

SPECIAL REPORT

RBC WEALTH MANAGEMENT

GLOBAL INSIGHT

2015 OUTLOOK



Half Full: Equities should deliver reasonable all-in returns in 2015 as U.S. economic growth more than offsets a weak Europe.



US: THE BULL KEEPS RUNNING



CANADA: OVERCOMING OBSTACLES



EUROPE: POLITICAL UNCERTAINTY



ASIA: VALUE ABOUNDS



RBC Wealth Management

There's Wealth in Our Approach.™

A LOOK AHEAD

This is our third annual “Year Ahead” edition of *Global Insight*. In one sense the movie just keeps rolling forward. The overarching theme—the global economy is gradually returning to something closer to normal led by a strengthening U.S. economy—was the principal thrust of last year’s edition and the one before that.

But when we look at the contributions from our analytical teams in North America, Europe, and Asia it’s inescapable just how much the financial and economic landscape has changed.

From the onset of the financial crisis through the Great Recession and European sovereign debt crisis the world was highly synchronised and interdependent. The financial markets and economies of the world were in trouble and the largest part of the immediate solution lay in massive doses of policy and policy leadership, often coordinated between different agencies and national governments.

No sooner was one big hurdle cleared than another appeared. And failure to negotiate any one threatened the whole edifice anew. It was a relentlessly risk-on, risk-off world.

But over the last 12 months that world has become highly de-synchronised. Reading this year’s report it is apparent that regions have distinctive outlooks, policy challenges, and options. Important links from one economy and market to the next remain, but there is a new resilience to adverse developments as well.

This is a welcome development and one that should make investing more interesting and potentially rewarding.



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All values in U.S. dollars and priced as of market close, November 28, 2014, unless otherwise stated.



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HALF FULL

A sustained U.S. expansion should more than offset any European weakness. The year ahead should see a strong U.S. dollar, reasonable gains for equities, and the beginning of rate normalization in the U.S. and U.K.

Our base case hasn't changed much in two years. Today it reads like this:

Heading toward “normal” ... The global economy is gradually moving back to something more recognizable as “normal” led by the U.S., which has shifted into a self-sustaining expansion that should include a few years of above-potential growth.

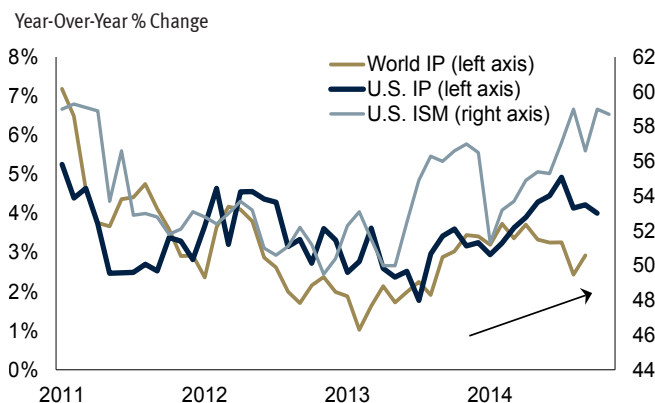
... led by the U.S. The U.S. (at 24% of world GDP) imports almost \$3 trillion of goods and services from abroad. Faster American growth means increased aggregate demand for many other developed and emerging economies.

Rate normalization ahead for some ... For some economies the need for extreme, unconventional monetary policies will diminish. This is already happening in the U.S. and the U.K. where quantitative easing has been wound down and rate normalization is expected to get underway in 2015.

... points to a stronger U.S. dollar. On the other hand, the ECB and the Bank of Japan are still intensifying their easing and may for some time. Repressed bond yields in the eurozone may slow the rise of yields in North America and the U.K. However, the biggest impact of divergent monetary policies will be in the currency market. We look for further weakness in the yen and the euro—or, if you prefer, further strength in the U.S. dollar.

Rising earnings = higher share prices. A pick-up in North American GDP growth and its spillover into other economies means corporate sales and earnings will likely rise further in 2015 and probably beyond. Share prices should be able to advance at least as fast, perhaps faster, as investors become more confident in the sustainability of global economic growth.

Global Industrial Production



Source - CPB Netherlands Bureau of Economic Policy Analysis; Institute for Supply Management

**Global momentum
is building, led by
the U.S.**

Job openings are up sharply and business' hiring intentions are on the rise.

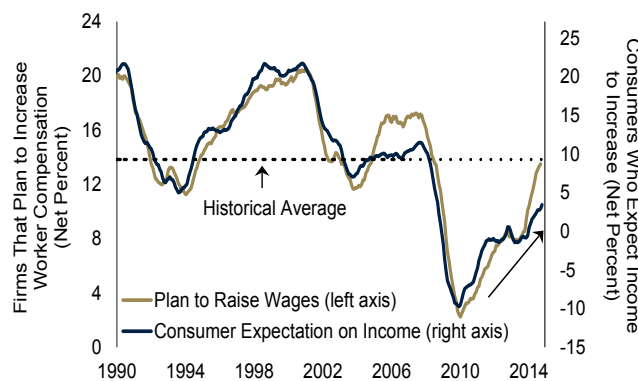
CONFIDENT THE U.S. CAN GO ON GROWING

Since 2011 U.S. GDP has inched along at around 2% per annum. Over the same stretch the private sector (some 80% of the economy) has grown at a more energetic 3.2%. Government spending is no longer shrinking, so overall GDP growth should step up a notch as long as the private sector can maintain this pace.

It may be able to improve on it. On the consumer side (70%+ of GDP), employment growth, currently running at a solid 2% rate, may pick up: layoffs continue to fall while job openings are up sharply and business' hiring intentions are on the rise.

Average weekly earnings growth has been uninspiring, but falling unemployment implies qualified workers are becoming harder to get. New hires are already getting paid more than the average existing worker. Worker and employer surveys suggest wage rates will likely rise (see chart).

Higher U.S. Wages Likely



Employers and workers both expect higher wages.

Source - The Conference Board Consumer Confidence Survey, NFIB Small Business Economic Survey, RBC Global Asset Management

Disposable incomes should grow a little faster and falling gasoline prices mean a larger proportion of the consumer spend will be headed for discretionary goods with their bigger multiplier impact on the economy. Consumer confidence, at 30-year lows in late 2011, recently touched a seven-year high.

Capital spending, currently growing at 7% in real terms, could accelerate. CEO confidence (*CEO Magazine* survey) is at a seven-year high. Corporate profits are in new high ground. Excess capacity is shrinking and the extended average age of capital equipment suggests a replacement cycle is due. Surging heavy truck sales in the last year (up 33%) indicate that may have started.

