RBC WEALTH MANAGEMENT

Global Insight

Perspectives from the Global Portfolio Advisory Committee

Defense mechanisms

Investors should use the recent rally as an opportunity to take a more defensive posture by upgrading the quality of U.S. equity portfolios.

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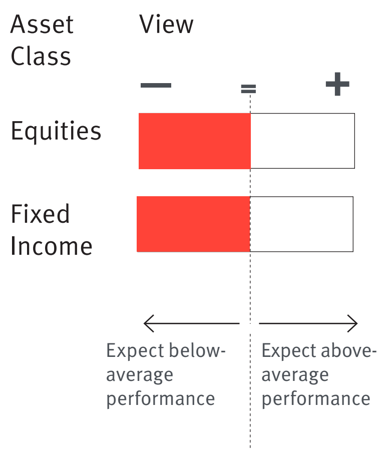

See “Views explanation” below for details

Source - RBC Wealth Management

Equities

- In April, most equity markets built on their rallies as U.S. and Chinese economic momentum improved. The S&P 500 reached a new all-time high, and European bourses performed well despite the persistence of lackluster economic data. “Better-than-feared” Q1 earnings reports also boosted equity prices.
- We continue to believe additional gains are in store for the next 12 months. Valuations remain within reasonable zones and forward earnings expectations seem achievable. While we would maintain total equity exposure at the Market Weight or benchmark level, we recommend adding some defensive ballast to portfolios over time. During the latter part of an economic expansion, trends can shift when least expected. We think the recent rally has created an opportunity to upgrade the quality of portfolio holdings.

Fixed income

- At its May confab the Fed offered few policy changes. Weak global growth and low inflation have fostered easy policy stances by global central banks, which will limit the upside for rates, in our opinion. Even though yield curves have steepened slightly, this doesn’t remove the caution flag since the U.S. economy continues to exhibit late-cycle tendencies. We maintain our view that the U.S. has entered a period similar to the late 1990s, when the Fed adopted a patient stance following a period of tighter policy and yield curves flattened/inverted over a number of years.
- “Reinvestment risk” continues to be an important consideration, and in the U.S. we feel investors should add duration to portfolios. We maintain our Market Weight in global fixed income and recommend investors focus on high-quality assets.

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.

Focus article

Defense mechanisms

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Yes, the stock market has come all the way back and pushed to a record high. No, it's not an unusual time to think about cushioning portfolios. Given the expansion's advanced age and lurking uncertainties, investors shouldn't be caught flat-footed in the event markets get rocky. We look at how to use the recent rally as an opportunity to take a more defensive posture by upgrading the quality of U.S. equity portfolios.

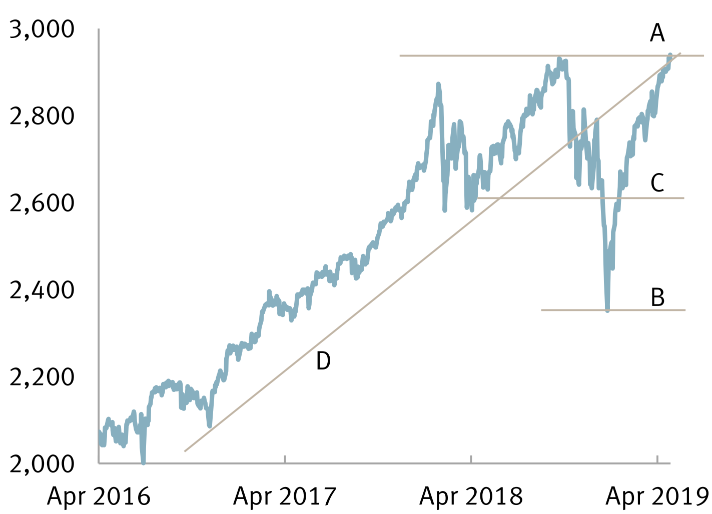
The U.S. equity market has rallied forcefully so far this year, with the S&P 500 climbing 25% since its December 2018 low. It recently pushed above last autumn's peak to reach a new all-time high.

Although the indicators we monitor are signaling positive GDP growth should continue for at least the next year, in our view this is a time to be vigilant.

At nearly 10 years old, the current economic expansion has grown long in the tooth by most of our objective measures. Valuations for major U.S. equity indexes and most sectors, while still reasonable, have shifted to above-average levels. The earnings and revenue growth outlook is much more muted than last year, and the forecast involves greater uncertainties. To this list of fundamental factors we can add potential trade frictions, reduced fiscal stimulus, and political headwinds both at home and abroad.

We think the recent rally has created an opportunity to take a more defensive posture by upgrading U.S. equity portfolios with an eye toward swapping into dividend-paying stocks and improving the overall quality of holdings.

S&P 500 Index with technical guides



Note: Light gray technical guides illustrate the wide trading range (A-B), support (C), and long-term trend (D)

Source - RBC Wealth Management, Bloomberg; daily data through 4/26/19

"The overall range is still in place even after the recent uptrend in the market."

– Bob Dickey, RBC Capital Markets, LLC Technical Strategist

Consistency is key

In our view, dividends should play an even greater role in portfolio construction late in the economic cycle and during recessions. Although dividend payouts have fluctuated over time, historically they have been much less volatile than stock prices, including during challenging periods for equity markets and the economy as a whole. The certainty of dividend returns can provide some welcome ballast when share values are under pressure.

A basket of large-capitalization U.S. dividend-paying stocks has outperformed the S&P 500 in all but one decade since the 1930s. The 1990s was the exception because Technology shares, most of which did not pay dividends, enjoyed a strong run late in the decade that had an outsized influence on overall returns. All of that advantage—and more—was given back in the "tech wreck" bear market early in the following decade.

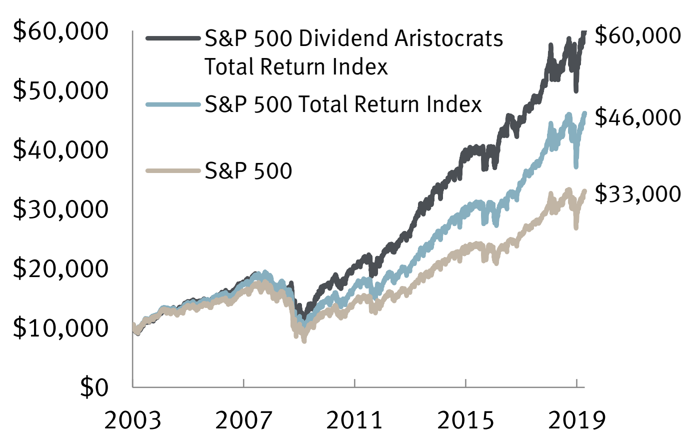
We recommend taking a total-return approach to selecting dividend-paying stocks by considering both income and capital appreciation potential. A third factor, dividend growth, can add substantial extra performance.

