

Global Insight

Perspectives from the Global Portfolio Advisory Committee

Dialing back policy stimulus

With many economies on a firm growth footing, central banks think it's time to start to transition policy from extraordinary to ordinary.

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Room to run



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With the 10-year Treasury yield breaking above the top of the range it's been locked in for the past seven months, investors may possibly look for direction from how the German 10-year Bund responds to potential action from the European Central Bank, as higher Bund yields could nudge Treasury yields higher.

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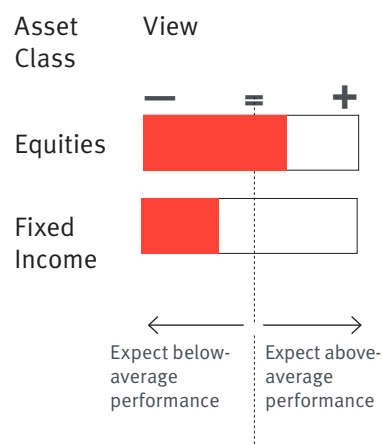
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All values in U.S. dollars and priced as of market close, October 31, 2017, unless otherwise stated.

RBC's investment stance

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See “Views explanation” below for details

Source - RBC Wealth Management

Equities

- Global equities pushed higher again in October as economic trends in most major economies continued to firm. Corporate earnings reports of economically sensitive, large multinational companies confirmed global growth is improving and, importantly, signaled it has room to expand further.
- While a consolidation period or pullback would be normal following double-digit year-to-date rallies in most markets, we believe a moderately Overweight position in global equities is still warranted as our positive long-term thesis remains intact. Corporate revenues, earnings, and estimates should continue to drift higher so long as the U.S. and global economies expand at least at an average pace and major central banks continue to focus on normalizing interest rates rather than restricting credit outright. We expect favorable conditions to persist in 2018, if not longer.

Fixed Income

- After an uneventful summer that saw U.S. volatility dip to an all-time low, Treasury yields spiked in the past two months, with the 10-year yield breaking out above its seven-month trading range on improved economic data and hawkish central bank rhetoric.
- But as important as the ebb and flow of the Treasury market is, Europe's bond market and central bank could help set the pace for the global fixed income market in coming months. Even though the European Central Bank plans to halve its bond purchase program in January and perhaps eliminate it altogether late in 2018, it seems unlikely to raise interest rates anytime soon. We believe this still-accommodative approach will help keep a lid on longer-term Treasury yields and on yields of other major fixed income markets over the medium term.

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.

Dialing back policy stimulus



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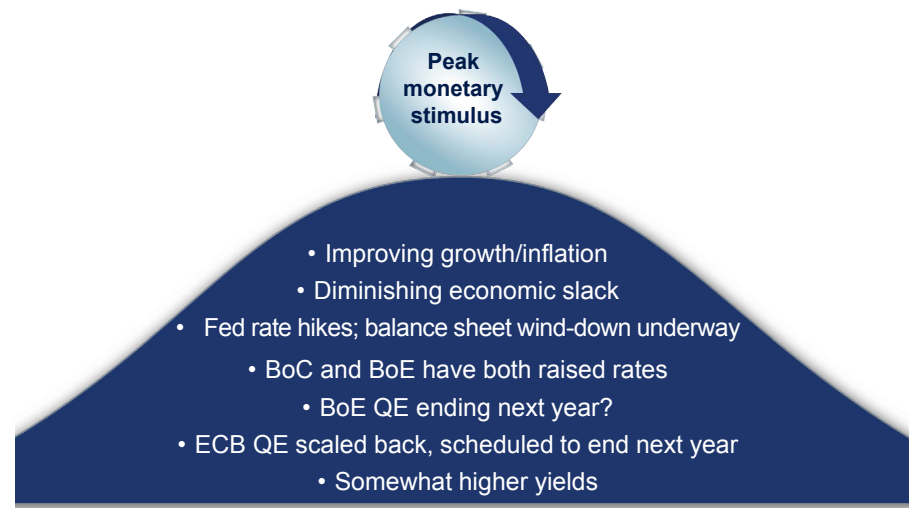
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Years of extraordinary monetary measures have allowed most major economies to regain a firm growth footing. Now a growing number of central banks feel the time has come to gradually return the policy setting to “normal.”

Global central banks used extraordinarily low benchmark rates and quantitative easing (QE) to deal with the impacts from the Great Recession and the European sovereign debt crisis. Now that economic conditions have stabilized central bankers feel it's time to begin normalizing monetary policy.

In this article, Craig Bishop and Alastair Whitfield provide their thoughts on the likely timing and trajectory of Federal Reserve (Fed) and European Central Bank (ECB) actions over the next couple of years.

Monetary stimulus is passing its peak



Source - RBC Wealth Management, RBC Global Asset Management

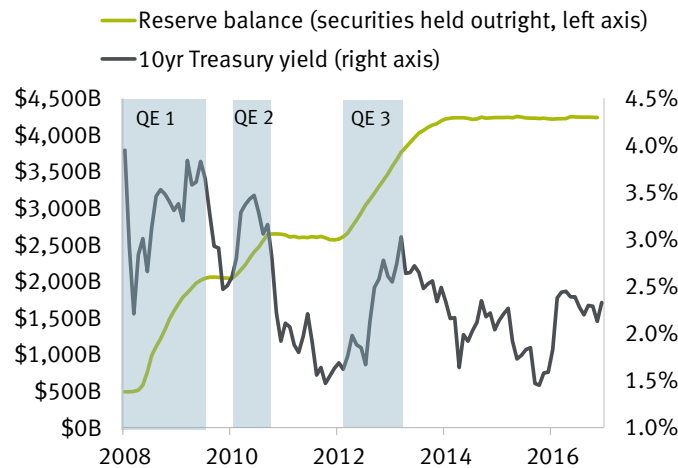
The great unwind

The Fed took short-term interest rates to zero in December 2008, where they remained for seven years. Recognizing that a zero interest rate policy wouldn't be enough by itself to stabilize the flailing U.S. economy, the Fed embarked upon a series of QE measures designed to lower longer bond rates as well as mortgage rates to more stimulative levels. That move increased the size of the central bank's balance sheet to \$4.5T (from about \$900B) over the course of six years (November 2008 to October 2014). In our view, the one-two punch of rate cuts and QE helped to pull the U.S. economy back from the brink and set the stage for its current solid underpinnings.

Dialing back policy stimulus

Once QE ended, the Fed acted to keep the size of the balance sheet near \$4.5T through the reinvestment of principal and interest payments until it judged the economy could stand on its own two feet. In the Fed's view, that time has arrived, and in October it began to unwind the balance sheet by not reinvesting all of the principal and interest payments it received that month. That amount left uninvested each month will taper higher over the next several quarters. Ultimately, reduced reinvestment and security maturities should result in an approximate \$2.0T–\$2.5T balance sheet. Due to the Fed's preparation, we don't expect this policy shift to be disruptive.