Supporting our conviction the U.S. expansion has become self-sustaining: the U.S. credit system is healthy and open for business. Capital has been restored, regulatory clarity has arrived, and fines paid. Lending standards have been lowered from ultra-tight to something closer to normal and most prospective borrowers are finding it easier to access credit—a contrast with the banking landscape in Europe.

EUROPE STRUGGLES

The eurozone is the “half empty” part of the metaphor. Summer weakness led to concern the U.S. expansion might be ambushed by renewed recession on the Continent. Short of a European banking crisis, the chances of which are becoming

Many European banks are developing a renewed appetite for lending.

increasingly remote, we see the effect of a slow or even recessionary Europe on North American growth as minimal.

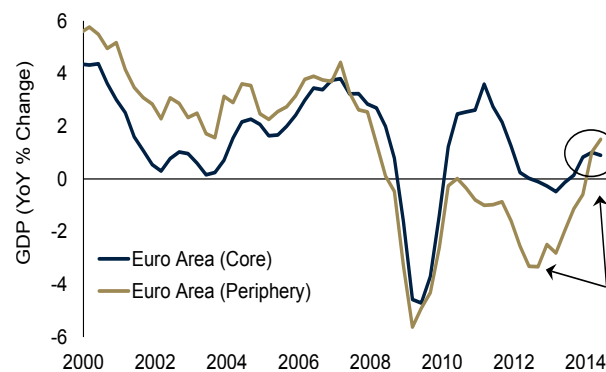
Europe faces challenges: unfavorable demographics, major policy disagreements, and unpredictable politics among them. But the ebbing of the sovereign debt crisis may open up some constructive possibilities.

Bank lending to the private sector, contracting since late 2012, had stabilized as of October. After a full year of intense capital raising, aided by the collapse of sovereign bond yields in the region, and with the capital adequacy stress tests behind them, many banks are developing a renewed appetite for lending.

Just as the U.S. economy needed a revived banking sector before it could run at or above its potential, for Europe some reasonable availability of credit is also a necessary pre-condition to a more robust, self-sustaining economic expansion. Some improvement looks likely in 2015.

Peripheral Europe Now Caught Up With Core

Euro Area GDP Growth Recoupling



Periphery hurt by debt crisis; now recoupled with core countries.

Note: Core is equally weighted Germany, France, Netherlands, Austria, Belgium; periphery is Italy, Spain, Ireland, Portugal, Greece.
Source - Haver Analytics, RBC Global Asset Management

Importantly, the periphery countries are growing again as a group, even as German growth has faded somewhat. Countries that acted to improve labour flexibility have fared the best. The two holdouts, France and Italy, have paid a price in slower growth and weak PMIs suggest conditions are softening further. After three successive quarters of negative growth Italy recently posted a record unemployment rate of 13.2%.

Europe may improve in 2015, but our recommended approach highlights selectivity in both equities and fixed income.

WAITING FOR CHINA

Growth has been downshifting from the unsustainable 10%–12% of a few years ago to something that can be sustained over a number of years—say 6%–7% per annum.

The policy challenge has been to simultaneously unwind the potentially destabilizing imbalances that had built up in an era of debt-fueled, excessive infrastructure and fixed asset investment. So far, so good with a few wobbles along the way. But sagging business confidence and leading indicator readings suggest the slowdown has further to run.

Equities offer the best combination of value and growth accompanied by moderate risk.

For the rest of Asia, an end to China's slowdown would be welcome as is stronger demand from North America. Japan's export sector in particular needs a more vibrant China.

A more sedate long-term growth trajectory for China and greater Asia poses problems for commodity producers for whom production rates and inventories—ramped up over a decade of short supply and rising prices—have not yet fully adjusted to the new reality.

CANADA WINS AND LOSES

The weak Canadian currency combined with strengthening American demand is already boosting sales of manufactured goods into the U.S. However, Canada's energy and resource sectors are feeling the pain from the combination of falling commodity prices and weak shipments into China. The declining Canadian dollar is providing some offset, but not enough.

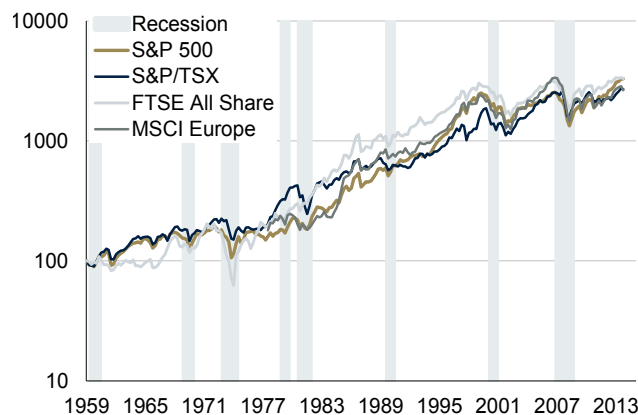
The net effect on GDP may be positive, but the resource groups' outsized weight in the S&P/TSX will drag on equity market performance until the commodity outlook improves.

GIVE EQUITIES THE BENEFIT OF THE DOUBT

Fixed income yields may remain "lower for longer," but a low return is just that—a low return. And, in a world where the Fed is expected to begin raising rates, risks are not negligible.

In our view, equities offer the best combination of value and growth accompanied by moderate risk. European and Asian stocks are cheap, but need to be approached with selectivity. North American stocks are only modestly above average valuations, but the region's GDP growth rate is the best in the developed world and looks to be gathering some additional pace.

Beware U.S. Recessions!



Source - RBC Capital Markets, Federal Reserve

There's no U.S. recession anywhere in sight. But if there were ...

This generally favorable outlook for equities would change for the worse if monetary conditions tightened sufficiently to make a renewed global economic downturn and, in particular, a U.S. recession probable. In our judgment, the opposite is happening: interest rates remain abnormally low and most banks are moving to lower barriers for borrowers.



THE BULL HAS FURTHER TO RUN

The U.S. stock market seems primed to tack on more gains in 2015 despite the likely start of Fed rate hikes and elevated valuations. But corporate earnings could go under the lens. Investors should upgrade the quality of portfolio holdings.

Q. Will the U.S. stock market be knocked off course when the Federal Reserve starts to raise interest rates?

A. Interest rate hikes shouldn't be a problem for the market until part way through or late in the tightening cycle, although it could be a bumpy ride at times.