A company that has regularly grown its dividend tends to be of higher quality, and more likely to deliver dividend payments consistently over time, than a company that doesn't increase its dividend regularly. Dividend growers also tend to have more capital appreciation potential.

For example, a $10,000 investment in 2003 in the S&P 500 Dividend Aristocrats Total Return Index (comprising companies that have raised dividends annually for at least 25 consecutive years) has increased at almost twice the rate of the S&P 500 and has exceeded the S&P 500 Total Return Index (which includes reinvested dividends) by a meaningful margin (see chart).

RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina views current dividend trends as favorable. Corporate confidence is positive, and this tends to be supportive of higher dividend payments. During the Q4 2018 earnings reporting season, 30% of S&P 500 companies raised their dividends.

Current value of $10,000 investment in 2003



Stocks of companies that consistently grow their dividends (Dividend Aristocrats) have significantly outperformed.

Note: The S&P 500 Dividend Aristocrats Total Return Index measures the performance of S&P 500 Index constituents that have increased dividends every year for at least 25 consecutive years. There are currently 57 companies in this index.

Source - RBC Wealth Management, Bloomberg; daily data through 4/17/19

The strength to persevere

We also think high-quality stocks have the potential to stand up better to the challenges the equity market is currently facing, such as late-cycle economic dynamics and a changing earnings and revenue environment.

A basket of high-quality U.S. stocks has outperformed a basket of low-quality stocks for the past year, including over the last six months when the market corrected and then rebounded.

"High-quality" companies typically exhibit several characteristics including strong free cash flow relative to enterprise value (high free cash flow yield); sturdy balance sheets; and consistent, reliable earnings streams. They also tend to deliver high returns on invested capital and equity, and enjoy high credit ratings (A+ to B+); as a result, they have strong earnings relative to interest expense. Finally, they are typically led by proven, highly regarded management teams.

Companies that grow dividends year in and year out are an important part of the quality basket. Consistent dividend growth has usually been a reliable sign of financial strength and dependable earnings performance versus peers. It is also a sign that management has delivered in good times as well as in challenging ones, and is focused on shareholders.

See our "Quality checklist" at the end of this article.

It's important to keep in mind that "quality" may not persist indefinitely. Economic conditions change, new competitive forces arise, and some companies inevitably stumble. What was a "high-quality" stock 10 years ago may not fit the bill today. In our view, this is one of several factors that support incorporating active portfolio management into the equity investment process.

While on balance our set of recession "early warning" indicators strongly suggests that U.S. economic growth will remain positive through the next 12 months and perhaps longer, it's always possible the next recession could arrive sooner than expected. It's also true that bear markets associated with recessions usually begin some months before the recessions take hold. Prudent portfolio management requires building in a margin of error for being wrong on timing, among other things. We believe now is the right time for investors to assess individual holdings and ask, "Would I be comfortable holding this stock through a protracted economic/market retrenchment?"

RBC Wealth Management U.S. economic indicator scorecard

Indicator	Status		
	Expansion	Neutral	Recessionary
Yield Curve (12-month to 10-year)	–	✓	–
Unemployment Claims	✓	–	–
Unemployment Rate	✓	–	–
Conference Board Leading Index	✓	–	–
ISM New Orders Minus Inventories	✓	–	–
Fed Funds vs. Nominal GDP Growth	✓	–	–

No sign a recession is imminent.

Source - RBC Wealth Management, Bloomberg, FRED Economic Data St. Louis Fed

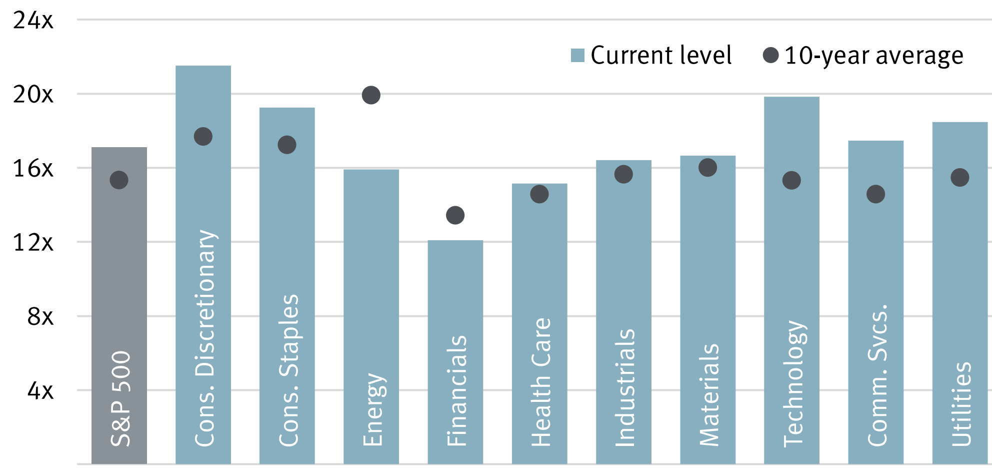
Preparing for turbulence

Whether the S&P 500 breaks out decisively above its very wide trading range of the past year or bounces back and forth within it for some months yet, we think there is scope for additional gains over the next year. Our primary leading economic indicators are signaling that the domestic economy can keep growing at a reasonable pace. Earnings are likely to increase over this period, as are share values.

But it could be bumpy along the way given the possibility of somewhat slower economic growth, a much less robust earnings and revenue growth environment, reduced fiscal stimulus, and lingering trade and political uncertainties. A heightened level of vigilance is warranted.

While we continue to recommend Market Weight or benchmark positions for U.S. equities, and would carry total equity exposure at the same level, the recent strong rally provides an opportunity to take a step toward more defensive positioning in which quality considerations should predominate.

12-month forward price-to-earnings ratios based on consensus forecasts



Note: Real Estate sector not included because data are only available from 9/30/16

Source - RBC Wealth Management, Bloomberg; data through 4/26/19

See our "Quality checklist" on the following page.

Quality checklist

Leading companies – Being the leader in an industry or product segment confers tremendous competitive advantages, which makes top-ranked companies very difficult to dethrone. They offer a successful product or service that has proven itself in the marketplace. Very often they occupy the strongest position in the minds of consumers, and those minds are hard to change. Such companies usually enjoy wider margins and larger profits than their competitors, allowing them to invest more heavily in growing their businesses and in developing new products, or improving old ones, than their competitors can afford to do. "Good management" of these companies largely consists of doing what it takes to hold onto that lead.