QE cycles and rate movements



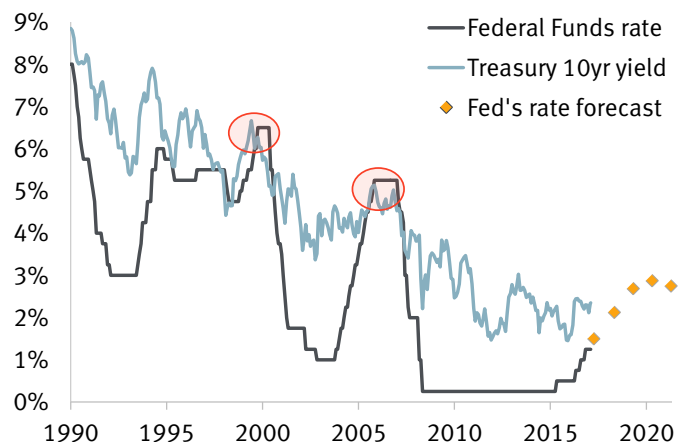
Past QE programs have corresponded to higher, not lower rates, as macro factors outweigh Fed demand changes.

Source - RBC Wealth Management, Bloomberg; data through 9/30/17

Rates – Fed on a mission

The Fed has been battling market expectations regarding its plans for raising interest rates since monetary policy normalization began in December 2015. It is not surprising the market remains skeptical of the Fed's forecasts given the four rate hikes forecast for 2016 turned into just one last December. But this year policymakers have stayed on track, with a likely rate hike next month fulfilling the Fed's three-hike projection from the beginning of the year. To us, the willingness

10yr yield typically restricted by peak Fed Funds rate



The Fed's long-run Fed Funds forecast of 2.75% could keep a ceiling on the 10yr yield.

Source - RBC Wealth Management, Bloomberg, Federal Reserve Forecasts; data through 10/5/17

Flatter curves have fanned recession fears, but, in our view, they are more reflective of current market dynamics.

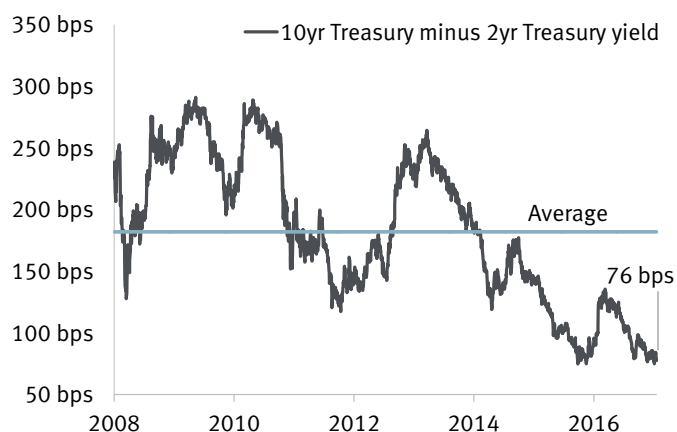
of the Fed to move ahead despite stubbornly low inflation—as measured by core Personal Consumption Expenditures (which exclude volatile food and energy prices) at 1.3%, well below the Fed’s 2% target—indicates a shift in attitude at the bank. The plan now, reading Fed Chair Janet Yellen and other officials, assumes inflation will reach the Fed’s target in the near term and they would rather act pre-emptively than wait for inflation to overheat. It is important to consider where Fed Funds settle when the Fed is done as this could determine the level on 10Y Treasury yields. In past hiking cycles, short- and long-term rates tended to converge at the terminal Fed Funds rate, and based upon the current “dot plot” (the projected path of short-term rates), it could be approximately 2.75% this time around.

Yield curves – Flatter for longer

The predictive power of yield curves has been on investors’ minds recently as the Fed’s rate hikes coupled with low inflation have combined to flatten the U.S. Treasury curve. The current 2Y/10Y Treasury difference is 76 basis points (bps), and the average since 2008 has been about 180 bps. Since December 2015, 2Y Treasury yields have increased 50 bps, while 10Y Treasury yields are higher by 4 bps.

Briefly, steep curves typically are seen as indicating an expanding economy; they also widen banks’ net interest margins and increase their appetite for lending. An inverted curve indicates the opposite, a slowing/recessionary economy as bank lending policies become more restrictive. Flatter curves have fanned recession fears, but, in our view, they more reflect current market dynamics of slow growth, inflation below the Fed’s 2% target, and steady, but gradual monetary policy normalization. To us this means the curve might even flatten further as short and long rates converge upon the terminal Fed Funds rate (see above) over the next two years. We do not yet see a recession on the horizon.

Further curve flattening likely as Fed tightens



Rising short-term rates from the Fed are likely to keep a lid on growth and inflation, pushing the yield curve flatter.

Source - RBC Wealth Management, Bloomberg; data period 10/14/08 – 10/31/17

Fiscal plans – Still waiting

Donald Trump’s election victory boosted hopes for a quick passage of his pro-growth agenda in the Republican-controlled congress. With Fed Chair Janet Yellen noting on several occasions the importance of fiscal policy and monetary policy to stimulate growth, expectations were high. Now, one year later, markets are still waiting and though currently buoyed by hopes for a grand tax reform plan, we believe the ultimate package will underwhelm growth projections, and tax reform

Powell will most likely continue with the slow and gradual pace of interest rate hikes, which has the market breathing a sigh of relief.

will become more modest individual and corporate tax cuts with a delivery date sometime in 2018.

Changing of the guard at the Fed

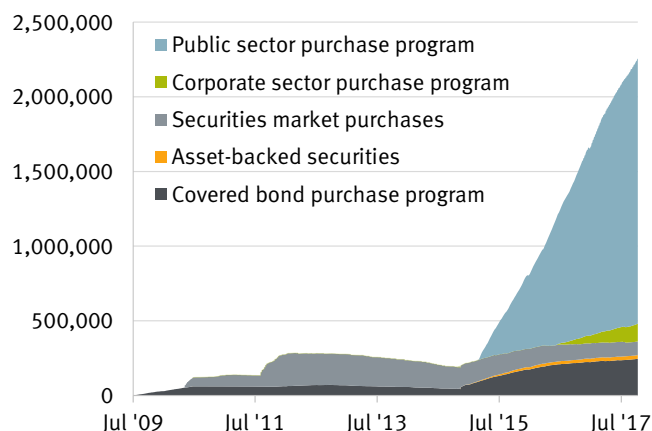
On the campaign trail, candidate Trump expressed his displeasure with Yellen even though his pro-growth agenda would likely benefit from current Fed policy. Despite the president saying Yellen has done an excellent job, Trump nominated current Fed Governor Jerome Powell to replace her as chair. Like Yellen, Powell will most likely continue with the slow and gradual pace of interest rate hikes, which has the market breathing a sigh of relief following speculation that Stanford University Professor John Taylor could be the next chair, as he was expected to be notably more hawkish with monetary policy. The bigger difference between Yellen and Powell lies in their stance on regulation of the financial services industry. Powell has stated that he is in favor of Dodd-Frank regulation and bank capital requirements enacted following the financial crisis, but notes that “we can do it more efficiently.” Powell also will likely look to reduce the regulatory burden on the small and mid-sized banks that felt the largest negative impact from financial crisis era reform.