The market often corrects within a 12-month period before the Fed's first rate hike. The average correction has been about 15% in the 12 tightening cycles since 1971, and they were brief, usually lasting about three months. We've already had one mild pre-hike correction this fall (about 7% lasting 19 days) and we can't rule out the possibility another pullback could materialize between now and when the Fed gets going.

Despite the ever-present possibility of corrections, the market's overall performance is usually positive over the three-, six-, and 12-month periods leading up to the Fed's first move. Further, the S&P 500 also has traded higher three months after the first rate hike by 3.1%, on average.

Thereafter the equity market has typically wobbled 6–12 months following the first rate hike and becomes even more vulnerable late in the cycle once the Fed has tightened enough to make a recession a real possibility. We don't believe the latter is a risk in 2015 and, in fact, a credible recession threat could be a long way away.



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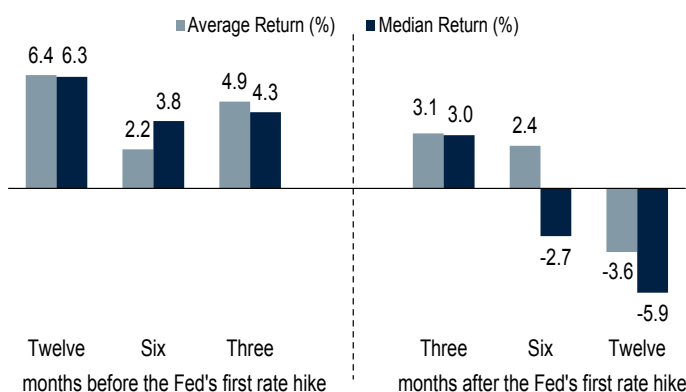


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Higher valuations are to be expected if the market has indeed shifted into a secular bull phase.

The Market Tends to Rise Before the Fed's First Rate Hike

S&P 500 Performance Surrounding the Federal Reserve's First Interest Rate Hike in the 12 Cycles Since 1971



Source - RBC Wealth Management, Bloomberg

A pullback is more probable 6–12 months after the first rate hike.

It's important to remember that no two tightening cycles are the same. This go-around, the Fed has signalled, and we expect, that it will likely proceed slowly and deliberately. However, that's assuming growth and inflation don't force the Fed's hand late next year or in 2016.

Q. The S&P 500's valuation isn't cheap. Is this a headwind?

A. The S&P 500's trailing 12-month P/E ratio has climbed from a low of 11.1x in 2009 to 18.0x currently. That's somewhat stretched and is above the 16.8x average since 2003 (the post-tech-bubble era).

While it's prudent to question how much higher valuations can move and scrutinize individual stock positions to determine whether their P/E ratios are justifiable, there are circumstances that warrant relatively high valuations.

Above-average P/E ratios tend to accompany low inflation, low interest rate environments. Importantly, higher valuations are to be expected if the market has indeed shifted into a secular (long-term) bull phase. Evidence is mounting this has occurred. During such extended bull markets, P/E ratios usually rise to extreme levels before they peak. (For more, see our [Higher to Climb?](#) report published in September 2014.)

Q. What are your favorite and least favorite areas of the market?

A. As we enter the mature phase of the corporate earnings cycle and because P/E ratios are above average, the quality of both earnings and corporate outlooks are likely to face greater scrutiny in 2015. Even when the market is rising and is expected to keep on going up it is always appropriate to consider replacing low- and deteriorating-quality positions with something better.

For us "high quality" features sustainable cash flow, balance sheet strength, as well as above-average, predictable sales and earnings growth. Such companies typically deliver high returns on capital and equity and enjoy superior credit ratings.

From a sector perspective, we would continue to overweight financials, health care, and industrials. Bank stocks should outperform heading into the Fed's first

rate hike. Health care has some powerful long-term catalysts behind it due to biopharmaceutical and technological advancements and also the aging of the baby boomers. Industrials as a group are positively correlated with rising interest rates and GDP. While we carry a neutral weighting on the overall technology sector, we find attractive candidates among companies geared toward “new tech”—mobile data and video, innovative personal devices, big data, and cloud computing.

We favor large-cap companies because their relative valuations are more attractive. Small-cap trailing P/E ratios are still sky high and their forward P/E ratios trade at wider premiums to large caps than usual.

With the help of roughly 10% y/y earnings growth and sturdy profit margins, we believe the S&P 500 can deliver high-single-digit returns plus dividends in 2015.

**RBC's Sector Views and
2015 Consensus Growth Expectations, Valuations**

S&P 500 Sector	Consensus Growth Estimates (y/y)			Forward P/E	
	Revenue	Margin	Earnings	2015	L-T Avg.
OVERWEIGHT					
Financials	3.8%	10.2%	15.3%	13.5	14.5
Health Care	6.2%	4.3%	10.6%	17.6	15.4
Industrials	3.3%	6.1%	9.8%	16.8	16.0
MARKET WEIGHT					
Consumer Discretionary	5.8%	10.7%	16.9%	18.9	18.5
Consumer Staples	4.8%	2.1%	7.3%	19.3	16.6
Materials	3.9%	10.7%	15.7%	17.1	17.1
Technology	6.7%	3.9%	11.4%	16.5	16.4
UNDERWEIGHT					
Energy	-3.0%	0.6%	-3.1%	15.0	12.6
Telecommunication Svcs.	3.2%	2.6%	5.7%	14.1	15.7
Utilities	1.9%	0.6%	2.3%	16.7	14.4
S&P 500	3.8%	6.0%	10.1%	16.4	15.0
S&P 500 ex-legal*	3.8%	4.4%	8.4%	n/a	n/a

**Most of our
overweight and
market weight
sectors should
post solid earnings
growth in 2015.**

* Excludes \$16.4B in after-tax legal expenses for large banks from Q1-Q3 2014. Source - RBC Wealth Management, RBC Capital Markets, Thomson Reuters I/B/E/S, Bloomberg; 11/24/14

Q. What keeps you up at night?

A. Mostly we sleep well at night. We view the current U.S. economic expansion as balanced and durable enough to enable the market to contend with temporary dislocations and deliver worthwhile returns for 2015.

But we are mindful that monetary policies have been so decidedly “unconventional” for so long, predicting how the unwinding of these policies will play out and how they will affect the global economy and financial markets is an uncertain exercise. Additionally, during the past few years sweeping regulatory changes (Volcker Rule, Dodd-Frank, Basel III) have diminished large banks’ ability and willingness to commit capital to bond trading activities, impacting credit markets and to some degree U.S. Treasuries. This exacerbates the possibility of short-term liquidity disruptions in the bond market.

