GLOBAL
Insight
WEEKLY

Wealth Management

Perspectives from the Global Portfolio Advisory Committee December 19, 2024

# Are we there yet?

Atul Bhatia, CFA – Minneapolis

Markets head lower following a hawkish rate cut by the U.S. Federal Reserve. We discuss the reasons behind the Fed's shift and if investors really need to fear higher rates caused by stronger growth.

The Fed's decision to cut interest rates by 25 basis points (bps) on Dec. 18 was hardly a surprise. The move was predicted by almost 90 percent of economists surveyed by Bloomberg and was fully consistent with interest rate futures pricing ahead of the decision.

Slightly more noteworthy, in our view, were the changes to the central bank's Summary of Economic Projections (SEP)—known colloquially as the "dot plot." These showed policymakers shifting their projections higher for year-end 2025 GDP growth, inflation, and policy rates. Notably, policymakers now see only two 25 bps cuts in 2025, putting the median projection for the year-end federal funds rate 50 bps higher than it was at the September policy meeting.

### Fed projections warrant hawkish shift

| Metric | December meeting | September meeting | Change |
|---|---|---|---|
| Change in real GDP | 2.1% | 2.0% | +0.1% |
| Unemployment rate | 4.3% | 4.4% | -0.1% |
| PCE inflation | 2.5% | 2.1% | +0.4% |
| Core PCE inflation | 2.5% | 2.2% | +0.3% |
| Federal funds rate | 3.9% | 3.4% | +0.5% |

Source - RBC Wealth Management, U.S. Federal Reserve

But what really got markets to take notice was the hawkish tone to Fed Chair Jerome Powell's remarks, where he said that it would take further progress on inflation to justify additional rate cuts. Following his comments, U.S. Treasury bond yields rose between eight and 15 bps, depending on maturity, while the S&P 500 fell nearly three percent.

Despite this initial selling pressure following the Fed announcements, we believe a rate-cut pause is both warranted and salutary, and investors should focus on the economic strength driving the policy shifts.

## Data dependent, but for real this time

Since before this rate-cut cycle began in September, Powell has claimed the central bank's moves were "data dependent." Likely true, but only technically so from our vantage point. Since July, we think rate cuts were largely pre-determined. An outlier reading could have kept rates unchanged, but for all practical purposes, data dependency was purely theoretical.

Based on the Fed's most recent comments, however, our sense is that the central bank is now shifting into a more natural reading of "data dependency," where it comes at the decision with a neutral bias, and it will only move if the data justifies it.

And as we look at the numbers, we think a pause is clearly warranted.

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For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

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The Fed's job is to maximize employment consistent with stable prices. How is it doing? Well, it's hard to argue there's an employment problem. The benchmark unemployment rate is nearly one percent below its long-term median, and the broadest measure of labor weakness—which captures discouraged and underemployed workers—looks even stronger; it's 1.6 percent below the long-term median. These measures have drifted slightly higher, but it's undeniable that employment is stronger now than it was during prior economic expansions, let alone recessions.

Inflation—and not job creation—is arguably where the Fed should be focused, a stance that Powell's press conference seemed to finally acknowledge. The core components of the Consumer Price Index (CPI), which excludes food and energy, are up over three percent year-over-year and prices on the broad basket of goods have been rising at an accelerating monthly pace. The Fed's two percent inflation target is technically based on a different measure of consumer prices, the Personal Consumption Expenditures Price Index (PCE), that was up 2.3 percent year-over-year in October, the last available reading.

Normally, it would be reasonable to say that being within 0.3 percent of the inflation target is close enough. But this is not a normal inflation environment. We're coming off a bout of near-double-digit inflation and it has left its mark on the U.S. economy. Even as annual inflation levels have moderated, market indicators of longer-term inflation expectations have remained above pre-pandemic levels. Expectations on price moves tend to be self-fulfilling; typically, businesses that expect higher supply costs are quick to raise prices and workers who think costs are going up are more aggressive in looking for wage gains.