Stealthy unwind in eurozone

The ECB’s gradual unwinding of its QE program is already underway. The central bank has increased the size of its balance sheet by more than €2T since 2009. Additionally, it has maintained a negative interest rate policy (NIRP) since the deposit rate was first reduced to -0.10% in June 2014 and subsequently cut to its current -0.40% level in early 2016.

ECB balance sheet expansion

Euro (in millions)



The ECB’s balance sheet has expanded by over €2T from its various purchase programs.

Source - RBC Wealth Management, Bloomberg; data through 10/16/17

The central bank started a slow unwind when it reduced its monthly asset purchases from €80B per month to €60B last December. In March of this year the language used by ECB President Mario Draghi removed reference to “using all instruments available within its mandate,” and then forward guidance was modified further in June by eliminating “or lower” when describing the future interest rate path.

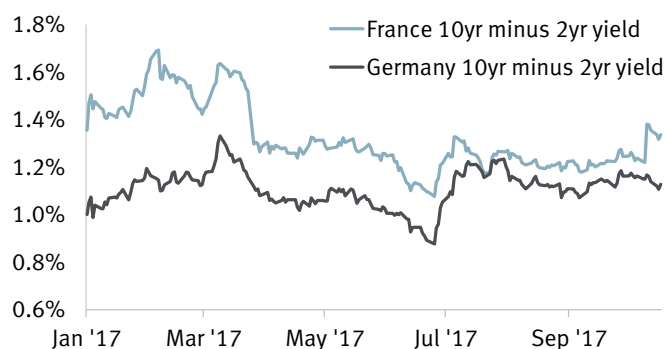
Dialing back policy stimulus

ECB opts for “lower for longer” QE tapering.

Now the ECB has announced the next stage of its tapering plan with monthly purchases to be reduced from €60B at the end of this year to €30B starting in January 2018. This reduction is consistent with expectations prior to the recent meeting, and was not as aggressive as some economists’ estimates had suggested with the amount to be possibly reduced to €20B. However, despite this tapering process, the unwind is set to remain gradual with the central bank maintaining an accommodative stance toward monetary stimulus.

As mentioned, this was already well flagged and is line with what we have previously seen from the ECB in terms of providing forward guidance so as to minimize unwanted market disruption. Meanwhile, Draghi has remained dovish and indicated that net asset purchases are to continue until at least the end of September 2018, but even beyond if necessary. Additionally, the ECB indicated that it will reinvest redemptions from the purchase programs for an extended period of time and as long as necessary. This confirms the previous rhetoric which has forestalled any anticipatory rise in bond yields, and instead resulted in yields moving lower following the ECB’s meeting. A reduction in monetary stimulus would typically indicate higher interest rates further down the line, which would inevitably push bond yields higher. But this remains absent while the current policy is maintained. The implied probability of a hike in policy rates by the end of 2018 remains low at only 30%.

Germany and France 10yr minus 2yr yields



Expectations for a rate hike by the ECB remain low as seen by the relative lack of change in 10yr minus 2yr yield spreads since the start of the year.

Source - RBC Wealth Management, Bloomberg; data through 10/18/17

We believe the ECB’s cautious stance around potential interest rate hikes is warranted. While eurozone economic data has shown Purchasing Managers’ Index data remaining elevated and GDP maintaining solid momentum, debt-to-GDP ratios are only just beginning to turn lower in the large euro area economies, and trajectories in Spain and Italy still remain vulnerable to any shock in baseline assumptions. Also, investment growth remains sluggish across the region, raising the question whether there will be any change in interest rates before Draghi’s term as president ends in 2019.

Yield curveball

Normally, reduced bond purchases by the central bank would mean that bond prices would weaken and bond yields would rise. Given that the ECB is likely to keep short-term rates very low (probably negative) for some time, that would suggest a steeper yield curve. However, we expect any such steepening will be modest for two reasons.

Dialing back policy stimulus

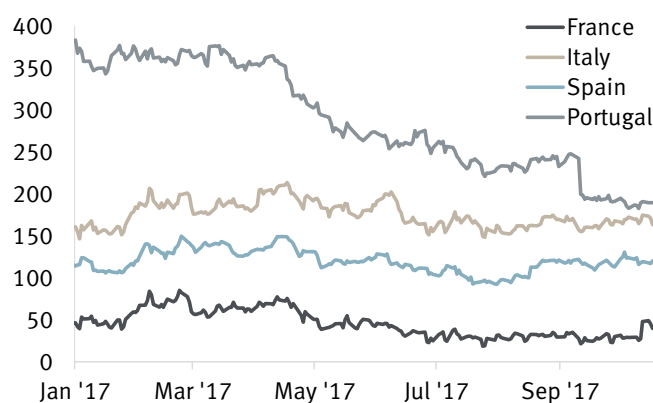
The bank's policy stance is likely to remain net accommodative until inflation ticks closer to its 2% target.

First, bond purchases by the bank have targeted longer-term maturities of peripheral country debt, which has kept the yields on those securities lower than they otherwise would be and restrained yields on core country debt in the process.

Second, bonds previously purchased by the ECB and scheduled for redemption in 2018 are estimated to be approximately €10B per month in 2018 by RBC Capital Markets, making the gross reduction in purchases significantly lower than the headline figure may suggest. Additionally, comments from the recent meeting suggest that these will remain a key feature for some time still.

Moreover, the ECB should be able to resist increasing its short-term policy rate for some considerable time. Despite solid GDP growth, a narrowing of the dispersion in economic performance between countries, and the steady decline in unemployment, there remains sizeable excess capacity keeping wages stable and core inflation low at just 1.1%. The bank's policy stance is to remain net accommodative until inflation ticks closer to its 2% target. Given that the ECB is likely to remain a significant participant in the market for the time being, we do not anticipate a sustained move higher in eurozone bond yields at this juncture.

Euro area 10yr yield spreads remain anchored



Despite talk of a QE unwind, euro area government spreads continue to remain relatively tight.

Source - RBC Wealth Management, Bloomberg; data through 10/18/17

Syncing up

We've focused on the Fed and the ECB in this article, but it can't be ignored that other central banks, such as the Bank of England and the Bank of Canada, are also moving to reduce monetary policy stimulus. So far, however, both are removing extra accommodation put in place to cushion the blow from recent economic and/or political events. Once completed, they will likely begin a holding pattern for future hikes, but we feel with improving global economic fundamentals it is only a matter of time before they too initiate the gradual, deliberate policy normalization process.