Unintended consequences stemming from the unwinding of central bank policies, combined with changes in the regulatory regime, could rattle markets and trigger a more significant equity correction than we forecast.

This is not our expectation. But the potential for a spillover of unanticipated bond market stress into an equity market with somewhat elevated P/E multiples leaves us characterizing ourselves as “nervous bulls.”



THE PIECES ARE STILL IN PLACE

Falling commodity prices on slack China growth is a big negative. But the importance of strong U.S. demand on all parts of the economy can't be overestimated. On balance, we are constructive on Canadian equities heading into 2015.

Q. What does the global outlook mean for Canadian stocks?

A. One hand gives, another takes away. The U.S. growth pick-up is good, China's slowdown is bad.

Stronger U.S. GDP growth coupled with a weaker Canadian dollar is unequivocally good for the Canadian manufacturing sector. Shipments and new orders have been rising for several quarters. Unfortunately, manufacturing accounts for a much smaller weight in the S&P/TSX than the sector contributes to Canada's GDP.

The opposite is true for energy and resources, which loom very large in the index at ~32% combined—substantially more than they represent within total Canadian economic output. While a lower dollar has been a help to commodity producers, the decline in energy, metal, and agricultural prices has been a powerful negative offset. Weak commodity prices can largely be laid at the feet of the slowing Chinese economy.

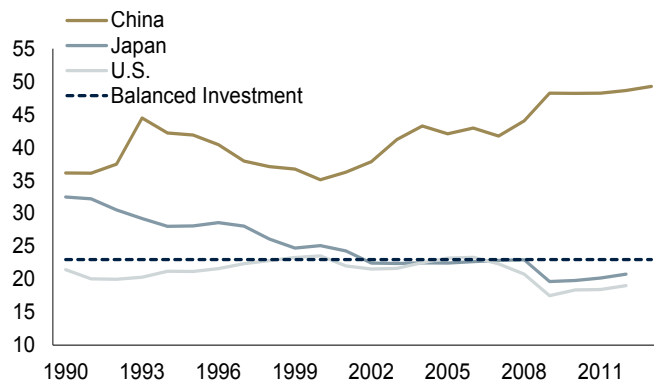
For more than a decade, rapid Chinese growth placed a heavy burden on global commodity supplies, eventually leading to major imbalances in the Chinese economy. Over the past couple of years, we have seen Chinese policymakers maintain tight monetary conditions to rein in the growth of debt-financed infrastructure and fixed asset investment. Slower growth in capital investment and overall GDP means slower growth in the consumption of most commodities.



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Chinese demand for commodities is going to be significantly lower than commodity producers had planned for.

Investment Share of Economy



Investment continues to dominate Chinese economy, creating instability.

Source - World Bank

The new reality is that growth in Chinese demand for commodities is going to be significantly lower than many commodity producers had planned for. It will likely take several more years for global supplies to adjust to this new reality. Add weakness in Europe, the next largest consumer of industrial commodities, and the overall set-up is not great.

Q. Does this mean Canadian stocks are a sell?

A. Despite the forgoing, stocks can get cheap enough to reflect this new reality, and certain areas of the commodity sphere may already be there or at least very close. Specifically, we like the potential for Canadian oils as we think crude prices are at or close to levels that will force supply discipline among global producers. As a group, Canadian energy companies tend to be well run with a focus on return on invested capital, returning capital to shareholders, and generally not pursuing growth for growth's sake at any cost.

That said, value is not a good predictor of performance in the near term for these groups. Commodity stocks need rising commodity prices before they can come into their own. That probably needs some combination of constrained supplies and prospects for somewhat faster growth in China.

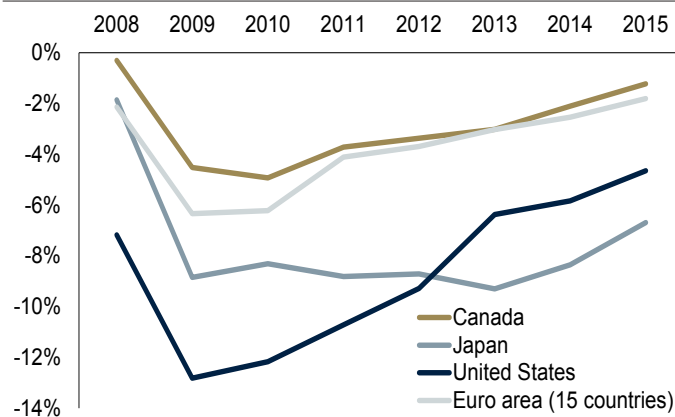
Beyond resources, within the heavyweight financial sector (37% of the index), we continue to like the long-term potential of the Canadian banks, even though loan growth in Canada is unlikely to be robust. The banks have collectively done a good job of developing businesses outside of core Canadian banking, and we think these will increasingly drive performance. Lifecos, now enjoying more regulatory clarity, will likely offer superior earnings and dividend growth over the next couple of years and would be beneficiaries of any interest rate increase.

Q. Does China's slowdown impact Canada in any other ways?

A. Besides the commodity complex, China has also played a big part in some of Canada's property markets. While this gets a lot of attention, it's not that unusual. Chinese and foreign buyers have played a role in driving demand and prices in most "global cities," so Toronto and Vancouver are not necessarily exceptional in this

Canadian housing
builds have
roughly kept pace
with household
formations.

Government Deficit as % of GDP



Canada set to approach a budget surplus in 2015.

Source - RBC Wealth Management, OECD Economic Outlook No. 95

regard. That said, China matters to the Canadian economy more than it does to say the U.S. However, 70% of Canada's exports still go south of the border, so a stronger U.S. can and is offsetting some of the drag from a slower China.

Q. Since you brought it up, should we worry that Canada has a housing bubble about to burst?

A. While this is the popular narrative, we don't see a lot of evidence. Yes, Canadians have a lot of debt, and yes, there are some frothy markets, but we think most of the country remains fairly well balanced. Absent a big negative economic shock that drives unemployment meaningfully higher (always the prime culprit in past property price downswings), we think the most likely outcome is a consolidation rather than a sharp downshift.

