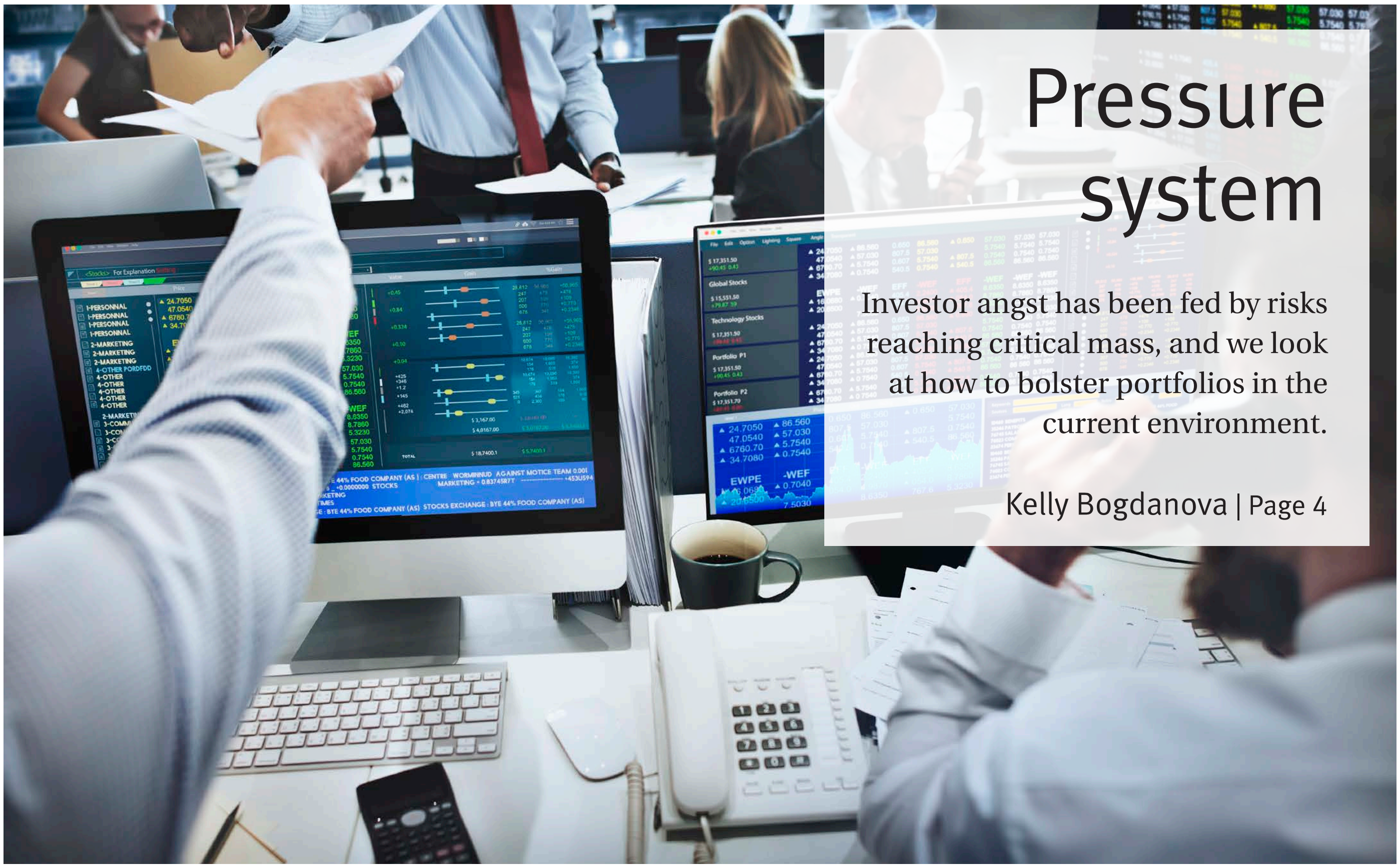
November 2018

RBC WEALTH MANAGEMENT

Global Insight

Perspectives from the Global Portfolio Advisory Committee



Pressure system

Investor angst has been fed by risks reaching critical mass, and we look at how to bolster portfolios in the current environment.

Kelly Bogdanova | Page 4

For important and required non-U.S. analyst disclosures, see page 22.

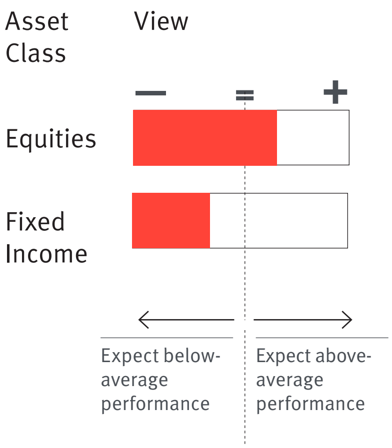
RBC Wealth Management

Table of contents

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

RBC's investment stance

Global asset views



See "Views explanation" below for details

Source - RBC Wealth Management

Equities

- We think the global equity market's steep decline in October is part of a temporary correction phase that should recede once it becomes clear that U.S. earnings growth is merely set to slow, not fully retreat, and that the global economy has the ability to work through its modest loss in momentum. Trade and tariff uncertainties should linger, but markets have already begun to account for these risks.
- The correction is not heralding some imminent economic downturn or U.S. recession, in our view, because reliable leading indicators are signaling growth in the next year, at least, and low recession risks. These factors should support corporate earnings growth, though at a slower pace. We continue to recommend that a global portfolio be moderately Overweight equities.

Fixed income

- With year-end approaching, the Federal Reserve is poised for one more rate hike while other major central banks will likely remain on the sidelines. Plans vary for 2019, with central banks in North America signaling further rate increases albeit at a gradual pace, while banks in the U.K./Europe likely will be more patient. Concerns over trade, domestic economic data, and uncertainty with Brexit and Italy could continue to weigh on market sentiment which in turn could potentially affect future central bank policy decisions.
- Credit continues to be our favorite sector within fixed income, and we maintain our selective focus on quality. Our Underweight to fixed income overall reflects the view that tight credit spreads amidst heightened volatility and higher rates limits opportunities, and we suggest shortening portfolio duration to be 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.

Focus article

Pressure system

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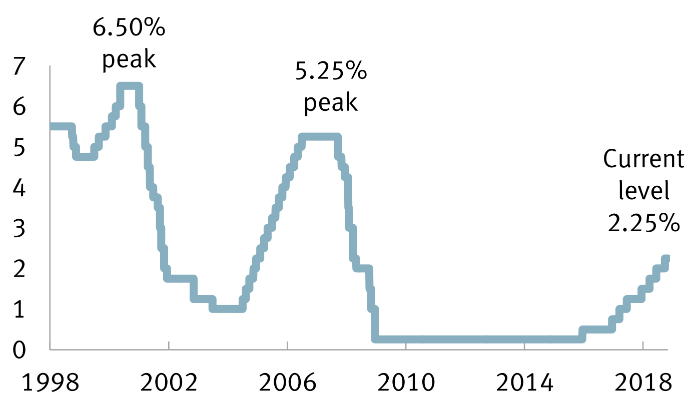
The maelstrom that ripped through markets was fed by investors wrestling with increasing angst. We explore the risks that reached critical mass, and why markets should be able to cope with them. We perceive a shift underway in market leadership and look at how to bolster portfolios in the current environment.