The Bank of Japan (BoJ) is likely to be the last to join the normalization party, all the more so given Prime Minister Shinzo Abe's convincing election win on October 22. However, Japan's economy is now growing consistently at 1% or better while the country's chronic deflation has given way to modest but sustained readings above zero. The prospects for more aggressive monetary easing have dimmed considerably and, in our opinion, further progress toward the BoJ's 2% inflation target will eventually begin to push market expectations toward anticipation of this last major central bank scaling back its extraordinary monetary accommodation.

Room to run

For some, the U.S. stock market action of the past couple of weeks might be ringing alarm bells. At first glance it appeared the S&P 500 and Dow Industrials were being propelled higher almost entirely by the sharp upward move of a few heavyweight all-stars—Microsoft, Amazon, 3M, and Caterpillar among them. Was it the beginning of a typical end-of-cycle divergence where the majority of stocks weaken while fewer and fewer large caps carry the market index up to its final peak?

We don't think so and for many reasons. The most important is that there is a better explanation: the big stocks that have been surging have done so in response to blowout earnings accompanied by strong forward guidance. Big caps that disappointed—notably GE—sagged. Meanwhile, the breadth of the market—how many stocks are going up versus how many are falling—is “in sync” with the overall price direction of the market. And that looks in no danger of changing.

Equity views

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

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

What's more, beyond the U.S., other major stock markets have been uniformly upbeat. That's particularly true for Europe, where we remain Overweight and where the Spanish crisis has failed to stop the broad averages from hitting new cycle highs. The U.K. market continues to shake off Brexit even as Canada's TSX, buoyed by banks and Energy, seems unfazed by NAFTA worries.

In Asia, Tokyo and Shanghai are at new cycle highs. Interestingly, now at an all-time high, is Korea's KOSPI, often

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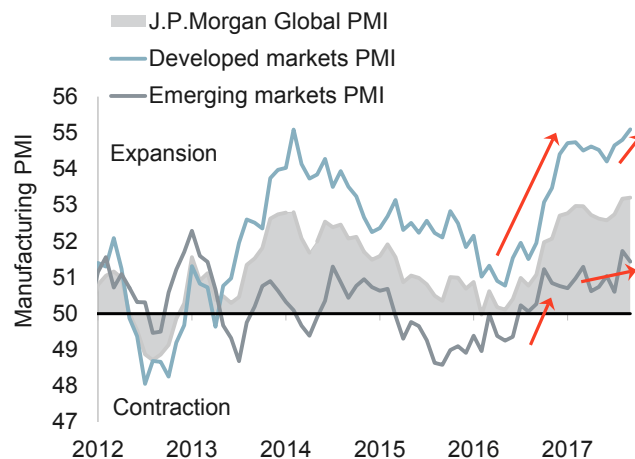
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Global manufacturing expanding robustly



Global economic signal has improved nicely.

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

referred to as “Dr. Market” because its direction often leads that of global industrial production. This, despite the fact Korean investors would appear to have other pressing issues to consider.

The earnings outlook is quite robust across the developed world and increasingly within the emerging economies. For example, we forecast S&P 500 earnings, which have stagnated for three years around the \$118 per index share level, at \$130 for this year and \$141 for next. We see even stronger growth in Europe. The S&P projected earnings have nothing included yet for whatever may arrive by way of tax reform or a cut in tax rates although the price-to-earnings multiple may have been baking some of this into valuations in recent weeks.

The biggest risk we see, outside of geopolitics, would come from an inability of Congress to deliver on a meaningful reduction in corporate tax rates. Should that happen, it could provoke a market pullback that retraces some of the gains since last spring. Given that there were very few prospects for any tax deal until recently, we expect any market reaction

to a failure of legislative deal-making to be limited.

With the consumer in confident, robust good health, CEOs upbeat about corporate prospects, and credit conditions still a very long way from restrictive, we expect the economic expansion and, hence, upward march of earnings and share prices have further to run. Conditions in most other important economies and markets are variations on the same theme.

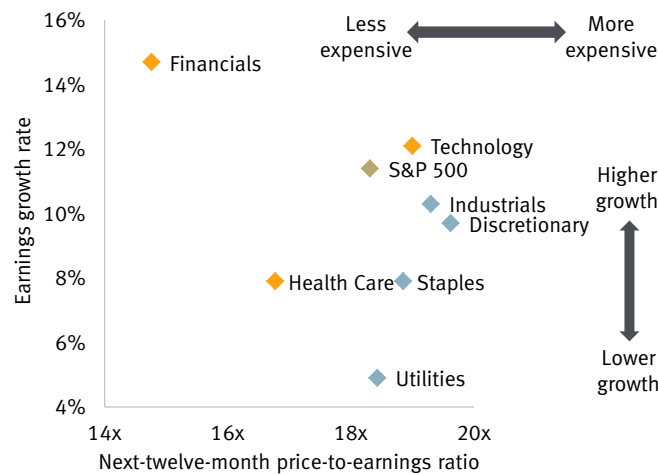
The only thing missing is mouth-wateringly cheap share prices, which, in our judgment, would be asking for too much at this stage in the long upward climb from the lows of the Great Recession. We regard our moderately Overweight commitment to equities as appropriate in a global portfolio and expect today’s favorable conditions for the economy and equities to extend through 2018 and probably beyond.

Regional highlights

United States

- The market’s persistent rally has been supported by strong economic data and the likelihood both the expansion and earnings growth will continue

U.S. sector growth and valuations



The three favored sectors offer varying blends of growth and value at better levels than the market.

Source - RBC Wealth Management, Bloomberg, Thomson Reuters I/B/E/S; data through 10/27/17; Telecom, REITs, and Energy excluded due to extreme values for various reasons

next year. Manufacturing activity, for example, climbed to the highest level in 13 years. None of our recession indicators are flashing red, or even yellow, for that matter, indicating the economy's foundation is the most stable of this cycle. To us, this should support at least an average increase in profits in 2018. If tax reform passes, earnings growth could be greater still.

- Q3 earnings season got off to a slow start mainly due to the insurance industry's severe hurricane losses. But due to strong earnings and revenue gains from the Technology and Industrials sectors, S&P 500 earnings growth is pacing at 7.0% y/y, despite a drag of roughly two percentage points from the insurers. We expect S&P 500 growth to exceed that level in Q4 as the insurance headwind lifts.
- We would continue to hold Market Weight exposure in U.S. equities—meaning invest at the strategic long-term allocation level in portfolios. For long-term positioning, we still favor Health Care, Technology, and Financials, with the former being the most attractive from a valuation standpoint.