Looking at the U.S. experience leading up to and through its housing downturn, we note Canadian housing builds have roughly kept pace with household formation, whereas the U.S. went through a three- to four-year period where housing completions sharply outpaced formations leading to a supply glut. Subprime became about 25% of the U.S. market, whereas it has never even risen beyond 5% in Canada. Plus, home equity levels remain quite robust, which offers a very substantial buffer, whereas even a small correction in U.S. prices back in 2006 was enough to start triggering defaults.

Q. One last question. What's your overall impression of how Canada is situated in a global context?

A. While there are issues that bear watching—weak commodity demand, consumer debt levels, some frothy housing markets—the overall outlook is constructive. Canada is likely to move back into a fiscal surplus for 2015, which would make it the only G7 nation to have a balanced budget. This should provide some available firepower to put a bit of stimulus into the system through tax cuts and spending—all the more likely to arrive given 2015 is an election year. Although a weaker dollar is producing some extra inflation, rates are likely to remain supportive. The importance of stronger demand from the U.S. can't be overestimated. 2015 looks pretty good to our eyes.



REAL CHANGE OR BUYING TIME?

Europe's choice is clear. It can keep trying to buy time or it can find the fortitude to implement deep structural reforms. Equity returns hang in the balance. Meanwhile, the upcoming U.K. election may usher in some unpleasant outcomes for the market.

Q. You have been cautious on European stocks and negative on the U.K. for some time and they've been great calls, what would cause you to become more bullish?

A. For Europe, evidence of deep structural reforms is key, in our view.

Draft legislation faces formidable hurdles before it is enacted and implemented. France and Italy in particular need a more pro-business stance. Continued euro weakness and an end to the Ukraine conflict would also help. A return to sustainable growth would suggest the region is less vulnerable.

Given low European valuation levels, improved prospects on these fronts could spur a rally. European markets trade on a 2015E P/E of 13.6x, about three multiples below the U.S., and at a steep discount on a P/B basis. Admittedly, corporate margins for European businesses are lower than for their U.S. peers.

U.K. market performance depends greatly on the prospects for the mining and energy sectors (25% of the index). Thus, a more constructive outlook for commodity prices than we currently hold would be necessary for us to consider a more positive stance. Lifting the political uncertainty around a possible referendum on EU membership would also be helpful.



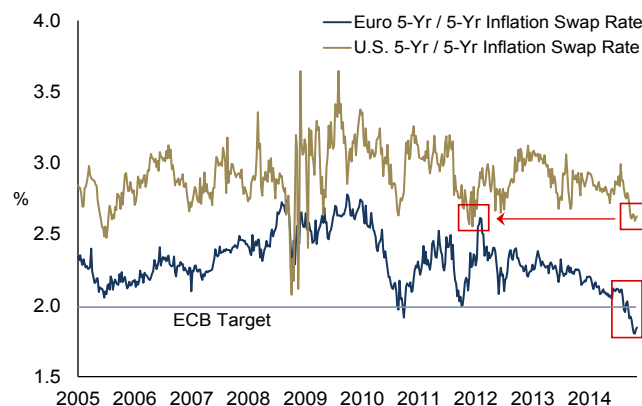
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Q. Conversely, what would cause you to turn more bearish?

A. We would become more bearish if the prospects for deflation/disinflation worsened further. Inflation expectations in the eurozone have fallen to a 10-year low, below the European Central Bank's (ECB) 2% target.

The International Monetary Fund estimates chances of deflation at 30% for the eurozone. The stagnant growth environment such a development would imply means debt burdens might increase and could become unsustainable.

Eurozone Long-Term Inflation Expectations Fall to 10-Year Low



Once expectations fall, it is difficult to restore inflation.

Source - RBC Wealth Management, Bloomberg; data through 11/6/14

Q. You've repeatedly said Europe needs to implement structural reforms. What is necessary and when might they materialize?

A. Reforms are needed in Brussels, as well as on a national level.

Initiatives promoting greater European integration were delayed by the recent European Commission elections. With the new European Commission in place, stalled discussions regarding key reform pillars (economic, fiscal, political union) should come back into focus, although the rising wave of euro-scepticism is a new hurdle.

At the national level, labour and product markets reforms are needed to make it easier to do business. As the chart on the next page shows, Portugal, Ireland, and Greece have improved in global competitive rankings. Some countries have been rewarded by the return of economic growth and falling fiscal deficits (Spain, Ireland). Much of the improvement has stemmed from enabling firms to hire and fire more easily.

In Italy and France the reform progress has been slow and riddled with setbacks.

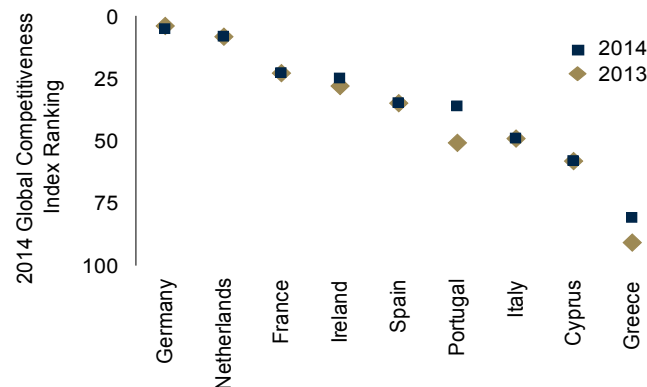
France has taken some tentative steps. The "Responsibility Pact" offers tax cuts for business of some €40B by 2017. There are plans to reduce the number of regional authorities to improve government efficiency. Moreover, Emmanuel Macron, the new minister of the economy, has promised deregulation of the transport, retail, legal, and pharmacy sectors, though legislation won't likely be passed for another six months.

We believe labour market deregulation is the key. So far the government appears loath to speak with unions, leaving negotiations unlikely before 2016. The situation in France might yet not be dire enough, as it was in Spain where youth unemployment exceeded 50%, to generate the will for change.

It is promising the recent Italian budget emphasized tax cuts over spending cuts. But constitutional reform needs to curb the Senate's power and reduce gridlock, as well as tackle judiciary inefficiencies—a key impediment to the ease of doing business.

A law to overhaul the sclerotic labour market passed the Senate in October. Currently, it is very difficult and costly to dismiss workers on open-ended contracts, a clear disincentive to hiring. The proposed law must pass the lower chamber of parliament where it risks being delayed or diluted by political horse-trading.

Competitiveness Ranking of Select European Countries



Some European countries' competitiveness has improved, thanks to reforms.