Turbulence that shook equity markets in October led to the steepest global monthly downturn in more than six years. Investor complacency, so prevalent during the summer gave way to timidity, and at times anxiety, as a number of risks reached critical mass.

Markets are coming to grips with the possibility that U.S. earnings growth could slow in 2019 to a greater degree than previously thought. This combined with softening Chinese and global economic trends were the biggest factors that drove equity prices lower in October, in our assessment.

Concerns that the Federal Reserve could shift toward a more aggressive rate hike pace, potentially blunting U.S. and global growth, were stoked by Fed Chair Jerome Powell's hawkish comments. Uncertainties associated with Brexit and Italy's confrontations with the EU also continue to linger.

Federal Reserve federal funds rate in % (upper bound)



The Fed has raised its target rate in recent years, but is still well below the two prior peaks.

Source - RBC Wealth Management, Bloomberg; data through 11/2/18

These risks have not changed our constructive view on U.S. equities because the two factors that influence stock prices the most over time—economic and earnings growth—are likely to be firm enough to push the market at least modestly higher in 2019.

Don't be Fed up

We think market angst about Fed rate hikes is overdone. "Hawkish" comments and all, the Fed still seems intent to march along at the pace of domestic economic data and it continues to signal a "gradual" approach to rate hikes. Unless this changes, we think the equity market can absorb another rate hike in December and more in 2019, whether three, as the Fed projects, or two, as the fixed income market forecasts.

Rate hikes typically become problematic for the U.S. equity market (and can indirectly impact other equity markets) when the Fed tightens too far, too fast and lenders begin to markedly restrict credit availability for households and businesses.

So far, we're not seeing signs of this. Quite the contrary, in a National Federation of Independent Business (NFIB) survey of small business owners, only 3% of respondents said that all of their borrowing needs were not satisfied, which is just one percentage point above the record low, and only 2% indicated financing was their top challenge.

Cracks in the earnings facade?

The corporate tax cut boost will be dropping out of the 2019 data and robust earnings comparisons from 2018 will make it difficult to achieve strong year-over-year growth.

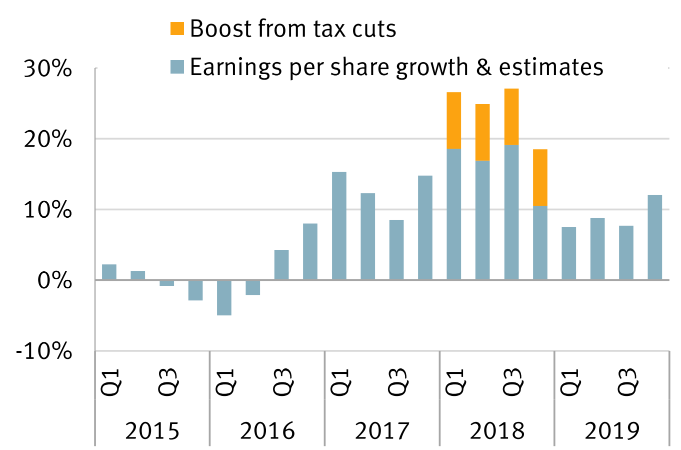
Concerns about the U.S. earnings outlook are warranted.

A reduction in next year's growth rate had been widely expected by market participants for months, simply because of the arithmetic. The corporate tax cut boost will be dropping out of the 2019 data and robust earnings comparisons from 2018 will make it difficult to achieve strong year-over-year growth.

Q3 results have added another dimension. Thus far, they have been solid overall with an exceptional 27% y/y earnings growth rate (includes roughly 8 percentage points from the tax cut boost), very good 8.0% y/y revenue growth, as well as above-average earnings beats and average revenue beats. However, some high-profile multinationals, particularly economically sensitive firms, have reported subdued margin and revenue trends due to rising input costs related to tariffs and/or wage growth, and warned of such pressures for future quarters. This has raised the possibility earnings growth could slow to an even greater degree than forecast and is forcing market participants to rethink Q4 and, importantly, 2019 prospects.

S&P 500 earnings per share growth (y/y)

Actual & consensus estimates*



Earnings growth is peaking this year, and 2019 estimates may be a bit too high.

* Actual earnings growth from Q1 2015 through Q4 2017. Q1 and Q2 2018 are actual data, but subject to revision. Q3 2018 and onward reflect the consensus estimates.
Source - RBC Wealth Management, Thomson Reuters I/B/E/S (consensus estimates); data as of 11/2/18

Pressure system

An in-depth RBC Capital Markets analysis of S&P 500 management conference calls during the Q3 reporting season reveals additional cracks. Twenty-three percent of executives believe underlying demand and economic conditions are mixed or weak. Almost one-third of companies cited higher commodity and raw materials prices and wage pressures. Trade and tariffs have been discussed on roughly 40% of the conference calls—a sharp increase. Forty-six percent of management teams said the strong dollar was a headwind.

The risk of downward adjustments seems more challenging for the market to handle, especially in a volatile environment when a number of other issues are also playing a role in the selloff.

We think all of this signals that the S&P 500 consensus earnings forecast got ahead of itself amid enthusiasm over previous results, and is now somewhat too high. The consensus forecast stands at $178 per share for 2019. RBC Capital Markets, LLC's Head of U.S. Equity Strategy Lori Calvasina is at a more conservative $173 per share level, which seems more realistic to us.

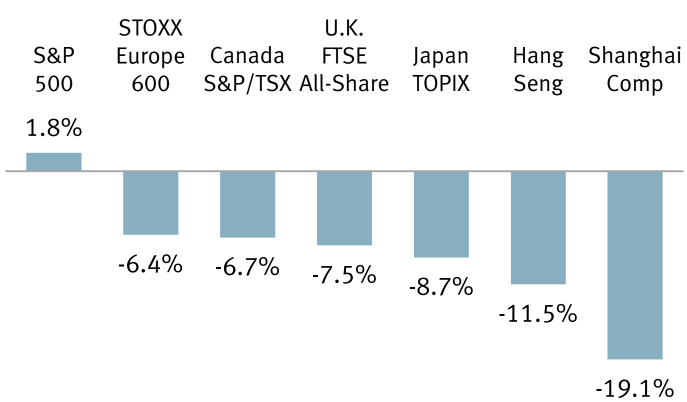
We believe the consensus could be trimmed to $173 or slightly lower in coming months. Normally the market can absorb such a modest hit to earnings in an orderly way, within a normal consolidation period. But given the long streak of upward earnings revisions that market participants had become accustomed to, the risk of downward adjustments seems more challenging for the market to handle, especially in a volatile environment when a number of other issues are also playing a role in the selloff. We think this will all get sorted out, but it could take some time.