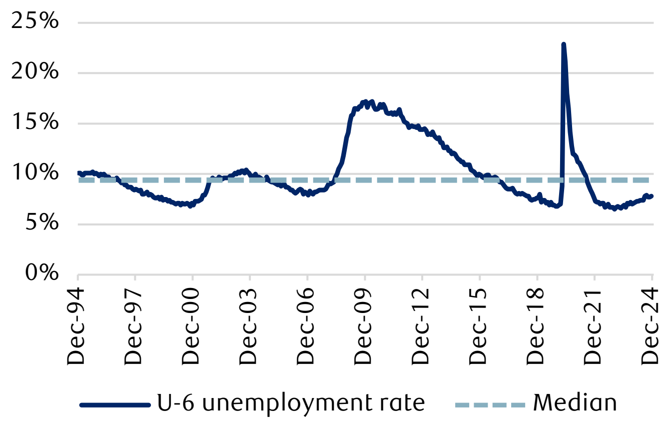
Against that backdrop, Powell's emphasis on inflation progress as a prerequisite for further cuts is reasonable, in our view. A contrary stance could risk losing control of the inflation narrative.

## Message of the markets

Although the S&P 500 sold off following the hawkish tone to Powell's press conference, we think it's a mistake to conclude that equity prices depend on lower interest rates.

For support, we need to look no further than the market's response since the Fed initiated its rate-cut cycle in September. Back then, investors were pricing in 2.5 percent of policy easing; today, that number is closer to 1.4 percent. Despite that shift toward higher future interest rates, and even with yesterday's selling, the S&P 500 gained five percent since the Fed's meeting in September. With monetary policy being driven by economic strength, we see nothing inconsistent with higher rates and higher stock prices.

**Broadest U.S. labor measure shows little weakness**




The U-6 unemployment rate includes the total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons.

Source - RBC Wealth Management, Bloomberg; monthly data through 11/30/24

We think the bond market is telling a similar story. Going into the Fed's September meeting, 10-year government bond yields were roughly 1.25 percent below three-month rates. As of Dec. 18, those rates are now essentially the same.

This type of relative move—referred to as curve steepening—can be a worrying sign when it's driven by the Fed aggressively cutting short-term interest rates to stimulate a slowing economy. That's not the case today, when the bulk of the steepening has come from rising long-term yields. That type of move is more consistent with a market pricing in solid economic growth and inflation risks than one that is concerned with an incipient recession.

## Risks remain

Putting it all together, we think a pause in rate cuts is clearly warranted. After that, policy should—and likely will—boil down to how prices and labor markets are performing. While current indicators are generally positive and could be consistent with little or no additional policy easing, future developments could warrant more aggressive rate cuts than the Fed currently projects.

The most obvious path we see for further easing is slowing inflation and rising unemployment, possibly from global economic softening reaching the U.S. Politics is also a potential factor. There is a growing probability of a U.S. government shutdown, for instance. In addition, the incoming Trump administration has indicated a wide-ranging set of measures that could create unanticipated, negative short-term economic consequences.

All in all, we think investors need to focus not only on what the Fed is doing, but why. And a shift toward slower interest rate cuts based on robust domestic economic performance is nothing to be feared.

## UNITED STATES

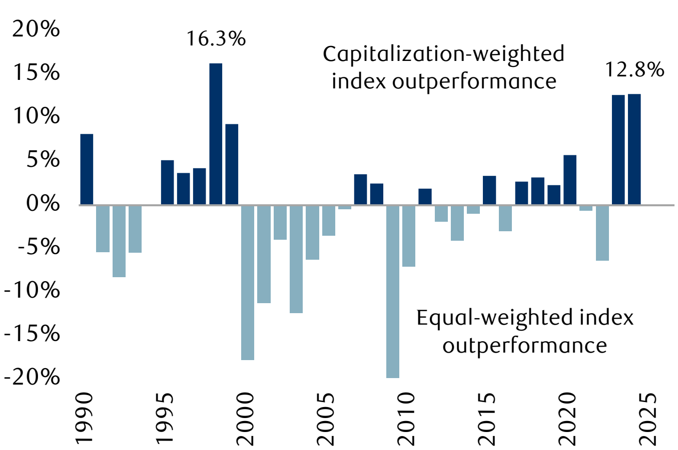
Tyler Frawley, CFA – Minneapolis

- **U.S. equities are on track for losses on the week** after selling off sharply in the wake of somewhat hawkish commentary from the Federal Reserve that followed its decision to lower interest rates on Wednesday. All major indexes are lower, with the Dow Jones Industrial Average being the worst relative performer, down 3.02%, and extending its losing streak to 10 consecutive trading days on Wednesday—its longest losing streak since 1974. The Nasdaq Composite has outperformed the S&P 500, but both are lower, falling 2.21% and 2.55%, respectively. Treasury yields moved sharply higher after the Fed's policy committee dialed back expectations for rate cuts in 2025, with the 10-year yield eclipsing 4.50%, the highest level since late May.