Note: Switzerland ranks 1, Singapore 2, U.S. 3, and U.K. 9
Source - RBC Wealth Management, World Economic Forum

Q. What does a strong dollar/weak euro mean for corporate earnings?

A. A weak euro could add 0.2% to 2015 GDP, according to RBC Global Asset Management. But many other central banks are trying to drive their currencies lower. This is why the trade-weighted euro has come down only 5% since summer, vs. a headline-grabbing move in EUR/USD of 11% in the same period. Stronger demand from trading partners is probably more important to earnings than lower prices due to currency adjustments.

Q. How might the upcoming U.K. election impact the domestic economy and equity market?

A. Two binary outcomes threaten the stock market: a referendum on exiting the EU if the Conservatives lead the next government or additional regulation if Labour, currently leading in the polls by a thin margin, were to get in.

A referendum may see planned capex programmes postponed or halted. The EU accounts for close to half of the U.K.'s exports and over a quarter of its foreign direct investment. EU retaliation in the event of a U.K. exit should not be ruled out. Alternatively, Labour is proposing a number of measures, such as hiking the minimum wage to £8.00/hour from £6.50, and freezing energy prices, which could erode corporate profitability.

We continue to prefer companies largely immune to the travails of the domestic economy. Resilient companies, leaders in their fields, with a strong international presence, healthy balance sheet, and robust cash flow generation should be core holdings. Europe has a deep pool of such candidates, particularly among consumer goods, luxury, and pharmaceuticals companies.



STILL RIPE FOR BARGAIN HUNTING

While China's slowing growth is grabbing the headlines, the strength of the services sector should not be overlooked. And Japan's cyclical bull run should have legs as Shinzo Abe's bold moves are very supportive of equities.

Q. How much further do you expect Chinese GDP growth to slow?

A. Chinese GDP growth peaked at 14% in 2007 and is currently around 7%–7.5%. It is difficult to discern how much of the slowdown has been specific to China and how much has been due to lower global growth, given China's deceleration has been in line with other emerging market economies.

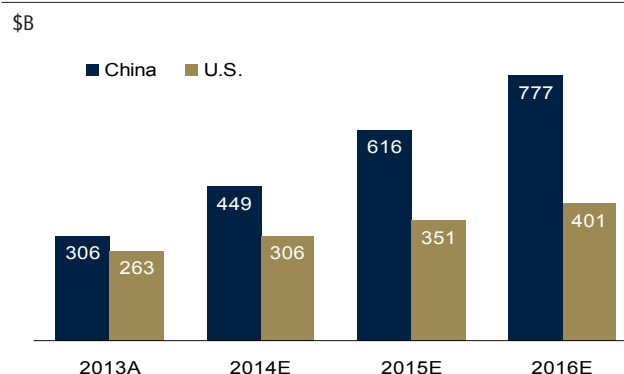
RBC Global Asset Management expects GDP growth in 2015 to slip to 6.75%, which compares with its estimate of 7.25% for 2014. This is a touch pessimistic versus the current consensus estimate. From our perspective, the government is likely to introduce pro-growth measures should GDP approach these levels. In mid-2013, Premier Li Keqiang stated that the growth target for 2014 was 7.5% while the minimum level of acceptable growth was 7%. Recently, there were discussions to lower the target for 2015 to 7%.

We would add that we believe the consistent strength of the services sector in China, which became the nation's largest employer in 2011, is sometimes overlooked by investors. For example, China now has close to 700 million Internet users, the majority of whom are mobile users. This has contributed to rapid growth in online retail sales, forecast to reach about \$450B in 2014, which is 50% higher than similar sales in the U.S.



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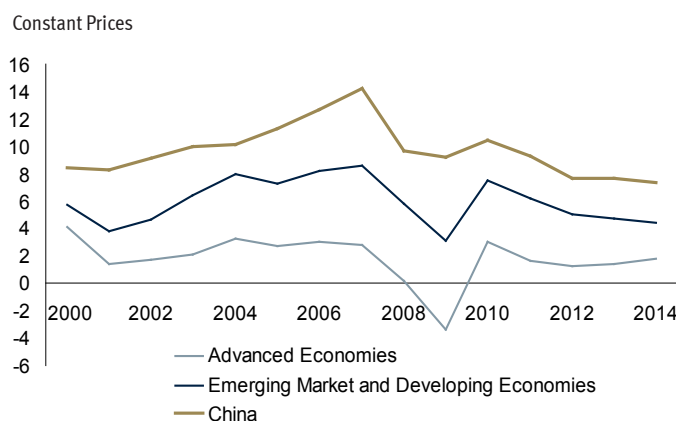
Online Retail Comparison Between China and U.S.



Source - RBC Capital Markets estimates, Company reports, iResearch, Department of Commerce

China's online retail sales have already surpassed the U.S.

Gross Domestic Product



Source - International Monetary Fund, World Economic Outlook Database, October 2014

Growth has been slower globally, not just in China.

Q. What impact would additional weakness in China's housing market have on the Chinese economy and region?

A. Housing market conditions differ across the nation's cities, which number well over 600 and include 235 cities with populations greater than one million. Generalizations about China's housing market only take one so far. Consequently, the outlook for prices in 2015 is mixed.

The base case is for modest price gains in the biggest cities and modest price declines in the lower-tier cities. Moreover, if the market were to show significant deterioration, the government would likely loosen policy, which is generally tight. The minimum down payment for first-time homebuyers remains high at 30%.

The housing market went through a period of policy-induced weakness in 2011 before recovering quite strongly in 2012–13. It has now weakened again—this time in response to oversupply. But inventories may have peaked already as new starts and land sales declined substantially in 2014.

Finally, a surprising fact: affordability of housing at the national level is at an all-time high as income growth continues to outstrip house price growth. The average house price is now 5.4x national income, a new low.

The biggest risk for Asian equities is a renewed slowdown in global growth.

Q. What does the strong dollar and Fed tightening mean for Asia Pacific markets?

A. Our base-case view—that the Fed will tighten modestly in 2015 because the U.S. economy is improving—should not be problematic for Asia.

A stronger dollar may be more challenging as it is arguably negative for Asian equities. Specific points of weakness may be seen in areas such as the Hong Kong housing market, which is extremely expensive. Secondary residential real estate prices have more than doubled since 2009. The Hong Kong dollar is tightly pegged to the greenback so a stronger U.S. dollar and higher U.S. interest rates would be headwinds for Hong Kong housing.