Unstressed balance sheets – If a company can consistently generate a higher return on its invested capital than the prevailing rate of interest on debt, then debt becomes a relatively inexpensive form of capital. That's why most companies have some debt. How much debt a company can carry may become an issue in an economic downturn if some or all of that debt has to be refinanced when interest rates may have become prohibitive and capital markets more difficult to access (or impossible, as in the financial crisis).

We would avoid companies with debt loads that could become problematic in a recession. We would be especially alert to large maturities coming due over the next few years, and to restrictive covenants on existing debt that could be triggered in a business downturn, potentially forcing the company into a disadvantageous restructuring.

High internal growth rate – As discussed earlier, dividends are an important component of investment return and growing dividends are even more valuable. But the greatest source of wealth accumulation for the shareholder is the compounding effect of earnings that are not paid out but rather retained in the business, adding to its invested capital. For most successful companies, that internal growth rate is substantially higher than the rate of return available from interest-bearing instruments or most other investable assets including unlevered real estate.

The fact that these retained earnings accumulate and compound inside the company for the shareholder's benefit, usually without attracting personal tax until the shares are sold (and then often at a reduced capital gains rate), makes this the most powerful driver of equity investment returns.

Dividend "quality" – We prefer companies that pay and grow their dividends—but not at any cost. Ideally, paying dividends out to shareholders should be somewhat painful for management teams because they would rather allocate the funds to high-return growth opportunities within the business. To some extent (but not always) a high payout ratio indicates a dearth of such opportunities and signals a slowdown in earnings growth may be somewhere down the road. We also look askance at companies that are only able to achieve steady growth in dividend payments by constantly raising the payout ratio or by borrowing the necessary funds.

Our preference, then, is for companies that can maintain or increase their dividends without impairing their financial conditions or forgoing growth opportunities.

Mood swings

Most but not all major averages have rallied to new highs following the steep September-to-December correction. The early part of the advance from late December looked mostly like a rebound off a deeply depressed, tax-loss-selling-induced low. The rally was widely distrusted. Many were concerned that it would give way to a retest of the lows or worse. A slowdown in Europe prompted fears that an “earnings recession” might take hold in the U.S.

Since February the pace of the advance has slowed, and the fears of a market retrenchment have ebbed. A better-than-expected Q1 in the U.S., some improving China data, and “green shoots” in Germany have eased concerns about this year’s earnings. Fears of a renewed market decline have given way to talk of an impending market “melt-up” and some aggressive index targets for the coming 12 months.

In order to welcome either of these outcomes one would have to see a few developments on the horizon which are not currently there. One would be an upgrade to earnings expectations for the second half of this year, accompanied by growing conviction this more robust momentum would continue through 2020. The first is possible, in our view, but the second is much more problematic.

In order for that earnings optimism to be viable we think there must be a U.S.-China trade deal—the more substantive and congressionally acceptable the better; China’s stimulus efforts must go on bearing fruit; and central banks should remain largely accommodative. Absent these, a sharp run-up in prices from here would likely put markets back where they were last summer—at above-average valuations heading toward a year likely to feature earnings uncertainty and potentially unsettling volatility.

Equity views

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

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

For now, we remain committed to Market Weight exposure for a global balanced portfolio. We expect most major markets will deliver worthwhile all-in returns (i.e., including dividends) over the next 12 months. Short of an insupportable market surge, the deal-breaker would be a set of circumstances that puts central banks back into a more aggressive tightening mode. So far, those conditions are not in sight.

Regional highlights

United States

- The U.S. equity market extended its rally in April, with the S&P 500 surpassing last autumn’s previous peak level. The market has benefited from relatively stable domestic economic data and improved Chinese trends, both of which have given way to cautious optimism about global growth prospects.

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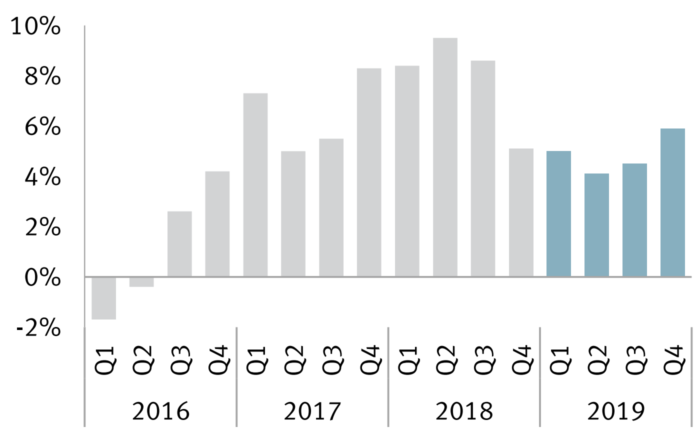
- "Better-than-feared" Q1 earnings results have also supported the market. With 60% of firms having reported thus far, S&P 500 earnings per share growth is tracking at 0.5% y/y, above the -2.3% consensus forecast when the earnings season began. We believe the growth rate will finish the season in positive territory, thus averting the start of an "earnings recession." Revenue growth is pacing at 5.0% y/y, a respectable level considering the high hurdle of 8.4% from the same period a year ago. The overall quality of reports and forward guidance has been mixed-to-good, in our assessment.
- We would use the market rally as an opportunity to upgrade the quality of equity holdings and swap into a greater share of dividend-paying stocks for portfolio ballast, as we discuss in this month's focus article, "Defense mechanisms." U.S. equity valuations are no longer inexpensive, our indicators are signaling the economic expansion is late in the game, and trade and tariff uncertainties linger. We recommend Market Weight exposure, and believe vigilance remains warranted.

Canada

- The Canadian banks have once again found themselves the target of bearish positioning by certain U.S. hedge fund managers; however, the number of shares sold short is significantly below the levels of the 2015–2016 period. A bear thesis on the Canadian banks invariably calls for a material increase in credit losses that is well beyond what we contemplate in our base-case outlook. While we concede those losses in the next recession could exceed the relatively modest levels experienced during the global financial crisis, we do not find support for a near-term inflection in loan losses given our assessment that recession risk remains relatively muted. Although not bearish on the group, we continue to advocate an Underweight positioning in light of slowing earnings growth, elevated household indebtedness, and stretched housing affordability in certain markets.
- RBC Capital Markets increased its oil price forecast for the balance of 2019 and through 2020. The firm's Equity analysts expect West Texas Intermediate (WTI) prices to average

S&P 500 revenue growth (y/y)

Actual in gray; consensus estimates in blue



It's no surprise revenue growth will likely slow in 2019, but estimates (in blue) are at respectable levels.