Rising rivalry

The U.S.-China tensions are another matter entirely and are much broader in scope.

The trade dispute has been front-and-center for Asian equity markets for months, causing deeper selloffs compared to Europe and North America. The U.S. market practically ignored this issue—until recently. It finally began to account for some of the risks as additional tit-for-tat tariffs were implemented and trade threats mounted, and the conflict widened to include a variety of Trump administration grievances about China's non-trade practices.

Year-to-date performance of select equity indexes



Trade, tariff, and economic concerns have weighed on Chinese equities.

Source - RBC Wealth Management, Bloomberg; data through 11/2/18; data in local currencies

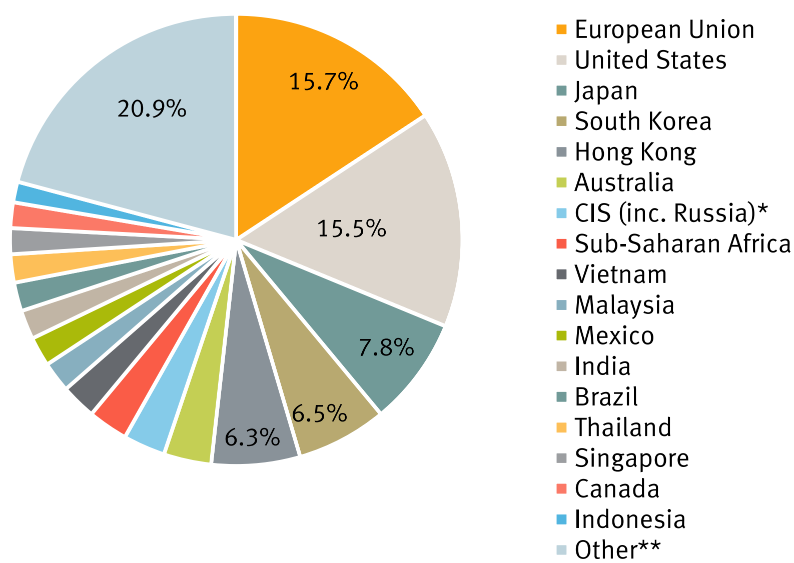
To us, this dispute is about much more than trade. In previous *Global Insight* publications our Hong Kong-based analyst Jay Roberts of RBC Investment Services (Asia) Limited wrote that "the trade surplus is not the real issue. And the answers are far from simple. The crux of the problem is that the U.S. is demanding that China change its laws, regulations, and behaviours. That's a real challenge." He also stated that "the current approach to China is bipartisan, meaning that what transpires during the U.S. midterm elections may have little impact on policy thereafter. There is even a line of thinking that the U.S.'s new, hard line on China is to attempt to restrict the country from becoming a superpower and protect U.S. hegemony."

The global order may be shifting from a unipolar world led by one country to a multipolar world where a few countries dominate.

There is a debate among foreign policy specialists about whether the global order is shifting from a unipolar world led by one country, the U.S., to a multipolar world where a few countries dominate—the U.S. and China from an economic standpoint, and the U.S., Russia, and China in the military sphere and other areas. RBC Global Asset Management Chief Economist Eric Lascelles said, "Arguably, the world is already beginning to experience some of the side effects of this transition, as rising tariffs between the U.S. and China are interfering with globalization in much the same manner that prior rivalries did."

Trade with the U.S. important to China, but it's not everything

Mainland China's largest trading partners as a % of China's total trade (includes exports and imports by country/region)



* Commonwealth of Independent States
** The sum of many countries with relatively small levels of trade with China
Source - RBC Wealth Management, Bloomberg Intelligence, International Monetary Fund; 2017 data

We think financial markets will be contending with the broader U.S.-China rivalry, on and off, for quite some time regardless of how the trade discussion between Presidents Trump and Xi plays out at the forthcoming G20 summit.

Seeing value in value stocks

Some of the challenges facing equity markets should begin to settle out in the months ahead, such as the shift toward slower earnings growth, clarity about the Fed's pace of interest rate hikes, and the path of the domestic and global economies.

Others issues, like the broader U.S.-China rivalry, could play out over many years and drift on and off the market's radar screen, sometimes impacting performance when trade, tariff, and economic growth issues surface. At other times, the rivalry will likely stay in the background, not driving equities in either direction.

Within the U.S., we favor value over growth stocks, and would also tilt toward defensive sectors.

Our view remains that investors should give equities the benefit of the doubt as long as the economic, credit, and earnings cycles remain favorable for stocks. All of our forward-looking U.S. recession indicators are signaling the expansion will persist for the next 12 months, at least.

Within the U.S., we favor value over growth stocks, and would also tilt toward defensive sectors for the time being.

Since the financial crisis ended in 2009, growth has outperformed value for much of the time on a global basis, including in the U.S. Given the trends so far during this correction and the drivers of these style groups, RBC Capital Markets believes a shift toward value is unfolding.

Value tends to outperform when the 10-year Treasury yield rises, inflation expectations move higher, and GDP growth strengthens, as well as during the latter stage of a bull market cycle. There have been two periods of U.S. value leadership during this bull market.

The Financials sector is the largest within value, and we view it as attractive. Historically, it has been positively correlated with changes in inflation expectations, and those expectations seem likely to rise. Bank stocks are still reasonably valued compared to the broader market and versus the historical average based on our assessment of multiple valuation measures, including price-to-book. Banks' balance sheets haven't been this strong in many decades.

We continue to recommend Market Weight exposure to U.S. equities and are constructive on the overall global equity asset class.

Crosscurrents

For developed country stock markets, 2018 has been a disappointment. The three major U.S. averages (Dow, S&P, and NASDAQ) are all barely above where they began the year; indexes in Canada, Europe, Britain, and Japan are all down by 7%–9%.

This is a surprising outcome. Last year ended on a very upbeat note. Corporate managements across the developed world had correctly guided their shareholders to expect a strong performance in 2017 for both revenues and profits. Moreover, most had extended that optimism to include 2018. And all this was in place before the massive U.S. corporate tax cut and budgetary spending plans arrived at the eleventh hour late in the year. At that point, at least for U.S. corporations, the earnings picture for 2018 as well as 2019 brightened even more.

The U.S. market soared: the S&P 500 rose 12% in two-and-a-half months, adding two full price-to-earnings multiples based on expected 2018 earnings. Most other markets also rose but by a more sedate 4%–8%—after all, they weren't getting a big tax cut.

In late January the party abruptly ended. A very sharp correction gave back all those gains that had piled up over 11 weeks in just 14 days. Since then each market has made its own way—most making marginal new highs in late summer before succumbing to the October downturn. The year-to-date picture is one of markets that are slightly ahead-to-down, even as solid gains in revenues and earnings have been delivered.

We think two related factors explain this: the passage of time and policy uncertainty.