Canada

- We recommend a Market Weight for Canadian equities. With respect to key market segments, we have become more constructive on the prospects for the domestic banks but remain wary of the medium-term outlook for the Energy sector.
- We believe bank valuations are reasonable and could expand in the event investors become more comfortable with the outlook for the housing market. Consensus expectations call for earnings growth of 5% next year, which we believe is a low hurdle. RBC Capital Markets

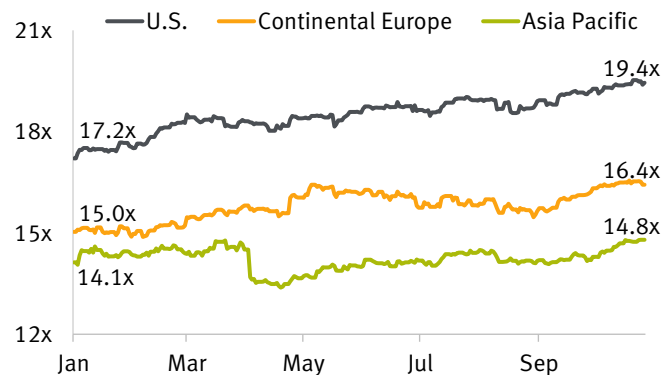
estimates that there could be double-digit upside to its 2018 earnings expectations if assumptions on credit losses, net interest margins, and expenses prove overly conservative.

- Canada's federal bank regulator released final guidelines on residential mortgage underwriting. The new rules will require that non-insured mortgage borrowers qualify for new loans at the greater of the contracted rate plus 2% or the Bank of Canada's five-year benchmark rate. RBC Economics believes the guidelines pose downside risk to its housing forecast but that the most likely outcome for the housing market remains a soft landing.
- NAFTA renegotiations have struggled to establish momentum with a number of U.S. demands considered to be nonstarters by Canada and Mexico. Whether these are genuine or part of a negotiating strategy is unclear but a number of strategists and economists are ascribing higher odds to an adverse outcome. RBC Global Asset Management increased its assumed probability of a NAFTA termination to 40% (from 15%).

Continental Europe & U.K.

- We maintain an Overweight recommendation on Europe. Economic momentum is robust, and the region's economy should continue to expand at an above-trend pace, in our view. Business sentiment is at a 10-year high, while German consumer confidence is at a 30-year high. Supportive factors include healthy credit growth and a gently stimulative fiscal policy, after years of extreme credit constraint and belt tightening.
- Given the summer strength of the euro, consensus expectations for Q3 corporate earnings were ratcheted down to mid-single-digit growth. The

Global valuations climbing at differing rates



European and Asian equities offer relative discounts on valuations that have expanded less quickly than their U.S. peers.

Source - RBC Wealth Management, Bloomberg; data through 10/25/17; forward price to earnings ratio used as valuation measure

lower hurdle should be surpassed given the strength of the domestic economy. For full-year 2018, earnings expectations point to respectable 8.5% growth.

- Equity valuations are now slightly above long-term averages, though this can be said of most regions. The discount relative to the U.S. remains unduly wide, in our view.
- We still like sectors exposed to the domestic European economy. Banking in particular appears poised to benefit from loan growth after years of cost rationalisation, as well as rebuilt balance sheets.
- The U.K., on the other hand, continues to be mired in uncertainty stemming from stalled Brexit negotiations and a weak government at a time the country is trying to redefine its economic model. The risk the U.K. crashes out of the EU without a deal on the future relationship continues to be uncomfortably high. As the economy weakens, we prefer U.K. companies with overseas revenues.

Asia

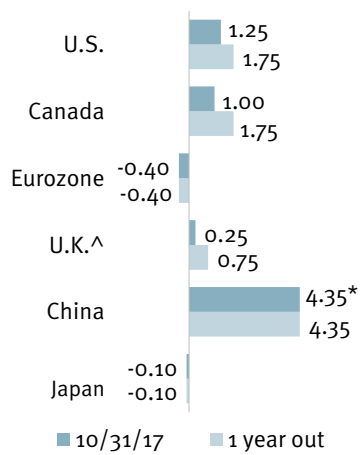
- The MSCI AC Asia Pacific Index continues to have a good year, +23.7%, and posted a strong return in October. A number of Asian indexes

are at all-time highs, propelled by the coordinated improvement in global leading economic indicators through the year. A period of consolidation is increasingly likely.

- Japanese Prime Minister Shinzo Abe won a convincing victory in the general election. Additionally, the Liberal Democratic Party won an important two-thirds majority in the powerful lower house of the Diet, Japan's parliament. Both the Nikkei and the TOPIX rose on the results as investors digested the strong likelihood the current direction of policy, which has been very friendly towards the equity market, will continue. The Nikkei is trading at its highest level since 1996. Japanese stocks have seen strength in 2017 despite the fact that the yen has actually appreciated modestly against the dollar.
- China's Q3 economic performance was robust, once again. FX reserves have been rising, and the currency has been stable. The consistency from China, coupled with benign equity markets in the world's second-largest economy, has been a tailwind for Asia in general. However, we maintain a Market Weight view on Chinese stocks. Valuations, especially for A shares, are not attractive.

Home on a *new* range?

Central bank rate (%)



^under review
*1-yr base lending rate for working capital, PBoC
Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, Consensus Economics

For seven months the 10-year Treasury yield has traded in a 2.10%–2.40% range due to slow global growth, low inflation, and geopolitical tensions. After testing the top of the range in recent weeks, we saw a brief breakout as global economic prospects have improved moderately, but also as a result of saber-rattling by major central banks with regard to potential policy actions and expectations for personnel changes at the Federal Reserve. We think, for now, investors should look to the European Central Bank (ECB) and the German 10-year Bund yield for direction.

In 2016, the German 10-year yield spent almost four months (mid-June to mid-October) in negative territory, hitting its all-time low of -0.19%, interestingly enough, at about the same time the 10-year Treasury yield bottomed at 1.36%. Brexit had just occurred and disinflation and deflation fears gripped the markets. From those levels, Treasury yields began their march higher, first as a result of improving economic fundamentals, and later following the 2016 U.S. presidential election. The Fed, after standing pat all year, hiked rates that December. Since then, the Fed has been on a steady, gradual path of policy normalization. It's been a slightly longer path to higher yields for the Bund, but a year after posting their historical lows, yields were almost 80 basis points higher. Here too, similar to the 10-year Treasury, central bank activity was a catalyst for higher yields as the ECB signaled a move toward reducing stimulus.

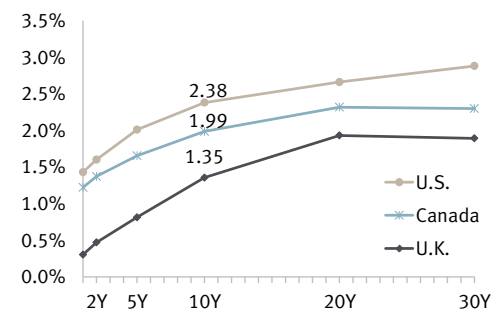
Higher Bund yields could very well push Treasury yields slightly upward, establishing a new range, but the message from the ECB is continuing to focus on maintaining an extended

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	-	=	5–7 yr

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

Sovereign yield curves



Source - Bloomberg

period of stimulus. In our view, this should constrain the rise in Treasury and global yields.