- **Narrow equity market performance has been a defining theme over the past two years,** with the market-cap weighted S&P 500 outperforming its equally weighted counterpart by 12.8% so far in 2024. This outperformance, if it holds, would be the largest margin since 1998, in a period marked by the lead-up to the Tech Bubble. It follows a similarly impressive 12.7% outperformance in 2023, underscoring the dominance of a small group of mega-cap stocks driving market returns over the past two years. Much of this outperformance has been fueled by enthusiasm surrounding artificial intelligence and the associated data center infrastructure buildout, which has disproportionately benefited a handful of technology and semiconductor companies. In fact, since the beginning of 2023, just eight stocks (NVIDIA, Apple, Amazon, Meta Platforms, Broadcom, Microsoft, Tesla, and Alphabet) have accounted for more than 60% of the S&P 500's overall 57.6% total return. While this leadership has powered impressive returns, it also leaves the broader market more vulnerable, in our view. Heavy reliance on these leaders creates heightened risks should AI-driven expectations falter or demand cool, and any missteps from these companies could ripple across the market. Historically, extreme periods of narrow leadership have often preceded corrections or shifts in market dynamics, suggesting investors may need to consider the risks of concentration while remaining vigilant for opportunities in overlooked areas of the market.

### Extremely narrow U.S. market breadth for a second consecutive year

S&P 500 Index performance minus S&P 500 Equal Weight Index




Source - RBC Wealth Management, Bloomberg; data as of 12/18/24

## CANADA

Luis Castillo & Josh Nye – Toronto

- **Canadian headline CPI came in a tick below consensus expectations in November** at 1.9% year over year (y/y) versus a 2.0% y/y consensus projection, the fourth consecutive month of headline inflation at or below the Bank of Canada's (BoC) 2% target. Price growth deceleration was broad-based in November, with the deceleration in mortgage interest costs being one of the main contributors. That being said, the BoC's preferred Core Median and Trim measures (which exclude volatile items from the calculation) came in above consensus expectations at 2.6% and 2.7%, respectively. Though these core measures are still much higher than the BoC would want to see at this stage, we don't think this will derail the bank from a 25 basis point rate cut in January. Underwhelming growth has led to notable slack in the Canadian economy, which we believe should further contribute to disinflationary pressure. The BoC has emphasized that growth needs to pick up to an above-trend pace to absorb slack in the economy and keep inflation from slowing too much.

- **The federal government's Fall Economic Statement (FES)** showed larger budget deficits but was eclipsed, in our view, by news from Parliament Hill as Finance Minister Chrystia Freeland unexpectedly resigned from the Cabinet just hours before the fiscal update. Freeland and Prime Minister Justin Trudeau had reportedly been at odds over new spending and how to address the protectionist threat posed by the incoming Trump administration in the United States. The FES included some new spending, such as a temporary sales tax break that took effect in mid-December, although an earlier proposal to send $250 cheques to working Canadians was absent from the fiscal plan. Other announcements were more business-friendly, including the extension of accelerated depreciation for some forms of business investment in an effort to boost capital spending. Given ongoing parliamentary gridlock and growing calls for the prime minister to resign, there is uncertainty over whether some of the policies announced in the FES will be implemented, in our view. The government did not table implementing legislation alongside the FES release.

## EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- **The Bank of England kept interest rates at 4.75%, in line with market expectations.** The most recent services data on inflation and wage growth, both above 5%, all but ensured this would be the case. But the dovish vote count, with only six votes in favour of a hold and three for a cut, surprised markets in light of the current inflationary pressure. Such dovishness suggests to us that the central bank's focus may be shifting to subdued growth, and the weakening hiring intentions in particular, from inflation.