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Equity views

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

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

At this time last year trade disputes were open questions. For example, would the U.S. go beyond threats to the actual implementation of tariffs? The answer turned out to be a resounding "yes." Nor does it seem that policy has run its course or that tariffs, once imposed, will ever be lifted even when the bilateral trade agreements they were designed to provoke have been agreed upon. The "USMCA" provided a sigh of relief that a deal could be struck, but it has yet to be ratified by any of the three governments. The midterm election results in the U.S. and the forthcoming installation of the new government in Mexico may leave the finalising of the agreement in abeyance for some time.

The U.S.-China dispute is much larger, has mushroomed beyond trade, and, left unresolved, would have knock-on effects for many economies. And of course there is Brexit, where the "drop-dead" date seemed so far away last November but is now just around the corner in March. Nor is the shape or likelihood of any deal obvious at this point.

We expect markets will be increasingly driven by the outlook for earnings in 2020, a year in which, in the U.S., the impact of tax cuts on reported earnings growth will largely disappear while the 2018–2019 tailwind provided by the 2017 budget deal's massive fiscal stimulus will turn into a modest drag. Meanwhile, all major central banks will have tightened policy further.

In our view, the correction that gripped markets this fall has been, in some significant part, a response to rising uncertainty about the 2020 landscape. And, to add further pressure, the discount rate one would employ to calculate the present value of a dollar of future earnings—for our purposes the U.S. 10-year Treasury rate—has risen from a benign 2.40% last year to a more onerous 3.20% today.

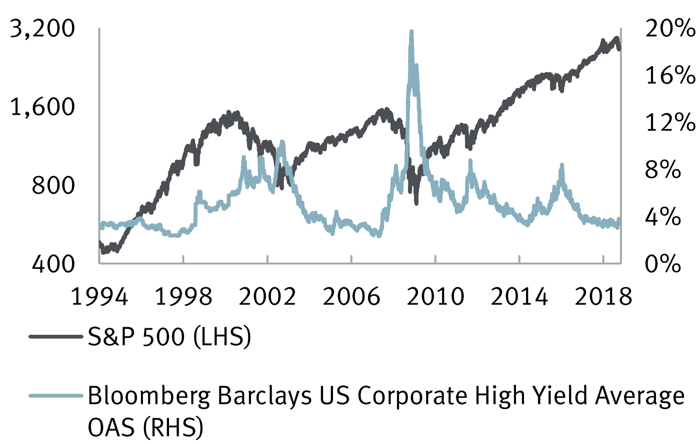
We believe the correction has been factoring in many of the concerns outlined above. We do not believe it is heralding some imminent economic downturn or U.S. recession because the reliable leading indicators of such a downturn are giving no such warning. We recommend a global portfolio be moderately Overweight equities.

Regional highlights

United States

- Investors should be glad October is over, as the 6.9% decline in the S&P 500 was the worst calendar month it has experienced since the 7.2% selloff in September 2011. To be fair, the peak-to-trough decline in January and February of this year was 10.2%, compared to a drop of 9.9% for the current selloff. Bond proxies, like Consumer Staples and Utilities, actually traded higher in October, while the more economically sensitive sectors like Consumer Discretionary, Energy, and Industrials all declined at least 10%. Despite the end of month bounce, many stocks remain in correction territory. A surprising 39% of S&P 500 companies are in full-blown correction territory, defined as trading more than 20% below their 52-week highs.
- Fortunately, contagion from equity markets was checked. High-yield bonds can be used as a rough proxy to measure the level of fear in bond markets, as they are considered "risky" assets of the bond universe. Typically, when economic and corporate prospects worsen, high-yield investors require higher interest rates relative to "risk-free" U.S. Treasury bonds for assuming the increased risk of corporate defaults. Currently, high-yield investors are not demanding greater premiums on these risky bonds, meaning the

S&P 500 and Bloomberg Barclays US High Yield Spread



Despite the selloff in U.S. equities, similar levels of fear are not present in fixed income markets.

Source - RBC Wealth Management, Bloomberg; data through 10/31/18

heightened fear present in equity markets is absent in fixed income markets. This lack of fear in bond markets supports our view that patience is the appropriate response to the recent equity selloff, and we would continue to hold a Market Weight position in U.S. equities.

Canada

- At 13.3x forward earnings, the S&P/TSX Composite's price-to-earnings (P/E) ratio remains below its long-term historical average and at a notable discount to the S&P 500's P/E ratio of 15.7x. We continue to view that discount as appropriate compensation for domestic-specific challenges, namely the impact of higher interest rates on consumers and the housing market, a lack of adequate oil pipeline capacity, and waning economic competitiveness relative to the U.S. Weighing a discounted valuation against these challenges, we maintain a Market Weight recommendation.
- The discounted valuation has done little to insulate the domestic equity market from the downdraft in global equities that began on October 10. Since that date, the decline of the S&P/TSX Composite is roughly in line with that suffered by the S&P 500, MSCI EAFE, and MSCI Emerging Markets benchmarks. Driving the weakness in the Canadian benchmark has been underperformance in Energy and Financials.
- The Canadian housing market has rarely been less affordable, according to RBC Economics. Mortgage rates have hit an important inflection point. A typical homeowner is now facing a higher borrowing rate upon renewal for the first time in nearly a decade, which has further stretched affordability despite flagging prices in key markets. Even with the obvious challenges facing buyers, RBC Economics sees the majority of local markets as balanced, with rates and affordability capping future potential excess.
- The discount on Canadian heavy oil recently breached $50 per barrel as overburdened pipeline and storage capacity were met by reduced demand caused by maintenance at key U.S. refiners. We expect the extreme discounts to ultimately improve as crude-by-rail volumes increase and refineries complete their turnarounds. However, we continue to see a period of wider and more volatile heavy oil discounts over the next 2–3 years due to inadequate pipeline capacity. With Canadian producers challenged to get their product to key demand points, South American heavy oil has recently enjoyed a new-found premium to the WTI benchmark.

Continental Europe & U.K.

- European markets struggled during the October correction. In addition to contending with trade tensions and continued emerging market difficulties, it faced the EU Commission's rejection of the Italian budget, which sent 10-year Italy-German sovereign yield spreads to five-year highs. All these factors make it difficult for the region's equity markets to regain traction, despite stronger employment, capital investment, and lending environments. We would expect these factors to underpin economic growth, though risk may well be to the downside. Valuations are not demanding, and we favour Health Care, and Industrials companies which benefit from long-term structural trends such as infrastructure spend, urbanization, and digitalization.