Source - RBC Wealth Management, Refinitiv I/B/E/S; data through 4/30/19

US$67 per barrel through year end and hold firm at US$66 next year. Crude prices have rallied sharply with WTI up roughly 40% in 2019 as risk sentiment has improved, Chinese oil imports have surged to new highs, and Saudi Arabia has vigilantly managed its output. We are cautious on the direction of crude prices in the near term as the potential for geopolitically-induced price spikes is balanced against the potential that higher prices could induce supply growth.

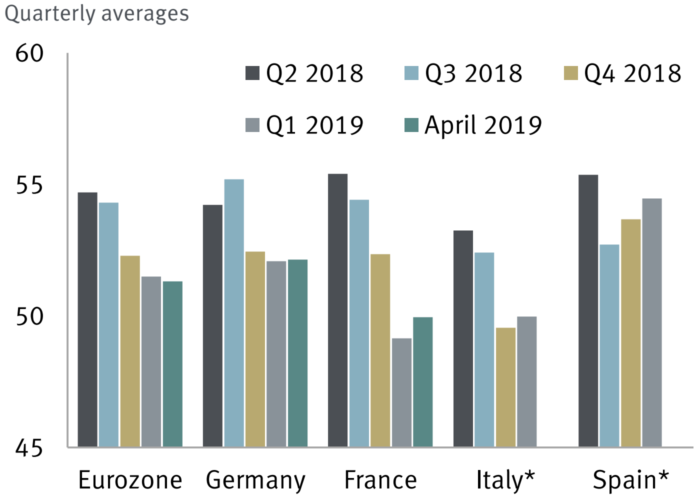
- Beyond the outlook for commodity prices, equity investors evaluating the Canadian energy sector remain focused on the prospects of improved takeaway capacity to reliably and efficiently move producers' output to market. In Alberta, the newly elected United Conservative Party majority government has promised an aggressive stance on pipeline development but it remains to be seen what impact that may have in advancing key projects.

Continental Europe & U.K.

- We are Market Weight European and U.K. equities. In Europe, after a jump of nearly 16% year to date, further equity advances will require a good earnings season and an improvement in the economy. The former might be optimistic given the economic slowdown so far in 2019; we believe the latter is possible thanks to the European Central Bank's dovish stance, a euro which is some 8% lower than this time last year, and green shoots emerging in China in April, although it could take a couple of months for these green shoots to feed through.
- We believe there are selective, interesting opportunities in European equities, particularly in Health Care, Industrials, and Technology companies benefitting from secular trends, and Consumer Goods and Services companies with leading market positions and strong brands.
- The outlook for U.K. equities remains tethered to the political backdrop. On the one hand, a soft Brexit would have a limited impact on the economy and remove crippling

Euro area composite Purchasing Managers' Indexes

Quarterly averages



Signs the European economy is bottoming

* April 2019 data for Italy and Spain not available at time of publication

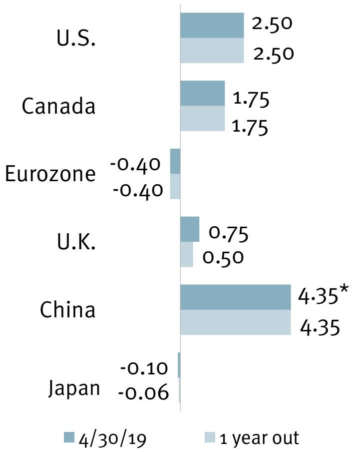
Source - Haver Analytics, IHS/Markit, RBC Capital Markets uncertainty. But on the other hand, given the increasing probability of general elections, a possible far-left, Labour-led government would be detrimental. These scenarios will play out over the next several months. For now, despite lingering business uncertainty, the combination of robust wage growth, full employment, and little prospect of rate hikes should allow the economy to continue to modestly grow. Valuations are cheap, at a price-to-earnings ratio of 12x the 2020 consensus earnings estimate, and we maintain our bias towards globally diversified companies.

Asia

- The MSCI AC Asia Pacific Index has held on to gains registered in Q1 2019 after a weak H2 2018.
- Equity gains continue to be led by mainland China. We maintain the view that there is a decent chance this is a bear market rally, chiefly because corporate earnings and earnings forecasts remain weak, by and large, and have yet to register any significant turn.
- However, Chinese economic data, such as credit growth, manufacturing leading indicators, and housing sales were stronger than expected in March. It is therefore possible the world's second-largest economy has bottomed out for the time being, although investors should await confirmation from further data.
- It appears that progress continues to be made in U.S.-China trade talks. A key point of uncertainty though is whether most, or even all, U.S. tariffs on Chinese imports will remain in place even if a trade deal is struck.
- We maintain a preference for Japan, primarily due to valuation, although we also acknowledge that the index is sensitive to global leading economic indicators and the global growth environment at present is soft.

“Low” returns or “no” returns: Putting the squeeze on investors?

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 the beginning of quantitative tightening (QT) in the summer of 2017 through the passage of the Tax Cuts and Jobs Act (TCJA) the following December, the specter of a U.S. Treasury debt tsunami has haunted debt markets. There has been a common belief a wave of supply would overwhelm markets, sending rates higher. Surprisingly, increased Treasury issuance hasn’t had the expected dire consequences. In fact, rates have decreased globally, resulting in a rise in the amount of sovereign debt with negative yields. Clearly, investors are all too willing to accept low or, in some cases, no returns in the current environment—but why?

Debt on the rise

According to the Bank for International Settlements’ global debt statistics through Q3 2018, “general government debt” outstanding was just shy of $49T. The U.K./Europe accounted for 21%, Canada 2.5%, Japan 19%, China 10%, and the U.S. 38%. As of the end of March 2019 outstanding negative-yielding debt exceeded $10T, with the biggest concentration in the euro area, Switzerland, Denmark, Sweden, and Japan, according to Bloomberg and the *Financial Times*. Negative-yielding debt accounted for more than 19% of the market value of the Bloomberg Barclays Global Aggregate Bond Index as of March.