Q. Asian markets look inexpensive. Are they cheap for a reason? What is the biggest risk?

A. Asian equities trade at 14.0x P/E and 1.5x P/B based on trailing data. MSCI World trades at 16.6x P/E and 2.2x P/B despite a better outlook for earnings growth in China. Valuations are unusually low due to persistent concerns over the sustainability of China's economic growth. Lower multiples in Japan are harder to justify at present given extremely supportive policy with respect to equities; however, persistently low growth undoubtedly plays a role.

The biggest risk for Asian equities is a renewed slowdown in global growth. A tail risk would be some kind of serious unwinding in the Chinese economy. Neither is our base case, although weak European data has increased the chance of the former.

Q. Why do you still favor the Japanese market?

A. We feel Japan is going through a cyclical bull market brought about by very aggressive government policy. It has been and will likely be bumpy, but we continue to see encouraging signs.

The number one goal of policymakers is to escape deflation. The current policy response—which includes the Bank of Japan devaluing the yen and purchasing stocks, as well as the Government Pension Investment Fund, the largest such fund in the world, increasing its allocation to stocks at the expense of cash and bonds—is very supportive for equities.

Thus far, policy is showing some success. Core inflation is moving higher and there is some wage inflation. Corporate inflation expectations are at 1.8% for the next three years.

The rapid decline in the yen has certainly helped earnings growth. Consensus earnings forecasts continue to move higher. Actual earnings for the benchmark TOPIX index have already exceeded the prior cycle high, yet the index is well below the level it achieved then. The reason for this is that valuations are relatively low. We think current multiples do not presently reflect some of the progress that has been made by the administration.



EASY DOES IT

With tightening likely kicking off in mid-2015 the Federal Reserve aims to neutralize broad market turbulence by being cautious and patient. But should things get a bit bumpy, investors would be wise to minimize any volatility via a diversified approach to credit.

Q. Where are we in the monetary policy normalization process as the Federal Reserve prepares for a potential rate hike in 2015?

A. The end to quantitative easing (QE) was the first step; an increase in short-term interest rates during 2015 is the next step in the normalization of U.S. monetary policy. RBC Capital Markets currently forecasts the first of three 25 basis-point hikes will occur in June 2015 with additional 25 basis-point hikes at subsequent FOMC meetings. This would leave the Federal Funds rate at 1.00% by the end of 2015.

From our perspective, however, this tightening cycle should be different than past cycles given the Federal Reserve has emphasized how policy decisions will depend on the economic data. It would not surprise us if the Federal Reserve decided to pause after its initial rate hikes to ensure the U.S. economy remained on strong footing before continuing with a tightening bias.

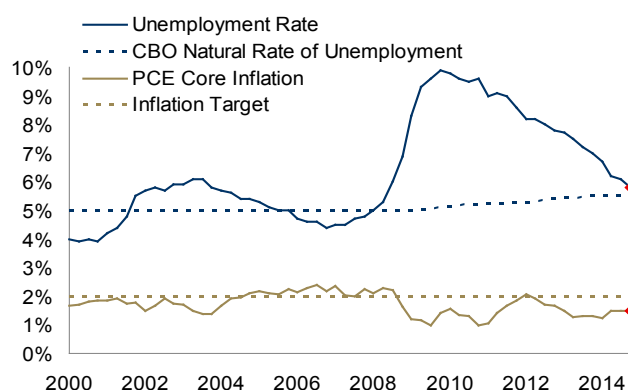


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BBB-rated space provides optimal trade-off between interest rate and credit risk.

The Fed Inches Closer to Employment and Inflation Goals



Source - RBC Wealth Management, Bloomberg; quarterly data through 9/30/14

Non-traditional monetary policies since 2008 have the Federal Reserve near its employment and inflation goals.

Q. What strategies should investors employ to minimize volatility and reduce liquidity risks?

A. As things stand, investors should focus on positioning along the curve, taking a diversified approach to corporate credit, and employing a high-coupon approach. Along the yield curve, intermediate maturities of 5–8 years allow investors to capture a large portion of the yield advantage on longer-dated issues, thanks to the roll-down effect, without assuming too much volatility.

Within corporate credit, we recommend investors focus on large investment grade issues for the core fixed income allocation, diversified across a range of sectors. We recognize the yield allure of non-investment grade credits, but these issues could be the most impacted by liquidity risks, which argues for below-benchmark allocations at this time.

Finally, investors need to consider the benefits of increased cash flow and less potential price volatility provided by high-coupon issues and weigh these benefits against a natural aversion to paying premiums for bonds.

Q. Credit spreads are tight, but fundamentals are supportive—where are the opportunities in corporates?

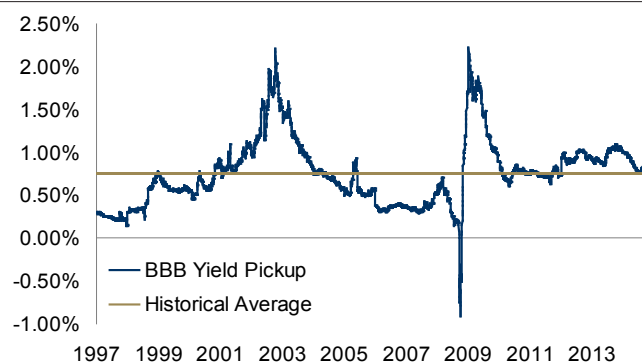
A. Leverage ratios are a key metric and at non-financial firms these have edged only slightly higher during the past year. Meanwhile, refinancing activity has meant that companies have been able to issue lower-coupon debt at longer maturities. This should keep near-term default rates well below historical averages.

Additionally, at this stage of the cycle we typically see corporate credit spreads begin to widen as companies pursue more aggressive growth strategies. At this point, however, we have actually witnessed more divestiture activity by firms in an effort to increase their focus on core businesses, which should be a net positive for creditors.

Looking ahead, we continue to believe the BBB-rated space will provide investors with the optimal trade-off between interest rate and credit risk. Unlike higher rated issuers, many lower-rated investment grade firms face greater constraints and must take into consideration the prospect of being downgraded to a speculative-grade rating.

We expect emerging market credit fundamentals to remain stable in 2015.

Yield Advantage of BBB-Rated Bonds Over A-Rated Bonds



Source - RBC Wealth Management, St. Louis Federal Reserve

BBB-rated debt offers higher yields with only a modest increase in credit risk.

Q. Will issuance from municipalities increase in 2015 given many are reporting improved finances?

A. Many large U.S. cities continue to struggle to restore revenue to pre-recession peaks due to declines in property tax collections and reduced funding by states and the federal government. But, the November elections may signal a turning point. Six states approved ballot measures to fund infrastructure projects that total \$6B of investment, according to the American Public Transportation Association.