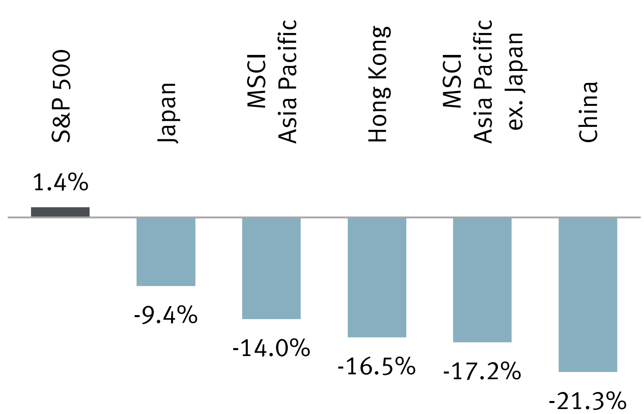
Global equity

- The defensive qualities of the U.K. equities market enabled it to outperform slightly in the period, in local currency terms. While the economy is holding up, Brexit negotiations are the real driver and there is still very little visibility there. We would expect U.K. equities to underperform in a hard Brexit scenario, but should our base case of a soft Brexit materialize, an upward rerating is likely given the FTSE All-Share Index's low 2019 P/E ratio of 11.9x and attractive dividend yield of 4.5%. We continue to favour Energy and Financials, with particular emphasis on life insurance.

Asia

- Asian equities continue to underperform in 2018. Losses are particularly acute in mainland China and Hong Kong and some peripheral Asian markets.
- Trade negotiations between the U.S. and China have ground to a halt. It is possible that something may be initiated between Presidents Donald Trump and Xi Jinping at the G20 at the end of November. But even if something does come of this meeting, the "cat is out of the bag" with respect to the wide range of issues with which the U.S. is now confronting China. There is no silver bullet to fix the situation. Indeed, we believe risks are skewed to a protracted deterioration in the relationship between the world's two largest economies.
- Recent verbal and policy intervention from the mainland China authorities to support markets may slow the pace of declines, which accelerated since tariffs were introduced in May. We think that the market bottom may coincide with earnings forecasts bottoming. Both 2018 and 2019 earnings forecasts for MSCI China sectors have been consistently revised down for the past six months.
- We recently upgraded Japan to Overweight from Market Weight. Employment data is particularly strong. Inflation is low, but positive—a significant achievement for Japan. Earnings growth is decent and equity valuations are attractive. Corporate cash levels continue to rise. The price-to-book value of the TOPIX Index remains relatively low despite return on equity, a measure of profitability, reaching a cycle-high of around 10%. One risk is appreciation of the yen. However, we expect the yen to weaken in 2019.

2018 returns (local currency)

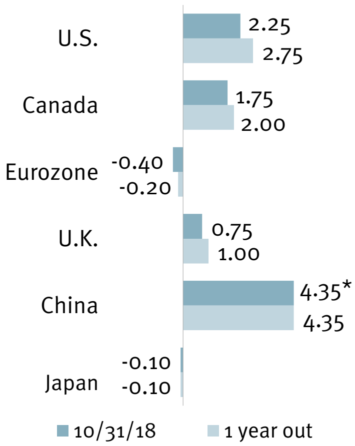


Asian equities are generally lower than their U.S. peers in 2018 on a deteriorating trade backdrop with the most acute losses experienced in China.

Source - RBC Wealth Management, Bloomberg; data through 10/31/18

Politics and central banks

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

The concept of an independent central bank is well rooted as being fundamental to the conduct of modern monetary policy, yet central banks and their respective governments can often have love-hate relationships. Governments love central banks when the banks' actions support a government's own fiscal policies and hate them when they conflict. The dissatisfaction usually manifests itself in political jawboning, but as we saw last summer in Turkey it can take on more sinister overtones.

Independence granted

The establishment of the U.S. Federal Reserve in 1913 set the stage and standards for the concept of an independent central bank which many others have followed since. The commonalities among many central banks in the post-Great Recession environment center on setting the objectives and targets for monetary policy, which have focused on stabilizing economies and financial systems.

Baby steps

The success of these measures is evident in the pace and durability of the current economic recovery, yet the process has been uneven across borders. The Fed and the Bank of Canada will continue to raise rates, albeit gradually, into 2019, while the Bank of England maintains a pace of one rate hike per year for the foreseeable future, subject to a productive Brexit negotiation outcome. The Bank of Japan (BoJ) and the European Central Bank (ECB), may be slow to start, yet recent measures from each—greater flexibility on rate targets from the BoJ and reduced securities purchases from the ECB—suggest additional policy normalization steps in the future.

Carry on

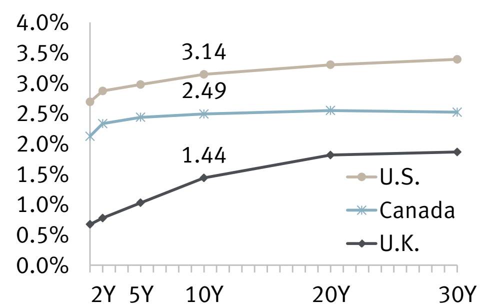
Political pressure on central banks can be unsettling for markets and investors, but the best demonstration of continued independence comes when central banks stick to their policy plans and not bend to the whim of politicians. In 2015, then-Fed Vice Chair Stanley Fischer noted that "over the past 25 years (global) central bankers have had to make use of their tools to meet unprecedented challenges.

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

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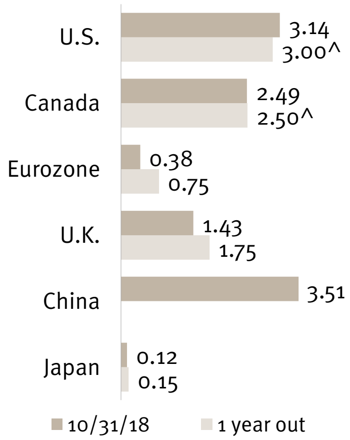
10-year rate (%)



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

Without the independence to pursue their mandates, this work would have been impossible."