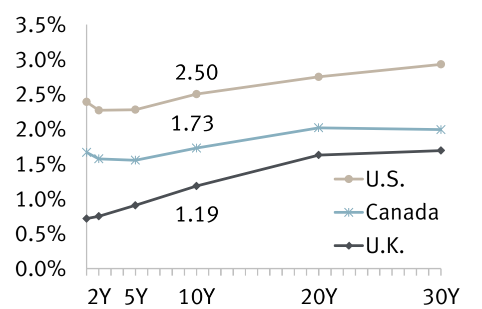
For FY2019 the U.S. deficit is projected by the Congressional Budget Office to be around $1.09T and the TCJA is forecast to add approximately $1T–$2T to the deficit over the next 10 years (i.e., approximately $80B–$160B per annum greater than it would have been). Furthermore, through QT the Fed has been reducing its Treasury purchases as it shrinks its balance sheet. This means the supply of Treasury debt coming into the market will continue to rise and ensure the U.S. maintains its position atop the global debt rankings.

Fixed income views

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

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

Sovereign yield curves



Source - Bloomberg

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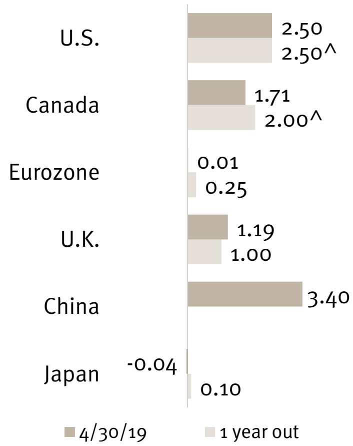
Global fixed income

10-year rate (%)



Note: Eurozone utilizes German Bunds.

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

Return *of* principal vs. return *on* principal

Current return data and fund flows clearly indicate investors are once again reaching for yield in this low rate environment. Even so, the demand for sovereign debt at low or negative yields suggests there may also be other issues weighing on investors. Slow global growth coupled with low inflation continues to push central banks toward easier policy stances which, in our opinion, should keep a lid on interest rates for some time. We feel this global growth uncertainty combined with a widespread demographic shift from aging populations desiring safe, high-quality investments should continue to foster strong demand for sovereign debt.

Regional highlights

United States

- Despite a recovery in the labor market following the weak February payrolls report, GDP growth that was much better than originally feared in Q1 at 3.2%, and strong rallies in risk assets, markets continue to price zero Fed rate hikes in the pipeline; meanwhile, the chance of a rate cut within the next year remains north of 70%. While we maintain that the Fed is done raising rates, a rate cut may be premature, in our view. The 10-year Treasury yield has steadied around 2.50%, a level we expect to hold until we get further clarity on the Fed's next move. We see any ceiling as below 2.75%.
- Credit markets have rallied strongly along with equities. U.S. corporate bond markets look increasingly rich as investors are being paid just 1.11% and 3.58% over Treasuries—the incremental yield for credit risk—on investment-grade and speculative-grade corporate bonds, respectively. Those aren't the lowest levels of this cycle, but they're inching closer. We favor investment-grade exposure over speculative-grade, and while we remain focused on quality, we remain comfortable with BBB-rated corporates where yields remain near 4%.
- The rush for yield in municipal markets shows no signs of slowing down as funds have seen 15 consecutive weeks of inflows, with investors piling in more than $30B over that time, the largest amount over any 15-week period since 2009. The average yield on the Bloomberg Barclays Municipal Bond Index has slipped to 2.30%, from a five-year high of 3.08% last November. In this environment, we continue look for bonds beyond 15 years on the yield curve, with at least seven years of call protection.

Canada

- The main event in Canadian bond markets once again stemmed from the Bank of Canada (BoC). The policymaking Governing Council kept the overnight rate unchanged at 1.75% but made a number of adjustments to its outlook. These included: a lowering of the 2019 Canadian growth forecast, a subsequent widening of the output gap, a reduction in the expected neutral policy rate, and an expectation growth will rebound in 2020. The changes signal a central bank that has moved from a mild tightening bias, to sitting on the sidelines and watching data unfold.
- Despite economists largely expecting these adjustments to take place, the bond market reacted strongly, sending yields lower. Rather than believe that the central bank is simply pausing, the bond market is pricing in a roughly 60% chance that the

BoC cuts the overnight rate by 25 basis points by December. A cut is fully priced into the market by the summer of 2020.

- With limited reason to suggest yields in the shorter end of the Government of Canada curve are heading anywhere soon, this improves the value of any instruments that pay above-market rates, such as Guaranteed Investment Certificates. We would also expect short-dated corporate bonds to continue to perform well as investors search for higher-yielding assets. By contrast, preferred shares were unchanged over April and are tracking for a dividend-like total return in 2019, after materially underperforming bonds in 2018. Late-cycle concerns keep us from pressing hard on the buy button despite significantly improved relative value.

Continental Europe & U.K.

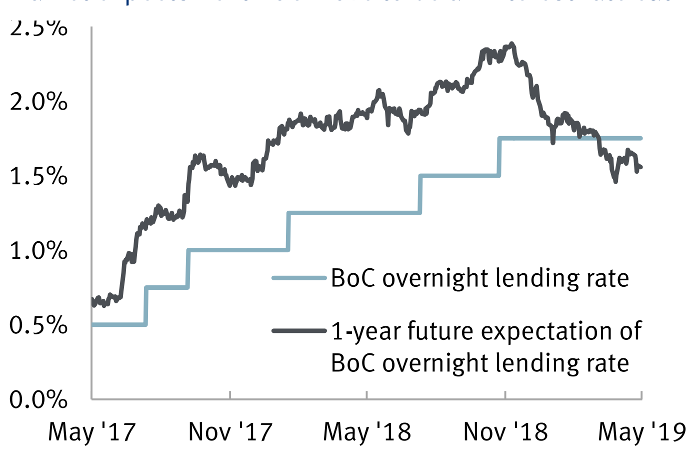
Europe

- We expect to see interest rates lower for longer in Europe given the European Central Bank's (ECB) continued dovish messaging and its concerns that the growth outlook remains tilted to the downside. ECB President Mario Draghi openly suggested the central bank would be willing to employ all tools necessary if the economic backdrop were to deteriorate further, and that it would continue its accommodative monetary policy stance for the foreseeable future.
- With a new round of targeted longer-term refinancing operations (TLTRO) to be introduced in September, along with discussions regarding a "tiered deposit rate," the market has pushed further out its interest rate hike expectations. This continues to provide support for our Market Weight position in European government bonds and modest Overweight in European corporate credit as yields are likely to remain range-bound.

U.K.

- In the U.K., the extension of Article 50 does not entirely remove Brexit uncertainty and the possibility of risk-off moves in financial markets. However, it has reduced the likelihood of an imminent hard exit, providing some relief in the market.
- The Bank of England is unlikely to look at raising interest rates so long as the Brexit stalemate continues.