- **Markets are now discounting 60 basis points (bps) of rate cuts in the UK in 2025, from 55 bps prior to the announcement.** They may be underestimating the extent of the upcoming monetary loosening. RBC Capital Markets expects one 25 bps cut per quarter next year.

- **European equities, for a variety of reasons, have notably lagged the U.S. in 2024.** Looking ahead to 2025, while we recommend holding a modest Underweight to European equities, we believe there are still compelling stock-specific opportunities for investors in the region. Accordingly, we think the opportunity set within Europe lends itself to taking a more active, rather than passive, approach to investing in European equities. We would focus on world-leading companies that benefit from and drive global structural trends, particularly in niches such as semiconductor manufacturing equipment, electrical and mechanical engineering, industrial gases, and health care.

### European equities have markedly underperformed their U.S. counterparts this year

Ratio of MSCI Europe ex UK Index to S&P 500 Index


Source - RBC Wealth Management, Bloomberg; data through 12/18/24

## ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **China reported it saw another month-over-month home price decline in November,** although the rate of decline was slower than in October. According to the National Bureau of Statistics, new home prices in 70 cities (excluding state-subsidized housing) dropped 0.2% from October, the smallest decrease in 17 months. The real estate crisis has weighed on China for more than three years. Just last weekend, Beijing pledged to stabilize the property market next year in an announcement following the two-day Central Economic Work Conference.

- **Looking into 2025, RBC Global Asset Management (GAM) believes the negative sentiment in China may be slightly overblown.** GAM estimates that North America makes up only 15.9% of foreign demand for Chinese products and, given China's large domestic market and its diversified export portfolio, the country may prove to be more resilient than commonly believed in the face of additional U.S. tariffs. Although recent announcements have underwhelmed, GAM believes China still has policy space to provide significant economic support. Finally, as we discussed last week, there has been a notable shift in China's monetary policy stance to "moderately loose" from "prudent," the first change in 14 years. GAM expects additional stimulus measures to be announced after the U.S. clarifies its tariff plans for China.

- **Honda Motor (7267 JP) and Nissan Motor (7201 JP) are exploring a potential merger** that may ultimately be expanded to include Mitsubishi Motors (7211 JP), according to an unconfirmed Reuters report. At the same time Bloomberg, in an unconfirmed report, said Hon Hai Precision Industry (2317 TT), the iPhone maker known as Foxconn, is in talks with Nissan's biggest shareholder Renault SA (RNO FP) regarding its willingness to sell its shares in the Japanese automaker. The challenging operating environment created by fierce competition from Chinese electric vehicles and potential new U.S. tariffs is reshaping the landscape for Japanese automakers, in our opinion.