Regional highlights

United States

- Investors are once again eyeing a return of the reflation trade as global growth and inflation expectations have shifted higher in recent months, pushing central banks across most developed economies in the same direction toward tighter policy stances. The 10-year Treasury briefly traded through the upper limit of the 2.10%–2.40% trading range that has held for much of the past seven months before closing October at 2.38%. We continue to see the 2017

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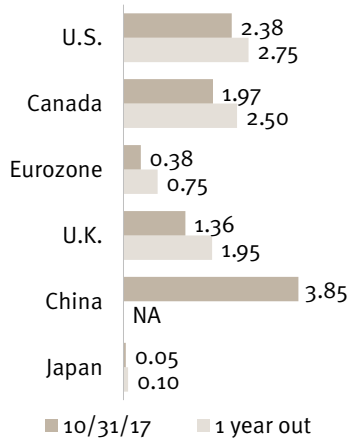
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Global fixed income

10-year rate (%)



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

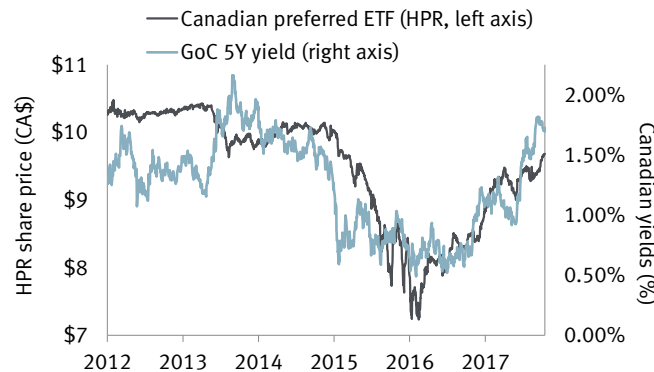
high of 2.63% as a firm ceiling for the rest of the year and would use a 10-year Treasury yield above 2.40% as an opportunity to extend maturities.

- As expected, President Trump nominated current Fed Governor Jerome Powell to replace Janet Yellen as the next Federal Reserve chair. Powell was seen as the “continuity candidate” who would continue Yellen’s dovish stance on monetary policy, but appease the administration’s deregulatory push. However, we note that no vice chair was nominated, and that the position could go to someone with a hawkish bias, but markets should weather that scenario.
- U.S. corporate bond markets are in a groove as improving economic growth, strong earnings, and low market volatility have all fueled a credit rally that pushed spreads—or the compensation for credit risk over Treasuries—near the lowest levels on record in October. The yield on the Bloomberg Barclays Ba US High Yield Index, one notch below investment grade, is now only 4.08%, just north of the all-time low of 3.91% set in 2013. In this environment where investors are not being rewarded for increased risks, we favor quality and see the best value in A and BBB-rated corporates.

Canada

- The Government of Canada curve has modestly flattened in October as yields fell in response to a more cautious-than-expected Bank of Canada policy meeting, challenging NAFTA renegotiations, and softer-than-expected domestic economic data. Although a moderation of growth is expected over the coming months after far exceeding its potential for four straight quarters, recent data shows that inflationary pressure also appears largely absent. In our view, this validates a patient, long-term approach to normalizing policy and reduces any immediate need to tighten further. Lower yields in October, together with the flatness of the curve, reduce the appeal of extension trades. We are more focused on bonds with short-to-intermediate maturities.
- We remain somewhat cautious of taking on more credit risk in Canada because investment-grade spreads sit close to the tightest levels in three years. Summer issuance was particularly strong but failed to dampen the significant demand for credit or for yield. We would continue to be selective when moving down the capital structure and would actively diversify geographic exposure.

The majority of Canadian preferred share prices are positively correlated with interest rates



We remain constructive on Canadian preferred shares over the medium term.

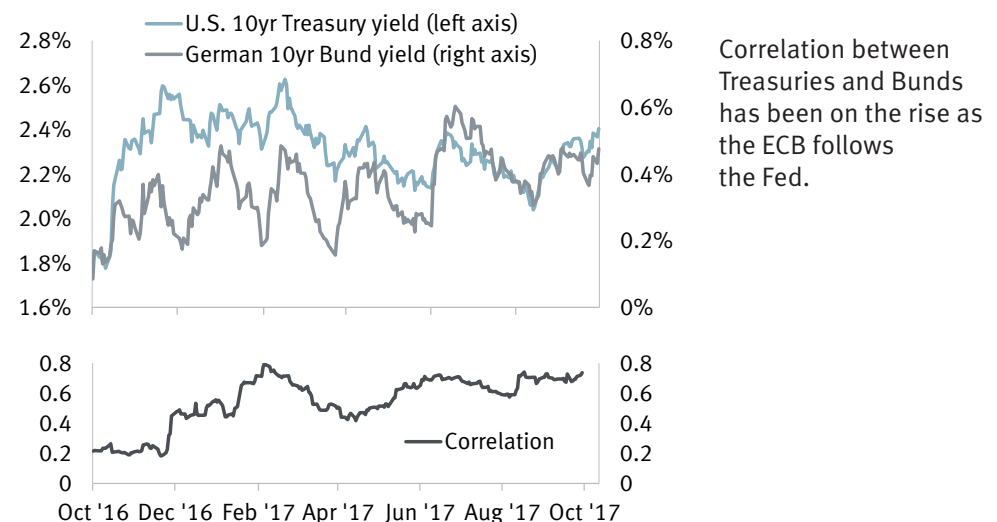
Source - RBC Wealth Management, Bloomberg; data through 10/24/17

- Preferred shares performed well in October in what looks like a delayed reaction to the move higher in government bond yields in September. We remain constructive on the prospects for preferred shares over the medium term while recommending diversification across share structure as well as sectors.

Continental Europe & U.K.

- Having not disclosed details in September of its tapering plans, the European Central Bank (ECB) announced a reduction in its monthly bond purchases from €60B per month to €30B at its October meeting.
- Despite this, ECB President Mario Draghi has remained dovish on the need to maintain monetary stimulus throughout much of 2018. With core inflation having slipped back to 1.1% y/y from 1.2% y/y, materially below the 2% y/y target, we expect the ECB to continue its accommodative approach while the region's growth remains healthy but inflation disappoints. With expectations for rate hikes not currently on the horizon, and both new bond purchases and reinvestments continuing for the euro area, we see core and peripheral government bonds remaining relatively well underpinned with spreads continuing to fluctuate around low levels.
- U.K. inflation upticked to 3.0% y/y for September vs. 2.9% previously, with RBC Capital Markets expecting the peak to be reached next month at 3.1%. This latest reading has increased our expectation the Bank of England will raise interest rates at its November meeting from 0.25% to 0.5%, with Governor Mark Carney likely to reiterate “the coming months” as a timeframe for additional hikes.
- We do not anticipate a November rate hike will translate into an outright tightening cycle in the U.K. The majority of Monetary Policy Committee members consider that “some” withdrawal of monetary stimulus is appropriate, although there is unlikely to be a unanimous decision.
- The U.K. continues to face challenges regarding its negotiations to depart from the EU, as well as a slowdown in economic momentum.