Market expects next BoC move to be an interest rate cut

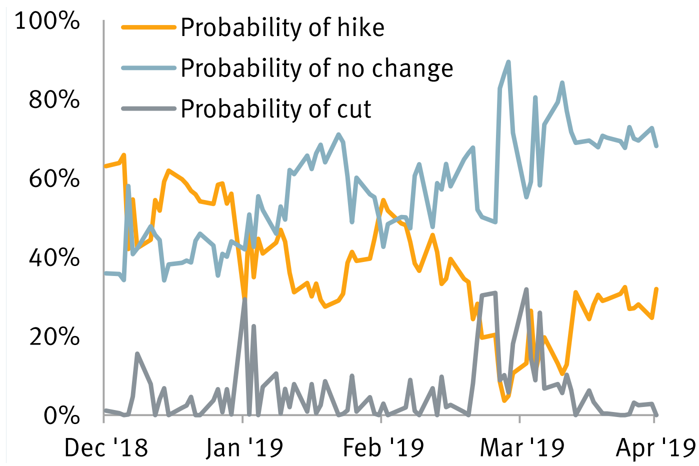


Although the BoC is happy to hold rates unchanged, markets continue to price in future BoC rate cuts.

Source - RBC Wealth Management, Bloomberg; market expectations based on forward swap contracts; data through 4/29/19

While there is noteworthy labour market tightness, inflation currently trending below target removes some pressure on the central bank. We maintain a Market Weight view on U.K. government bonds with short-duration positioning for now. We also see the yield pickup in U.K. corporate credit as attractive but remain selective and continue to be Market Weight in our allocation.

No Bank of England rate hikes expected in 2019



Source - RBC Wealth Management, Bloomberg; market implied probablities derived from overnight index swaps; data through 4/30/19

Despite labour market tightness, inflation currently below trend removes economic pressure on Bank of England.

Currencies

Currency forecasts

Currency pair	Current rate	Forecast Jun 2020	Change*
Major currencies			
USD Index	97.48	95.28	-2%
CAD/USD	0.75	0.74	-2%
USD/CAD	1.34	1.35	1%
EUR/USD	1.12	1.17	4%
GBP/USD	1.30	1.33	2%
USD/CHF	1.02	0.98	-4%
USD/JPY	111.4	118.0	6%
AUD/USD	0.70	0.67	-5%
NZD/USD	0.67	0.63	-5%
EUR/JPY	125.0	138.1	10%
EUR/GBP	0.86	0.88	2%
EUR/CHF	1.14	1.15	0%
Emerging currencies			
USD/CNY	6.73	7.50	11%
USD/INR	69.6	75.00	8%
USD/SGD	1.36	1.44	6%

* 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

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U.S. dollar: Range-bound

A cautious Fed has done little to shake the resilient U.S. dollar in 2019. The U.S. economy continues to outpace its G10 peers, which alongside relatively attractive interest rates has helped prop up dollar demand. Investor fears of deteriorating global growth conditions are further driving flows into the perceived safety of the dollar, although signs of steadying growth abroad and progress around U.S.-China trade tensions could cause support to begin to fade later in 2019.

Euro: Lower for longer

The euro is grinding lower in 2019 as signs of a growth recovery remain elusive. Manufacturing activity continues to be battered by weak external demand and, in turn, could dampen prospective growth stemming from what has been resilient domestic demand so far in 2019. The European Central Bank alluding to the potential for further monetary stimulus measures, if needed, could keep pressure on the euro; however, a cyclical recovery in growth should underpin a modest euro uptick by year-end, in our view.

British pound: Watching and waiting

The British pound remains stubbornly trapped within a narrow trading range as Brexit gridlock shows little signs of breaking. A potential crashing out of the EU was averted in April with another extension pushing out the U.K.'s scheduled exit date to October 31. An EU review of progress is planned for June and while it would be desirable to reach a deal sooner, the currency is likely to remain in "wait-and-see" mode until clarity emerges on the path forward for Brexit.

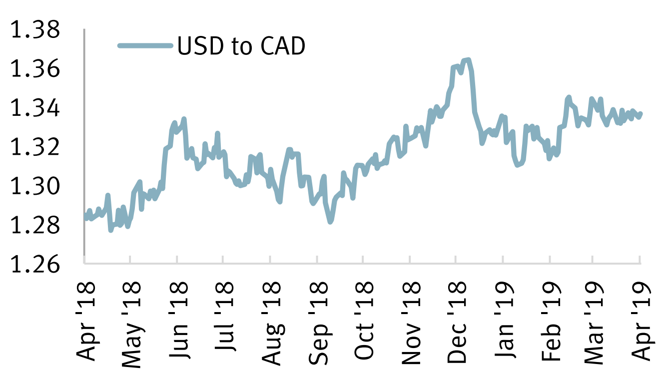
Canadian dollar: In limbo

There is limited scope for the Canadian dollar to gather upward momentum in the remainder of 2019, in our view. A prolonged pause in policy tightening by the Bank of Canada alongside a patient Fed points to a lack of rate dynamics that should keep the loonie range-bound. Steady oil prices, bouts of risk-off sentiment, and a potential delay to USMCA ratification pose downside risks for the currency; however, these risks appear contained at this stage.

Japanese yen: Grinding lower

Strong Japanese investor appetite for foreign assets alongside firming risk sentiment has seen the yen slip against the U.S. dollar so far in 2019. Further outflows could keep the currency under pressure, although as concerns grow regarding the aging U.S. business cycle, demand for the yen as a safe-haven currency should increase, keeping the yen trending sideways in 2019.

Range-bound performance persists for the Canadian dollar



A lack of rate dynamics is keeping the Canadian dollar within a narrow range.

Source - RBC Wealth Management, Bloomberg; data through 4/23/19

Commodities

Commodity forecasts

	2019E	2020E
Oil (WTI $/bbl)	$63.88	$65.88
Natural Gas ($/mmBtu)	$2.80	$2.75
Gold ($/oz)	$1,301	$1,300
Copper ($/lb)	$2.76	$3.00
Soybean ($/bu)	$9.40	$9.70
Wheat ($/bu)	$4.95	$4.98

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

Oil – China lending a hand

WTI prices have rebounded by 45%+ since hitting a low of roughly $45.50/bbl last December. China has been importing about 10.3M bbl/d since the start of the Iran sanctions, up more than 1.5M bbl/d y/y. Effective May 2, the U.S. will not extend Iranian waivers. RBC Capital Markets analysts raised their 2019 forecast to $64/bbl but believe prices will be range-bound until the U.S. is unable to generate 1 million+ bbl/d of annual supply growth.