Regional highlights

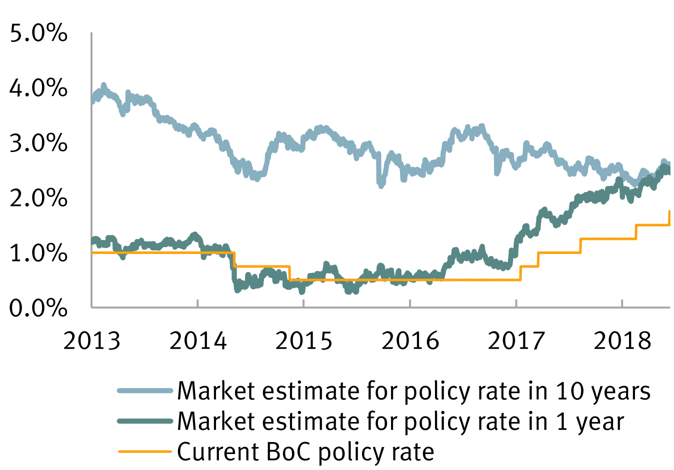
United States

- President Donald Trump has put pressure on Fed Chair Jerome Powell, but we expect this to have no impact on Fed policy decisions. The market is already pricing a 75% likelihood of the fourth rate hike this year at the December meeting, but that will depend entirely on the data. Growth has been robust of late, but should that moderate into year-end amid further equity market weakness, the Fed reserves the right to take a pass.
- The benchmark 10-year Treasury yield touched 3.23% in October, the highest level since 2011, and up 0.33% from the beginning of September. This is the third such jump in yields since the 2016 presidential election. Yields found tight trading ranges after the previous two moves, and this time should be no different, in our view. We expect the 10-year to trade between 3.10% and 3.40%, with 3.40% likely to prove to be the peak for this economic cycle. But global growth concerns, as well as recent equity market pullbacks, should present downside risks for yields.
- Preferred shares, a highly interest rate-sensitive sector, have been the most impacted by the recent rise in yields. But given our view that we are near peak yields for the 10-year this cycle, we would recommend fixed-to-float coupon hybrid preferreds, which offer duration risk of less than five years, and yields near 6%.
- Municipal bonds underperformed Treasuries for much of October, falling 0.53% as supply increased and investors pulled money from municipal funds. The sector has become more attractive across the yield curve, but we continue to favor longer-dated municipal bonds, where tax-exempt yields exceed Treasury yields just 18 years out on the curve.

Canada

- In a particularly choppy month for global markets, Canadian Government yields ended marginally higher. The yield curve flattened, with longer-dated bond yields fully retracing an early month spike in the wake of weaker-than-expected retail sales and housing starts. Shorter-

Market expects just 3 more BoC rate hikes



With the BoC and the market at odds over policy rates, we suggest investors allocate to short- and intermediate-term bonds.

Source - RBC Wealth Management, Bloomberg; data through 10/28/18

dated bond yields were boosted by a hawkish Bank of Canada (BoC) that raised interest rates 25 basis points, as expected, but also dropped the language suggesting a "gradual" hiking path, replacing it with the "need to rise to a neutral stance to achieve the inflation target." The BoC's estimate of the neutral rate is roughly five hikes away from the current overnight lending rate though the market is pricing in a peak in rates two hikes short of that neutral rate.

- If the BoC follows through with reaching neutral but does not invert the curve along the way, yields would be set to rise on longer-dated bonds more than is currently priced in. We are more comfortable recommending short-to-intermediate maturities that offer a lower expected volatility of returns, a better source of liquidity as we edge closer toward the end of the cycle, and an opportunity to reinvest at more attractive rates if the BoC follows through with more hikes next year than is currently expected.
- Investment-grade corporate bonds and preferred shares haven't been spared from the market volatility. Large price moves in preferred shares have opened up a number of value opportunities, but we remain more cautious on corporate bonds, where valuations have improved but remain uninspiring.

Continental Europe & U.K.

Europe

- Despite the latest economic data being weaker than anticipated, European Central Bank (ECB) President Mario Draghi maintained that the risks to the eurozone outlook remained "broadly balanced," with no downgrading of view on the outlook for the euro area. With no changes made to the rhetoric on asset purchases or interest rates, our attention now turns to December, when we expect some clarity on the ECB's reinvestment policy for the maturing debt.
- Draghi suggested he was confident of an agreement between Italy and the EU over current budget negotiations and noted the ECB retains the ability to target an individual country's bonds through its Outright Monetary Transactions (OMT) policy, which can help alleviate the stress of higher Italian yields. Italian 10-year yield spreads versus Germany have dropped some 20 basis points recently; however, we expect them to remain volatile while

Italian & German yield spreads fall 20 bps in October

Italian 10-year yield & German 10-year yield spread

Source - RBC Wealth Management, Bloomberg; data through 10/26/18

negotiations continue. We still have a greater preference for European credit, although we are monitoring the impact of reduced monthly purchases of €15B per month for the remainder of the year.

U.K.

- In the U.K., political risks remain at the forefront of investors' minds given both the intraparty wrangling for Prime Minister Theresa May and the ongoing Brexit negotiations. This continues to drive investor sentiment, with U.K. 10-year Gilt yields falling toward their recent lows. We continue to position defensively, with our Market Weight views on both rates and credit.

Asia

- The combination of higher yields driven by a more hawkish Federal Reserve and heightened U.S.-China trade tensions continues to dominate the tone for the Asian credit market. Particularly, the U.S. dollar remained firm against most emerging market currencies like the Indonesian rupee and the Indian rupee, which is testing its lowest level in well over a decade. These factors conspired to drive the JP Morgan Asia Credit Index (JACI) return of -1.13% in October.

- With a trade war between the world's two largest economies on the horizon, China boosted the liquidity in its financial system. The People's Bank of China (PBoC) cut the reserve-requirement ratio (RRR) for large-scale commercial banks, shareholding commercial banks, city commercial banks, non-county rural commercial banks, and foreign banks by 1%, effective October 15, releasing some RMB 750B into the economy. While we do not expect the RRR cut to translate directly into better performance in the Chinese bond market, we acknowledge the major policy shift towards an easing bias, which in turn should help reduce volatility.

- China has also announced a $3B (dollar-denominated) sovereign bond issue. While the multi-tranche issue is small relative to the country's more than $3T in reserves, we believe China is looking to help anchor corporates' cost of borrowing. On top of the usual 5-year and 10-year government bonds (priced at 30 and 45 basis points over 5-year and 10-year U.S. Treasuries, respectively), China also launched a 30-year tranche (priced at 70 basis points over the 30-year U.S. Treasury). The issue was five times oversubscribed, which helped to somewhat stabilize market sentiment.

LNG: Winter is coming

Commodity forecasts

	2018E	2019E
Oil (WTI $/bbl)	68.18	75.91
Natural Gas ($/mmBtu)	2.95	2.85
Gold ($/oz)	1,275	1,300
Copper ($/lb)	2.89	2.75
Corn ($/bu)	3.75	3.94
Wheat ($/bu)	5.01	4.90

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

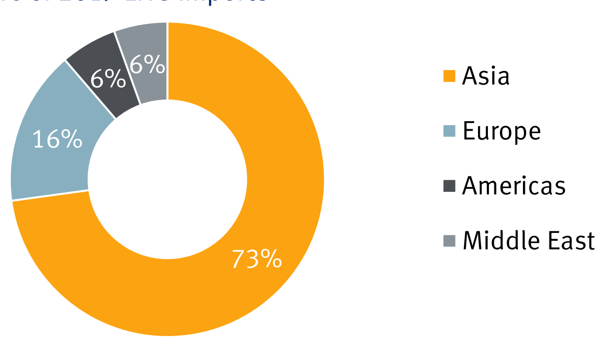
It's that time of year when we crank up the heat as the chilly weather begins to set in. However, not all countries have an abundance of natural gas. China has been transparent with its plans to curb pollution via liquefied natural gas (LNG) and is quickly becoming a key LNG importer. We take a look at challenges associated with balancing the perceived supply deficit.