## MARKET
# Scorecard

| Equities (local currency) | Level | MTD | YTD | 1 yr | 2 yr |
|---|---|---|---|---|---|
| S&P 500 | 5,872.16 | -2.7% | 23.1% | 23.9% | 52.4% |
| Dow Industrials (DJIA) | 42,326.87 | -5.8% | 12.3% | 13.5% | 28.6% |
| Nasdaq | 19,392.69 | 0.9% | 29.2% | 30.1% | 81.1% |
| Russell 2000 | 2,231.51 | -8.3% | 10.1% | 12.6% | 26.5% |
| S&P/TSX Comp | 24,557.00 | -4.3% | 17.2% | 19.1% | 26.3% |
| FTSE All-Share | 4,478.99 | -1.0% | 5.8% | 7.6% | 11.7% |
| STOXX Europe 600 | 514.43 | 0.8% | 7.4% | 8.2% | 21.1% |
| EURO STOXX 50 | 4,957.28 | 3.2% | 9.6% | 9.6% | 30.3% |
| Hang Seng | 19,864.55 | 2.3% | 16.5% | 19.5% | 2.1% |
| Shanghai Comp | 3,382.21 | 1.7% | 13.7% | 15.4% | 6.8% |
| Nikkei 225 | 39,081.71 | 2.3% | 16.8% | 19.3% | 42.0% |
| India Sensex | 80,182.20 | 0.5% | 11.0% | 12.4% | 30.7% |
| Singapore Straits Times | 3,779.62 | 1.1% | 16.6% | 21.4% | 16.6% |
| Brazil Ibovespa | 120,771.88 | -3.9% | -10.0% | -7.9% | 17.4% |
| Mexican Bolsa IPC | 49,952.40 | 0.3% | -13.0% | -13.5% | 0.6% |
| **Gov't bonds (bps change)** | **Yield** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. 10-Yr Treasury | 4.504% | 33.6 | 62.5 | 57.3 | 102.2 |
| Canada 10-Yr | 3.223% | 13.7 | 11.3 | 5.6 | 40.9 |
| UK 10-Yr | 4.558% | 31.6 | 102.1 | 86.3 | 122.9 |
| Germany 10-Yr | 2.245% | 15.7 | 22.1 | 16.6 | 9.3 |
| **Fixed income (returns)** | **Yield** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. Aggregate | 4.79% | -0.9% | 2.1% | 2.9% | 5.4% |
| U.S. Investment-Grade Corp | 5.18% | -0.8% | 3.3% | 4.1% | 9.4% |
| U.S. High-Yield Corp | 7.27% | 0.0% | 8.7% | 9.8% | 21.6% |
| **Commodities (USD)** | **Price** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| Gold (spot $/oz) | 2,588.29 | -2.1% | 25.5% | 27.7% | 44.3% |
| Silver (spot $/oz) | 29.32 | -4.3% | 23.2% | 23.2% | 26.3% |
| Copper ($/metric ton) | 8,868.97 | -0.3% | 4.8% | 5.7% | 7.7% |
| Oil (WTI spot $/bbl) | 70.08 | 2.0% | -2.2% | -3.3% | -5.7% |
| Oil (Brent spot $/bbl) | 72.86 | -0.1% | -5.4% | -6.5% | -7.8% |
| Natural Gas ($/mmBtu) | 3.40 | 1.2% | 35.4% | 36.0% | -48.4% |
| **Currencies** | **Rate** | **MTD** | **YTD** | **1 yr** | **2 yr** |
| U.S. Dollar Index | 108.1290 | 2.3% | 6.7% | 5.4% | 3.3% |
| CAD/USD | 0.6931 | -2.9% | -8.2% | -7.1% | -5.1% |
| USD/CAD | 1.4428 | 3.0% | 8.9% | 7.7% | 5.3% |
| EUR/USD | 1.0367 | -2.0% | -6.1% | -5.1% | -2.1% |
| GBP/USD | 1.2585 | -1.2% | -1.1% | -0.5% | 3.6% |
| AUD/USD | 0.6225 | -4.4% | -8.6% | -7.2% | -6.9% |
| USD/JPY | 154.7400 | 3.3% | 9.7% | 8.4% | 13.3% |
| EUR/JPY | 160.4300 | 1.3% | 3.0% | 2.9% | 10.8% |
| EUR/GBP | 0.8238 | -0.8% | -5.0% | -4.6% | -5.5% |
| EUR/CHF | 0.9336 | 0.2% | 0.5% | -1.4% | -5.6% |
| USD/SGD | 1.3630 | 1.8% | 3.2% | 2.3% | 0.3% |
| USD/CNY | 7.2857 | 0.5% | 2.6% | 2.2% | 4.5% |
| USD/MXN | 20.3840 | 0.0% | 20.1% | 18.8% | 3.1% |
| USD/BRL | 6.2931 | 5.4% | 29.6% | 28.3% | 18.6% |

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. 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 0.69 means 1 Canadian dollar will buy 0.69 U.S. dollar. CAD/USD -8.2% return means the Canadian dollar has fallen 8.2% vs. the U.S. dollar year to date. USD/JPY 154.74 means 1 U.S. dollar will buy 154.74 yen. USD/JPY 9.7% return means the U.S. dollar has risen 9.7% vs. the yen year to date.

Source - Bloomberg; data as of 12/18/24

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As of September 30, 2024

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|---|---|---|---|---|
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| Hold [Sector Perform] | 599 | 40.07 | 153 | 25.54 |
| Sell [Underperform] | 38 | 2.54 | 3 | 7.89 |

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