Natural gas – Injection season

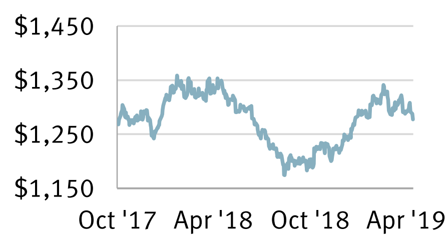
U.S. inventory levels reached a five-year low at the end of March (a seasonally low period). However, inventories are also expected to rise steadily throughout the year as we enter into the injection season which occurs between April and October. Year to date, prices have declined about 12%. RBC Capital Markets analysts lowered their 2019 natural gas forecast to $2.80/mmBtu (from $3.00/mmBtu). We continue to expect a muted price outlook driven by growth in U.S. domestic production.

Copper – Push and pull

RBC Capital Markets analysts increased their 2019 copper forecast to $2.76/lb (from $2.63/lb) but maintain a cautious tone. Earlier this year, China raised its 2019 budget for its electrical grid investment, representing around 37% of Chinese copper demand. Inventory levels are sitting near three weeks' worth of global consumption (low by historical standards), which should provide downside support for copper prices. However, weaker auto sales and a slowdown in property starts in China will likely keep copper prices range-bound.

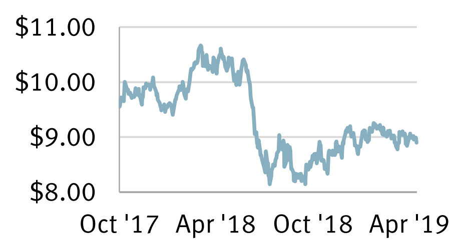
Gold – Rally has stalled

Despite weakness in the U.S. dollar, the price of gold has struggled on the heels of increased appetite for risk assets. Gold recently posted fresh 2019 lows, breaking below the $1280 level. While sentiment appears to have drifted to the downside, we continue to see a favourable setup for gold in light of accommodative monetary policies and the potential for a pickup in market/economic volatility.



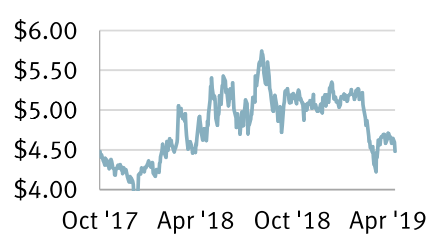
Soybeans – Weaker China demand

We expect demand for Chinese soybean feed to soften following an outbreak of swine fever. China has culled more than a million pigs following the discovery, and pork production is expected to decline about 30% in 2019. Soybean pricing has weakened month over month. Global inventories remain elevated at around 107 million tonnes. We expect softer price action until we get more visibility on U.S.-China trade developments.



Wheat – Cutting carbs

Sentiment continues to be bearish with export demand skewing to the downside amid intensifying global competition. Lower feed and residual use in Europe and Iran has also caused slippage in global consumption. Global inventories rose to 275.6 million tonnes at the end of March, above expectations of 271.2 million tonnes. Prices have weakened recently, but remain flat y/y.



Source - RBC Wealth Management, Bloomberg; date range: 10/3/17–4/16/19

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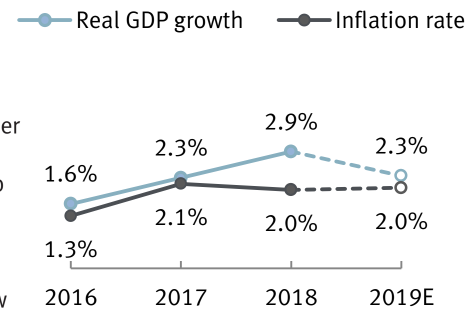
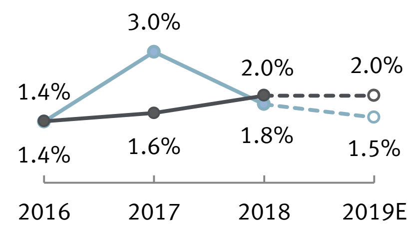
Key forecasts

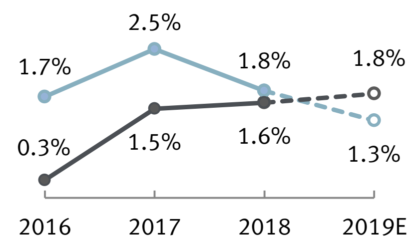
United States – Very strong labor market
Q1 2019 GDP topped even optimistic forecasts, hitting a 3.2% q/q pace, helping to alleviate recession fears. Consumer spending remains the dominant driver of economic growth with the Jan./Feb. slowdown giving way to a 0.9% m/m jump in personal spending in March. Housing activity has shown signs of life as mortgage rates continue to fall, improving affordability. The labor market remains strong, with 196,000 jobs added in March and unemployment claims falling below 200,000, a level not seen since the 1960s.



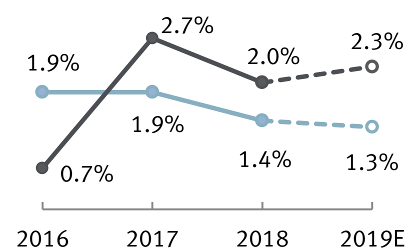
Canada – Reaccelerating inflation
BoC rate hikes remain on hold. The market is now pricing in rate cuts. Governor Stephen Poloz says trade issues and elevated household debt pose risks to the economy; however, rates remain low and people continue to service their debt. GDP fell in February to -0.1% m/m from 0.3% m/m in January. Inflation jumped close to the BoC's 2% target in March on the biggest one-month increase in gasoline prices in a decade.



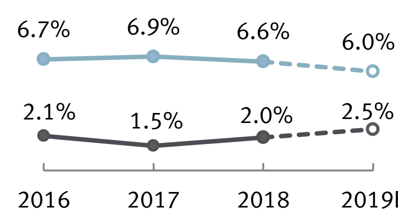
Eurozone – Improving
Eurozone PMIs remain mixed; the Manufacturing in contractionary territory at 47.5 in March, while the Services PMI strengthened to 53.3. Retail sales improved in February to 2.8% y/y. Q1 2019 GDP growth gave the ECB reason to cheer, accelerating to 0.4% q/q from 0.2% q/q in Q4 2018. Country- specific shocks are dissipating including social unrest in France, Italian budget battles, and German auto companies adjusting to new emission standards.