The key to Treasury movements may lie with German Bunds



Source - RBC Wealth Management, Bloomberg; data range: 10/26/16 – 10/24/17

(Re)balancing on a tightrope

Commodity forecasts

	2017E	2018E
Oil (WTI \$/bbl)	49.36	53.00
Natural Gas (\$/mmBtu)	3.07	3.16
Gold (\$/oz)	1,263	1,300
Copper (\$/lb)	2.67	2.75
Corn (\$/bu)	3.65	3.93
Wheat (\$/bu)	4.45	4.73

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

Oil prices have gathered modest momentum over the past two months, and now sit just shy of the 2017 highs. Near-term tightness in the physical oil market has led to rising spot prices and some backwardation at select parts of the futures curve. The recent strength reflects a number of factors: declining global inventories, improving expectations for global economic and oil demand growth, and geopolitical flare-ups. However, we believe prospects of increasing U.S. domestic shale output may limit further significant price gains.

OPEC, Russia, and other producers initiated production cuts at the start of 2017 in an effort to curb excess supply in the market. The process took longer than the group anticipated to bear fruit. However, according to the International Energy Agency (IEA), inventory levels finally seem to be reversing course. The IEA estimates that global oil inventories fell by 500,000 barrels per day in Q3 2017, the third consecutive quarterly draw. With the agreed production cuts extended until Q1 2018 and compliance levels at record highs, OPEC and other producers are showing real commitment.

The success of this effort to rebalance the global oil market depends heavily on continued demand growth. Indeed, that growth started to accelerate in recent months, and is expected to stay firm into next year. In September, the IEA revised its estimates higher for 2017 global oil demand growth for the third month in a row. The agency attributed the revisions to strengthening global economic conditions, which bolstered its confidence that shifting fundamentals are enabling demand to catch up with supply. Unplanned outages caused by geopolitical tensions in the Middle East, notably in Libya and Iraq, have also helped oil prices stay elevated.

As expected, the recent run in oil prices has led U.S. shale producers to revise their investment and drilling plans. Oil drilling activity in the Bakken is up almost double year over year, and the rig count continues to increase in the Permian. While higher U.S. production is unlikely to completely derail the OPEC rebalancing efforts, the market may be challenged to find an equilibrium price much higher than current levels. RBC Capital Markets currently foresees the WTI oil price to remain range-bound between \$45 and \$55 through 2018.

U.S. crude inventories

Million barrels



U.S. crude oil stockpiles have remained stubbornly high, but are finally showing signs of retreating.

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Source - RBC Wealth Management, U.S. Energy Information Administration; data through 10/13/17

Currency forecasts

Currency pair	Current rate	Forecast Sep 2018	Change*
Major currencies			
USD Index	94.55	98.30	4%
CAD/USD	0.77	0.79	3%
USD/CAD	1.28	1.26	-2%
EUR/USD	1.16	1.08	-7%
GBP/USD	1.32	1.24	-6%
USD/CHF	0.99	1.08	9%
USD/JPY	113.64	104.00	-8%
AUD/USD	0.76	0.73	-4%
NZD/USD	0.68	0.69	1%
EUR/JPY	132.34	112.00	-15%
EUR/GBP	0.92	0.87	-5%
EUR/CHF	1.16	1.17	1%
Emerging currencies			
USD/CNY	6.63	7.60	15%
USD/INR	64.74	66.80	3%
USD/SGD	1.36	1.45	7%

* 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: Pause for breath

Speculations around Janet Yellen's successor as chair of the Federal Reserve has created volatility, with the market attempting to infer what the future path of monetary policy is likely to take. The particularly bad hurricane season's impact on U.S. economic data is also making underlying trends more ambiguous. Once these temporary factors have fully washed out, we still hold the market will mark up its expectations for short-term rates, and carry the dollar with it.

Euro: Rates going nowhere, slowly

While the European Central Bank is beginning to show signs of discomfort over euro strength, it is still not a main focus for now. Commentary indicating a "lower for longer" train of thought suggests a very gradual pace of normalisation, perhaps even more so than the market is expecting. This slower-than-expected policy normalisation should keep the currency relatively contained over the next year.

British pound: Political machinations

After its strong performance through September, the pound gave up a lot of its gains in early October. The growing

risk of a leadership shake-up within the incumbent Conservative Party heightened the market's perception of U.K. political risks, compounded by negotiations with the EU struggling to make meaningful progress. We hold our bearish outlook for GBP as concerns around future growth build.

Canadian dollar: Bumpy road ahead?

CAD traded broadly sideways through October, despite reduced expectations of another rate hike by year-end. We expect the Bank of Canada will resume hiking rates over the next 12–18 months, and this will support CAD, which we expect to outperform most G10 currencies. However, risks from NAFTA renegotiations, a highly indebted consumer, and continued uncertainty in the Energy sector have the potential to derail the trend.

Japanese yen: Gradual ascent

The LDP and Komeito coalition maintained their two-thirds supermajority in the October general election. This continuity in the executive, and likely the policies of the central bank, will allow the yen to continue the gradual climb in evidence through much of the year so far.

Dollar continues to gradually regain its footing

U.S. Dollar Index



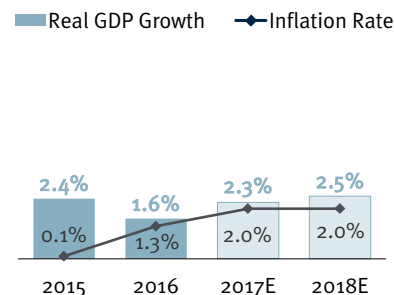
Tax reforms and higher rate expectations should carry the dollar higher towards year-end.

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Source - RBC Wealth Management, Bloomberg; data through 10/31/17

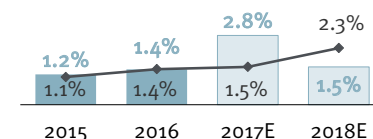
United States — Hurricanes skewed data

- Jitters surrounding Trump's nomination for Fed chair. Balance sheet unwinding began without any meaningful market moves. ISM manufacturing data firmed to cycle highs, sentiment indicators confirm strength. Hiring fell by 35K, but the unemployment rate fell to 4.2%, the lowest in a decade. Preliminary Q3 GDP at 3.0%. Housing activity slowed due to disruptions in the south. Inflation moved higher due to 11% increase in price of gasoline.



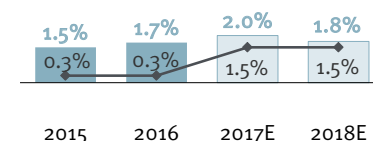
Canada — BoC on hold

- Softening data keeps Bank of Canada from a 3rd interest rate hike. Retail sales disappointed, falling 0.7% over the month. Headline inflation continued to accelerate higher to 1.6% y/y, from 1.2% two months prior; however, the increase was led by gasoline. Housing data mixed. GDP growth stalled to flat m/m. Pace of hiring remains steady, unemployment rate remains 6.2%.