Global LNG demand is anticipated to reach a record high of 308 million tonnes per annum (mtpa) in 2018 (up 8.5% y/y) according to Bloomberg, with half of that growth driven by China and the remainder split between Japan, South Korea, and India. LNG has become increasingly important in these regions fueled by declining local production, a lack of gas pipelines, and initiatives to combat air pollution and global warming. By 2030, Bloomberg expects 450mtpa of LNG will be required to keep the market balanced, with Asia accounting for about 86% of the total growth. The number of LNG importers has increased to 42 countries from 34 since 2015. Demand, however, is expected by Bloomberg to slow in 2020 before ramping back up as China starts to receive pipeline gas from Russia and as Japan restarts its ninth nuclear power plant.

The supply side tends to be more complex given the capital intensity of LNG projects and past difficulties in securing long-term contracts. The combination of buyers with credit ratings below investment grade and, in some cases, a preference for shorter-term contracts has made it challenging to move forward on project financing. Therefore, less established LNG players generally have less success in developing new facilities. Project geographies are also points of contention as increased transportation costs could incur unfavourable economics. The escalation in the trade dispute has caused China to impose a 10% tariff on U.S. LNG imports, making the Shell-led LNG Canada project more attractive, in our opinion. LNG Canada received a positive final investment decision on October 1 and plans to produce 14mtpa (starting in 2023), the equivalent of about 1.8 billion cubic feet per day (bcf/d) of natural gas production. According to the U.S. Energy Information Administration, production in the U.S. amounted to approximately 75 bcf/d in 2017.

All else equal, anticipated LNG demand outstrips the current supply environment. Therefore, while the road may be bumpy, we expect more projects to move forward with a positive final investment decision within the next few years.

Share of 2017 LNG imports



Demand from Asia will be a key driver behind the growth of future LNG projects.

Source - The International Group of Liquefied Natural Gas Importers (GIIGNL)

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Currency forecasts

Currency pair	Current rate	Forecast Dec 2019	Change*
Major currencies			
USD Index	97.12	96.67	0%
CAD/USD	0.76	0.78	3%
USD/CAD	1.31	1.28	-2%
EUR/USD	1.13	1.16	3%
GBP/USD	1.27	1.25	-2%
USD/CHF	1.00	1.03	3%
USD/JPY	112.94	125.0	11%
AUD/USD	0.70	0.67	-4%
NZD/USD	0.65	0.63	-3%
EUR/JPY	127.76	145.0	13%
EUR/GBP	0.88	0.93	6%
EUR/CHF	1.14	1.20	5%
Emerging currencies			
USD/CNY	6.97	7.30	5%
USD/INR	73.95	73.00	-1%
USD/SGD	1.38	1.40	1%

* 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: Onwards and upwards

The U.S. dollar surged in late September, reviving the uptrend seen over the April to mid-August period. Rising U.S. bond yields on the back of an upbeat Fed assessment of the need for further rate hikes appeared to spark the U.S. dollar's upswing. A ratcheting up of trade tensions dampened risk appetite and an October selloff in equity markets provided further support to this "safe-haven" asset. In our view, supportive factors should sustain U.S. dollar gains through early 2019.

Euro: Risky business

Renewed political pressures contributed to the euro tumbling from multi-month highs against the U.S. dollar in late September. A flare-up of frictions between Italy and the EU around the former's budget plan sent the cost of Italian debt sharply higher, souring investor sentiment. Italian risks should remain contained, although euro weakness could persist. Widening rate spreads favor the U.S. dollar through early 2019, in our view.

British pound: Buckle up for Brexit

After slipping to a 14-month low against the U.S. dollar in August, the pound gained ground in September before sliding again in October. Growing optimism that a withdrawal agreement would be reached between the EU and the U.K. underpinned the late summer rally before renewed Brexit uncertainty gripped the pound. With negotiations in a critical stage leading up to the planned March 2019 exit date, elevated uncertainty around how developments will unfold keep us cautious on the pound.

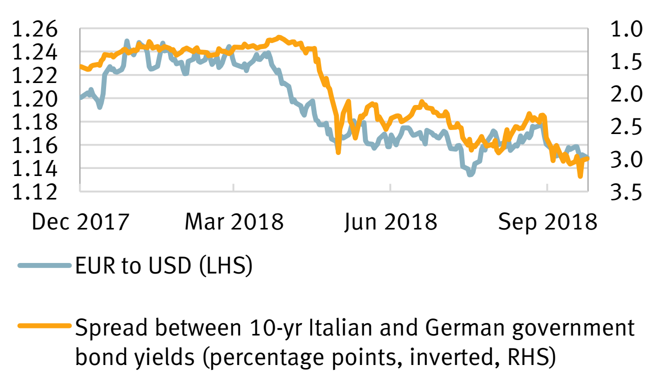
Canadian dollar: Trade relief?

A brief rally in the Canadian dollar following the announcement of the USMCA trade pact on October 1 unwound throughout the month, keeping the currency more than 4% lower against the U.S. dollar year-to-date. The Canadian dollar appears poised to strengthen, in our view, as financial markets shift focus to domestic economic conditions and the need for the Bank of Canada to raise its key policy rate further through the first half of 2019.

Japanese yen: Pressure may prevail

The yen found support in October after falling to an 18-month low against the U.S. dollar earlier in the month. The widespread global equity market decline and ensuing risk-off sentiment sparked a retreat to the perceived safety of the yen. However, without a shift to tighter monetary policy from the Bank of Japan, further Fed tightening through 2019 and an attendant rise in investor hedging costs should drive renewed yen weakness, in our view.

Italian pressures weighing on euro performance



Concerns around the Italian budget plan sent the cost of Italian debt sharply higher, adding further pressure to the euro.

Source - Bloomberg, RBC Wealth Management; data through 10/22/18

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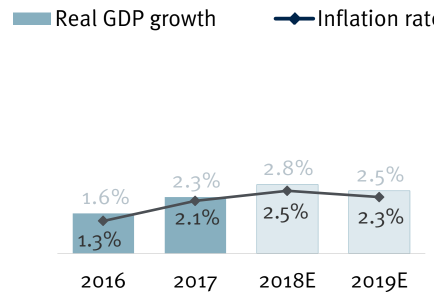
Key forecasts

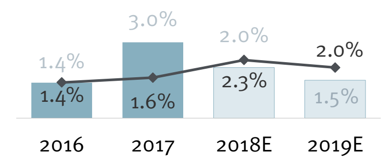


United States — Crosscurrents

- Continued economic growth with Q3 GDP at 3.5% q/q led by a 4.0% q/q increase in consumer consumption. Hiring and retail sales data skewed by fall hurricanes. Rising mortgage rates and a lack of affordable inventory hitting home selling activity hard, existing-home sales down by 570,000 units y/y. Midterm election uncertainty and equity market volatility potentially weighing on consumer/CEO sentiment.

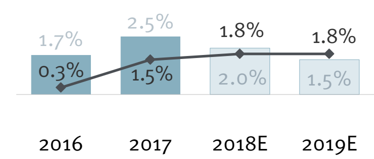
Canada — Mixed month

- The Bank of Canada raised rates as expected, signaled a desire to raise policy rate toward neutral, above current market estimates. Businesses' capital expenditure plans strong despite trade uncertainty. Hiring reaccelerated by 63,000 in September, pushing the unemployment rate back below 6.0%. Wages growing at 2.2%. Core inflation held at 2.0% y/y for second consecutive month.