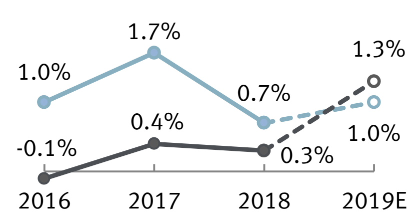
United Kingdom – Brexit stockpiling
Manufacturing activity was robust in February, with manufacturing production expanding 0.9% m/m and industrial production growing 0.6% m/m. GDP growth surprised to the upside, expanding 0.2% m/m in February. Economists suspect some of the growth may be Brexit stockpiling as companies brought orders forward ahead of the original March 29 deadline. Financial services and insurance sector output fell for the 12th consecutive month.



China – Progress on trade
Progress continues to be made on trade negotiations with the U.S. boosting asset prices. The official gauge of manufacturing activity fell in April, although other economic data shows signs of stabilization. The Markit Manufacturing PMI maintained expansionary levels despite the export outlook remaining unclear. Policy measures will continue to support growth offsetting to some degree a soft global outlook and a weak private sector.



Japan – Low rates to continue
The surprise 0.9% m/m March drop in Japan's industrial production is pointing to an economic contraction in Q1 2019. However, external demand for Japanese goods from China is showing signs of recovering, and firmer domestic demand stemming from front-loaded consumer spending and public investment ahead of a sales tax hike in October should help economic growth moving forward. The Bank of Japan pledged to keep rates extremely low through at least spring 2020.



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	2,945.83	3.9%	17.5%	11.2%
Dow Industrials (DJIA)	26,592.91	2.6%	14.0%	10.1%
NASDAQ	8,095.39	4.7%	22.0%	14.6%
Russell 2000	1,591.21	3.3%	18.0%	3.2%
S&P/TSX Comp	16,580.73	3.0%	15.8%	6.2%
FTSE All-Share	4,067.98	2.3%	10.7%	-1.4%
STOXX Europe 600	391.35	3.2%	15.9%	1.6%
EURO STOXX 50	3,514.62	4.9%	17.1%	-0.6%
Hang Seng	29,699.11	2.2%	14.9%	-3.6%
Shanghai Comp	3,078.34	-0.4%	23.4%	-0.1%
Nikkei 225	22,258.73	5.0%	11.2%	-0.9%
India Sensex	39,031.55	0.9%	8.2%	11.0%
Singapore Straits Times	3,400.20	5.8%	10.8%	-5.9%
Brazil Ibovespa	96,353.33	1.0%	9.6%	11.9%
Mexican Bolsa IPC	44,597.32	3.0%	7.1%	-7.8%
Bond yields	**4/30/19**	**3/29/19**	**4/30/18**	**12 mo. chg**
US 2-Yr Tsy	2.266%	2.260%	2.488%	-0.22%
US 10-Yr Tsy	2.502%	2.405%	2.953%	-0.45%
Canada 2-Yr	1.563%	1.549%	1.893%	-0.33%
Canada 10-Yr	1.712%	1.617%	2.307%	-0.60%
UK 2-Yr	0.764%	0.642%	0.776%	-0.01%
UK 10-Yr	1.185%	1.000%	1.418%	-0.23%
Germany 2-Yr	-0.584%	-0.602%	-0.586%	0.00%
Germany 10-Yr	0.013%	-0.070%	0.559%	-0.55%
Commodities (USD)	**Price**	**1 month**	**YTD**	**12 month**
Gold (spot $/oz)	1,283.55	-0.7%	0.1%	-2.4%
Silver (spot $/oz)	14.95	-1.1%	-3.5%	-8.5%
Copper ($/metric ton)	6,486.50	-0.9%	8.0%	-5.1%
Uranium ($/lb)	20.90	-0.5%	-12.6%	-7.7%
Oil (WTI spot/bbl)	63.91	6.3%	40.7%	-6.8%
Oil (Brent spot/bbl)	72.80	6.4%	35.3%	-3.2%
Natural Gas ($/mmBtu)	2.58	-3.3%	-12.4%	-6.8%
Agriculture Index	273.20	-2.2%	-5.8%	-13.4%
Currencies	**Rate**	**1 month**	**YTD**	**12 month**
US Dollar Index	97.4790	0.2%	1.4%	6.1%
CAD/USD	0.7468	-0.3%	1.9%	-4.1%
USD/CAD	1.3388	0.3%	-1.8%	4.2%
EUR/USD	1.1215	0.0%	-2.2%	-7.1%
GBP/USD	1.3032	0.0%	2.2%	-5.3%
AUD/USD	0.7048	-0.7%	0.0%	-6.4%
USD/JPY	111.4200	0.5%	1.6%	1.9%
EUR/JPY	125.0200	0.5%	-0.6%	-5.3%
EUR/GBP	0.8604	0.0%	-4.3%	-2.0%
EUR/CHF	1.1432	2.4%	1.6%	-4.5%
USD/SGD	1.3608	0.4%	-0.2%	2.6%
USD/CNY	6.7349	0.3%	-2.1%	6.4%
USD/MXN	18.9460	-2.5%	-3.6%	1.2%
USD/BRL	3.9210	0.0%	1.2%	11.8%

Chinese equities extended YTD outperformance in April as the U.S. and China neared a trade deal.

Global short-term yields all fell in April as markets priced in future rate cuts.

Oil rallied to six-month highs after the White House announced the end of sanction exemptions on Iranian crude.

The U.S. dollar strengthened against most currencies after a robust Q1 2019 GDP print.

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 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD -4.1% return means the Canadian dollar has fallen 4.1% vs. the U.S. dollar during the past 12 months. USD/JPY 111.42 means 1 U.S. dollar will buy 111.42 yen. USD/JPY 1.9% return means the U.S. dollar has risen 1.9% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 4/30/19.

Research resources

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Hold [Sector Perform]	589	40.07	107	18.17
Sell [Underperform]	87	5.92	5	5.75

Ratings: Top Pick (TP): Represents analyst's best idea in the sector; expected to provide significant absolute total return over 12 months with a favorable risk-reward ratio. **Outperform (O):** Expected to materially outperform sector average over 12 months. **Sector Perform (SP):** Returns expected to be in line with sector average over 12 months. **Underperform (U):** Returns expected to be materially below sector average over 12 months. **Restricted (R):** RBC policy precludes certain types of communications, including an investment recommendation, when RBC is acting as an advisor in certain merger or other strategic transactions and in certain other circumstances. **Not Rated (NR):** The rating, price targets and estimates have been removed due to applicable legal, regulatory or policy constraints which may include when RBC Capital Markets is acting in an advisory capacity involving the company.

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