighs

- The Bank of England (BoE) started August with a rate hike, and inflation accelerated to 2.5% y/y from 2.4% y/y, though the pickup appears to be temporary. Core services inflation held steady at 2%, and wage growth slowed to 2.4% y/y from 2.5% y/y. Consumer credit growth slowed on rising borrowing costs, but Brexit uncertainty should keep the BoE from tightening again until 2019.



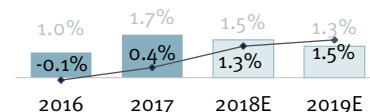
## China — Slower

- Economic growth has hit a mid-year lull, as the trade war with the U.S. deepens and credit restrictions take effect. Fixed asset investment rose just 5.5% y/y, the slowest pace since 1999, and retail sales dipped to 8.8% y/y from 9.0% y/y. Unemployment increased. That, coupled with slowing growth and falling stock prices, prompted easing measures including tax cuts and lower reserve ratios.



## Japan — Growth pickup

- Q2 GDP grew 1.9% q/q annualized, offsetting a 0.9% decline in Q1 as private consumption increased 0.7% q/q and business investment rose 1.3% q/q. Consumption was fueled by a 3.6% surge in labor cash earnings, but this may not be sustainable as it was primarily due to bonuses. Capex, while strong, is exposed to trade conflict and slowing Chinese growth.



Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management

# Market scorecard

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	2,901.52	3.0%	8.5%	17.4%
Dow Industrials (DJIA)	25,964.82	2.2%	5.0%	18.3%
NASDAQ	8,109.54	5.7%	17.5%	26.1%
Russell 2000	1,740.75	4.2%	13.4%	23.9%
S&P/TSX Comp	16,262.88	-1.0%	0.3%	6.9%
FTSE All-Share	4,106.14	-3.5%	-2.7%	0.8%
STOXX Europe 600	382.26	-2.4%	-1.8%	2.2%
EURO STOXX 50	3,392.90	-3.8%	-3.2%	-0.8%
Hang Seng	27,888.55	-2.4%	-6.8%	-0.3%
Shanghai Comp	2,725.25	-5.3%	-17.6%	-18.9%
Nikkei 225	22,865.15	1.4%	0.4%	16.4%
India Sensex	38,645.07	2.8%	13.5%	21.8%
Singapore Straits Times	3,213.48	-3.2%	-5.6%	-1.9%
Brazil Ibovespa	76,677.53	-3.2%	0.4%	8.2%
Mexican Bolsa IPC	49,547.68	-0.3%	0.4%	-3.2%
Bond yields	8/31/18	7/31/18	8/31/17	12 mo. Chg
US 2-Yr Tsy	2.627%	2.669%	1.326%	1.30%
US 10-Yr Tsy	2.860%	2.960%	2.117%	0.74%
Canada 2-Yr	2.070%	2.069%	1.275%	0.80%
Canada 10-Yr	2.228%	2.310%	1.849%	0.38%
UK 2-Yr	0.731%	0.772%	0.176%	0.56%
UK 10-Yr	1.427%	1.330%	1.034%	0.39%
Germany 2-Yr	-0.605%	-0.570%	-0.727%	0.12%
Germany 10-Yr	0.326%	0.443%	0.361%	-0.04%
Commodities (USD)	Price	1 month	YTD	12 month
Gold (spot \$/oz)	1,201.40	-1.9%	-7.8%	-9.1%
Silver (spot \$/oz)	14.54	-6.3%	-14.2%	-17.4%
Copper (\$/metric ton)	5,968.00	-5.0%	-17.2%	-11.7%
Uranium (\$/lb)	26.45	2.3%	10.7%	31.3%
Oil (WTI spot/bbl)	69.80	1.5%	15.5%	47.8%
Oil (Brent spot/bbl)	77.42	4.3%	15.8%	47.8%
Natural Gas (\$/mmBtu)	2.92	4.8%	-1.3%	-4.1%
Agriculture Index	286.06	-3.4%	1.4%	2.2%
Currencies	Rate	1 month	YTD	12 month
US Dollar Index	95.1400	0.6%	3.3%	2.7%
CAD/USD	0.7667	-0.3%	-3.6%	-4.3%
USD/CAD	1.3040	0.3%	3.7%	4.5%
EUR/USD	1.1602	-0.8%	-3.4%	-2.6%
GBP/USD	1.2960	-1.2%	-4.1%	0.2%
AUD/USD	0.7189	-3.2%	-7.9%	-9.5%
USD/JPY	111.0300	-0.7%	-1.5%	1.0%
EUR/JPY	128.8400	-1.5%	-4.8%	-1.6%
EUR/GBP	0.8955	0.5%	0.8%	-2.8%
EUR/CHF	1.1242	-2.9%	-3.9%	-1.5%
USD/SGD	1.3721	0.8%	2.7%	1.2%
USD/CNY	6.8315	0.2%	5.0%	3.7%
USD/MXN	19.0850	2.3%	-2.9%	6.7%
USD/BRL	4.0540	7.9%	22.5%	28.7%

The NASDAQ outperformed as Tech stocks reported strong earnings.

Treasury yields declined as U.S. economic data consistently missed estimates.

Copper fell into a bear market on concerns of waning global growth.

Increasing likelihood of a “no-deal” Brexit weighed on the pound.

Equity returns do not include dividends, except for the Brazilian Ibovespa. Equity performance and bond yields in local currencies. U.S. 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 0.76 means 1 Canadian dollar will buy 0.76 U.S. dollar. CAD/USD -4.3% return means the Canadian dollar has fallen 4.3% vs. the U.S. dollar during the past 12 months. USD/JPY 111.03 means 1 U.S. dollar will buy 111.03 yen. USD/JPY 1.0% return means the U.S. dollar has risen 1.0% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 8/31/18.

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