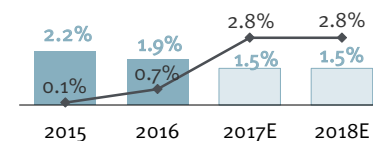
Eurozone — Slow and steady

- European Central Bank announced net asset purchases to be reduced to €30B a month starting Jan 2018 out to projected conclusion Sep 2018, or beyond, if necessary. Governing council suggested policy to remain stimulative until inflation gets "close to, but below 2%." Currently, core inflation sits at 1.10% y/y.



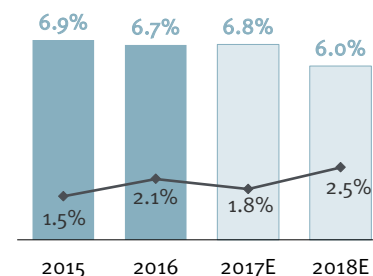
United Kingdom — Balancing act

- Inflation surged to 3% y/y, and Q3 GDP growth at 0.4% q/q surprised to the upside on better industrial production. BoE expected to raise rates this month. The bank will have to balance tepid consumer spending with a reduction in economic slack that may keep inflation from retreating.



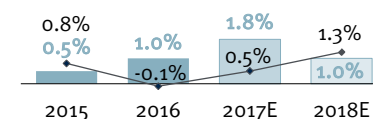
China — Quality growth over quantity

- GDP growth healthy at 6.8% in Q3, buoyed by retail sales and industrial production. Fixed asset growth sunk to 7.5%, slowest in 18 years, despite higher infrastructure spending by the government. De-risking measures to keep growth moderate through 2018, with restrictions on real estate speculation and higher short-term lending rates, designed to maintain a sustainable expansion.



Japan — Still work to do

- Core inflation stayed unchanged from prior month, rising just 0.7% y/y, below 2% target. Foreign demand driving growth as trade remains strong, with exports rising 14.1% y/y. Shinzo Abe's coalition election victory drove stock market optimism and weakened yen, and loose monetary policy expected to continue.



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

Market scorecard

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	2,575.26	2.2%	15.0%	21.1%
Dow Industrials (DJIA)	23,377.24	4.3%	18.3%	28.9%
NASDAQ	6,727.67	3.6%	25.0%	29.6%
Russell 2000	1,502.77	0.8%	10.7%	26.1%
S&P/TSX Comp	16,025.59	2.5%	4.8%	8.4%
FTSE All-Share	4,117.69	1.7%	6.3%	9.3%
STOXX Europe 600	395.22	1.8%	9.4%	16.6%
EURO STOXX 50	3,673.95	2.2%	11.7%	20.3%
Hang Seng	28,245.54	2.5%	28.4%	23.2%
Shanghai Comp	3,393.34	1.3%	9.3%	9.4%
Nikkei 225	22,011.61	8.1%	15.2%	26.3%
India Sensex	33,213.13	6.2%	24.7%	18.9%
Singapore Straits Times	3,374.08	4.8%	17.1%	19.9%
Brazil Ibovespa	74,308.49	0.0%	23.4%	14.5%
Mexican Bolsa IPC	48,625.53	-3.4%	6.5%	1.3%
Bond yields	10/31/17	9/29/17	10/31/16	12 mo chg
US 2-Yr Tsy	1.600%	1.483%	0.841%	0.76%
US 10-Yr Tsy	2.379%	2.334%	1.826%	0.55%
Canada 2-Yr	1.394%	1.517%	0.547%	0.85%
Canada 10-Yr	1.951%	2.099%	1.196%	0.76%
UK 2-Yr	0.460%	0.467%	0.263%	0.20%
UK 10-Yr	1.332%	1.365%	1.245%	0.09%
Germany 2-Yr	-0.750%	-0.692%	-0.618%	-0.13%
Germany 10-Yr	0.363%	0.464%	0.163%	0.20%
Commodities (USD)	Price	1 month	YTD	12 month
Gold (spot \$/oz)	1,271.07	-0.7%	10.3%	-0.5%
Silver (spot \$/oz)	16.72	0.4%	5.0%	-6.6%
Copper (\$/metric ton)	6,816.75	6.0%	23.4%	40.8%
Uranium (\$/lb)	20.05	-0.4%	-0.9%	7.7%
Oil (WTI spot/bbl)	54.38	5.2%	1.2%	16.0%
Oil (Brent spot/bbl)	61.37	6.7%	8.0%	27.1%
Natural Gas (\$/mmBtu)	2.90	-3.7%	-22.2%	-4.3%
Agriculture Index	276.82	-1.6%	-4.9%	-8.3%
Currencies	Rate	1 month	YTD	12 month
US Dollar Index	94.5520	1.6%	-7.5%	-4.0%
CAD/USD	0.7758	-3.3%	4.3%	4.0%
USD/CAD	1.2888	3.3%	-4.1%	-3.9%
EUR/USD	1.1646	-1.4%	10.7%	6.1%
GBP/USD	1.3283	-0.9%	7.6%	8.5%
AUD/USD	0.7656	-2.3%	6.2%	0.6%
USD/JPY	113.6400	1.0%	-2.8%	8.4%
EUR/JPY	132.3400	-0.4%	7.6%	15.0%
EUR/GBP	0.8767	-0.6%	2.7%	-2.2%
EUR/CHF	1.1618	1.6%	8.4%	7.0%
USD/SGD	1.3628	0.4%	-5.8%	-2.0%
USD/CNY	6.6350	-0.3%	-4.5%	-2.1%
USD/MXN	19.1466	4.9%	-7.6%	1.5%
USD/BRL	3.2713	3.4%	0.7%	2.4%

The Japan Nikkei 225 Index reached a 21-year high, helped by Prime Minister Shinzo Abe's coalition election landslide victory.

Short-term Treasury yields jumped on expectations for a nomination of a less dovish Fed chair.

Brent reached a 2-year high of \$60 per barrel as OPEC production cuts are expected to continue.

European currencies weakened on dollar strength and protests in Catalonia.

Equity returns do not include dividends, except for the German DAX and 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 0.77 means 1 Canadian dollar will buy 0.77 U.S. dollar. CAD/USD 4.0% return means the Canadian dollar has risen 4.0% vs. the U.S. dollar during the past 12 months. USD/JPY 113.64 means 1 U.S. dollar will buy 113.64 yen. USD/JPY 8.4% return means the U.S. dollar has risen 8.4% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 10/31/17.

Research resources

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Rating	Count	Percent	Investment Banking Services Provided During Past 12 Months	
			Count	Percent
Buy [Top Pick & Outperform]	859	52.92	294	34.23
Hold [Sector Perform]	660	40.67	154	23.33
Sell [Underperform]	104	6.41	7	6.73

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