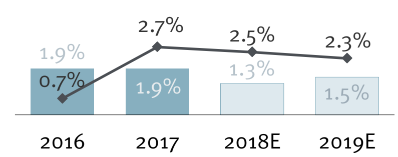
Eurozone — Italian credit downgrade

- Italian lawmakers continue to clash with the European Commission about the budget deficit of 2.4% of GDP. The nation's credit rating was put on negative outlook by S&P, while it was cut to Baa3 by Moody's. Eurozone PMIs continue to decline from summer highs, although still in expansion territory. Core inflation increased to 1.1% y/y from 0.9% y/y, led higher by rising education costs as the effect of legislative changes in Italy wears off.



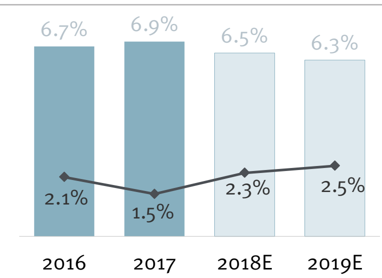
United Kingdom — Growth steadying

- The Bank of England made no changes to monetary policy as Brexit negotiations cloud the economic outlook, weighing on business spending. Yet officials believe the output gap has closed, and that inflation will remain above 2% over the next 3 years. Industrial and manufacturing production both rose a solid 1.3% y/y, respectively. Core inflation dipped to just 1.9%, the slowest pace of 2018.



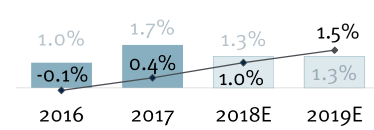
China — Support coming

- Q3 GDP growth slowed to 6.5% y/y, the slowest pace since 2009. Industrial production rose just 5.8% y/y and the Manufacturing PMI approached 50 as new export orders declined. Stocks in deep correction and the yuan has weakened to nearly 7 per dollar. Government support is on its way including infrastructure spending, lower bank reserve requirements, and even personal tax cuts.



Japan — Temporary hiccup

- The Bank of Japan left its policy rate unchanged at -0.1%, with core inflation only increasing slightly to 1.0% y/y from 0.9%. Officials noted that risks are skewed to the downside given slowing growth in China as well as other emerging market weakness. Industrial output and retail sales stumbled, falling 1.1% and 0.2% m/m, respectively, as natural disasters temporarily slowed 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	2,711.74	-6.9%	1.4%	5.3%
Dow Industrials (DJIA)	25,115.76	-5.1%	1.6%	7.4%
NASDAQ	7,305.90	-9.2%	5.8%	8.6%
Russell 2000	1,511.41	-10.9%	-1.6%	0.6%
S&P/TSX Comp	15,027.28	-6.5%	-7.3%	-6.2%
FTSE All-Share	3,904.23	-5.4%	-7.5%	-5.2%
STOXX Europe 600	361.61	-5.6%	-7.1%	-8.5%
EURO STOXX 50	3,197.51	-5.9%	-8.7%	-13.0%
Hang Seng	24,979.69	-10.1%	-16.5%	-11.6%
Shanghai Comp	2,602.78	-7.7%	-21.3%	-23.3%
Nikkei 225	21,920.46	-9.1%	-3.7%	-0.4%
India Sensex	34,442.05	-4.9%	1.1%	3.7%
Singapore Straits Times	3,018.80	-7.3%	-11.3%	-10.5%
Brazil Ibovespa	87,423.55	10.2%	14.4%	17.6%
Mexican Bolsa IPC	43,942.55	-11.2%	-11.0%	-9.6%
Bond yields	**10/31/18**	**9/28/18**	**10/31/17**	**12 mo. chg**
US 2-Yr Tsy	2.867%	2.819%	1.600%	1.27%
US 10-Yr Tsy	3.144%	3.061%	2.379%	0.76%
Canada 2-Yr	2.338%	2.214%	1.394%	0.94%
Canada 10-Yr	2.494%	2.427%	1.951%	0.54%
UK 2-Yr	0.751%	0.824%	0.460%	0.29%
UK 10-Yr	1.437%	1.573%	1.332%	0.11%
Germany 2-Yr	-0.618%	-0.523%	-0.750%	0.13%
Germany 10-Yr	0.385%	0.470%	0.363%	0.02%
Commodities (USD)	**Price**	**1 month**	**YTD**	**12 month**
Gold (spot $/oz)	1,214.76	1.9%	-6.8%	-4.4%
Silver (spot $/oz)	14.25	-3.1%	-15.9%	-14.8%
Copper ($/metric ton)	6,036.50	-3.6%	-16.2%	-11.4%
Uranium ($/lb)	28.10	2.2%	17.6%	40.2%
Oil (WTI spot/bbl)	65.31	-10.8%	8.1%	20.1%
Oil (Brent spot/bbl)	75.47	-8.8%	12.9%	23.0%
Natural Gas ($/mmBtu)	3.26	8.4%	10.4%	12.6%
Agriculture Index	283.56	2.4%	0.5%	2.4%
Currencies	**Rate**	**1 month**	**YTD**	**12 month**
US Dollar Index	97.1270	2.1%	5.4%	2.7%
CAD/USD	0.7600	-1.9%	-4.5%	-2.0%
USD/CAD	1.3157	1.9%	4.7%	2.1%
EUR/USD	1.1312	-2.5%	-5.8%	-2.9%
GBP/USD	1.2766	-2.0%	-5.5%	-3.9%
AUD/USD	0.7073	-2.1%	-9.4%	-7.6%
USD/JPY	112.9400	-0.7%	0.2%	-0.6%
EUR/JPY	127.7600	-3.2%	-5.6%	-3.5%
EUR/GBP	0.8862	-0.5%	-0.2%	1.1%
EUR/CHF	1.1409	0.1%	-2.5%	-1.8%
USD/SGD	1.3857	1.4%	3.7%	1.7%
USD/CNY	6.9757	1.6%	7.2%	5.1%
USD/MXN	20.3389	8.7%	3.5%	6.2%
USD/BRL	3.7224	-8.1%	12.5%	13.8%

Chinese stocks took the brunt of the selloff on tariff impacts and concerns over slowing global growth.

Canadian 2-year yields fell following a mid-month BoC policy rate hike but later reversed to end the month higher.

Crude oil prices fell on concerns that Saudi Arabia would increase supply amidst slowing demand.

The yen strengthened as investors sought safe-haven currencies.

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 -2.0% return means the Canadian dollar has fallen 2.0% vs. the U.S. dollar during the past 12 months. USD/JPY 112.94 means 1 U.S. dollar will buy 112.94 yen. USD/JPY -0.6% return means the U.S. dollar has fallen 0.6% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 10/31/18.

Research resources

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