Even with the approved ballot measures and a recent increase in refunding activity due to low interest rates, we expect new issuance to remain flat in 2015, little changed from the roughly \$315B of new debt issued in 2014. Muni prices should continue to be supported by low new issuance.

Q. Are there opportunities in emerging markets given the current backdrop?

A. We think of emerging market (EM) fixed income primarily in terms of U.S. dollar-denominated debt. Broadly speaking, we expect EM credit fundamentals to remain stable in 2015 as economic growth in these economies should continue at the current pace. In our opinion, the EM credit cycle is less advanced than that of the U.S. and Canada because leverage remains benign and we have yet to see an uptick in shareholder-friendly activities (e.g., share repurchases, which are typically detrimental to bond holders).

Select oil and gas issues could offer an attractive opportunity sometime in 2015 as falling oil prices have led to wider credit spreads. If OPEC agrees to reduce supply to stabilize prices, we foresee opportunities arising among quasi-sovereign oil producers where weaker credit metrics are less of a concern due to implicit support from respective governments.

Regarding risks, the Federal Reserve's monetary policy has broad implications for the public finances of EM nations, as well as for EM corporate spreads. Moreover, potentially slower-than-expected Chinese demand poses a risk to EM exports. Nevertheless, we view bouts of volatility as opportunities to tactically gain exposure to fundamentally sound EM credits that do business in regions of the world that exhibit positive growth trends, such as the U.S.



STANDING PAT?

Our base case does not call for a rate hike in 2015 but recently we have seen encouraging evidence of growth momentum. Investors need to keep an eye on credit risk since the risk-reward for corporates is currently less than optimal.

Q. Will the Bank of Canada finally hike interest rates in 2015?

A. No, we don't think so. We would still caution investors that higher rates are more likely than lower rates despite the Bank of Canada's (BOC) neutral bias. Canadian economic data was volatile and uneven over the course of 2014, keeping the central bank on the sidelines. We do see value in identifying certain factors that could lead the BOC to pull the trigger on a rate hike in 2015 should they prove to be sustainable.

First, it's hard to ignore recent employment reports that were quite strong. In November we learned that 43,000 jobs were created in October, dropping the unemployment rate to a six-year low at 6.5%. The prior report was even stronger, which is good news.

Second, the Canadian dollar weakened versus the U.S. dollar over the course of 2014, while at the same time a confident American consumer has developed a renewed appetite for the kinds of goods and services Canada has typically sold into that market. If the BOC concludes that Canada's excess capacity has shrunk to levels that have presaged higher inflation in the past, then a rate hike sometime in 2015 becomes a possibility.

As things stand we don't expect the BOC to respond immediately to the Federal Reserve's first rate increase, which we expect to arrive midyear. But the kind of vigour



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Overall, we favour
high-quality,
short-to-
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in the U.S. economy implied by the Federal Reserve beginning to tighten would argue for collateral strength and a similar rate response north of the border.

Q. With credit spreads hovering near their cycle lows where do you see value right now?

A. Low interest rates and the search for yield have produced tight credit spreads. In our opinion, the right strategy in such an environment emphasizes putting runs on the board rather than relying on home runs. Overall, we favour high-quality, short-to-intermediate-dated securities designed to preserve capital. Guaranteed Investment Certificates (GIC) are our choice for shorter-dated exposure, given their yield advantage. Bonds in the 3- to 8-year portion of the curve offer extra yield for only moderate term extension. The preferred share space offers little in the way of attractive value at the moment, but may soon if tax-loss selling activity results in discounted issues becoming oversold.

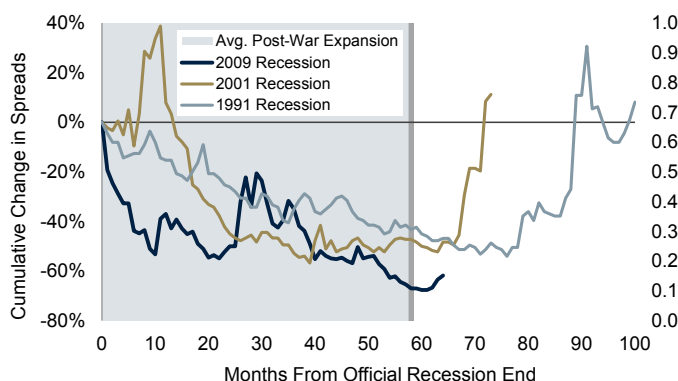
Q. Between interest rate risk and credit risk, which do you believe is the most significant right now?

A. Credit risk. Canadian corporate bond spreads sit at the 15-year average despite BBB-rated bonds—the riskiest component of the index—representing the highest proportion of the index on record. This leaves investors receiving only average compensation for above-average risk.

There are factors to consider in terms of credit risk beyond simply the potential for a default. Lower-quality credits enjoy inherently less market liquidity than higher-quality credits. This is exacerbated in periods of volatility, and will be even more so going forward, especially under the new Basel III regulations. There are also opportunity costs to consider. Currently, we prefer higher-rated names because these are more liquid and thus we can use them as a source of funds should spreads widen to more attractive levels, as we expect they will over the next several quarters.

Investment Grade Corporate Bond Spreads

Cumulative Spread Change From Official End of Previous Three Recessions



Source - RBC Wealth Management, Barclays, NBER, Bloomberg

Though there are reasons to expect that this expansion will last longer than average, the risk of higher credit spreads is growing.

Q. What do the new Basel III regulatory requirements mean for fixed income investors?

A. Basel III is a broad framework, but we define it as one that aims to strengthen the capital, liquidity, and risk profiles of banks. On the capital front, we saw the launch of several non-viable contingent capital (NVCC) preferred shares and corporate bonds in Canada in 2014. Basel III makes it mandatory for all marketable securities issued by banks to have this feature so investors should understand how these securities work. Essentially, the NVCC feature allows the bank supervisor in Canada, OSFI, to convert such capital into common equity if it determines a bank has become insolvent (non-viable) as a part of efforts to avert a future financial crisis.

With respect to liquidity, Basel III has placed a premium on deposits gathered from individuals. This is in part why GIC rates remain attractive as we enter 2015 and why we favour them.

The new capital regulations have made it more onerous for banks to carry an inventory of bonds, especially lower-rated bonds. Investors will feel this change most in times of stress when the market comes under selling pressure and dealers may not be as likely to provide price support.

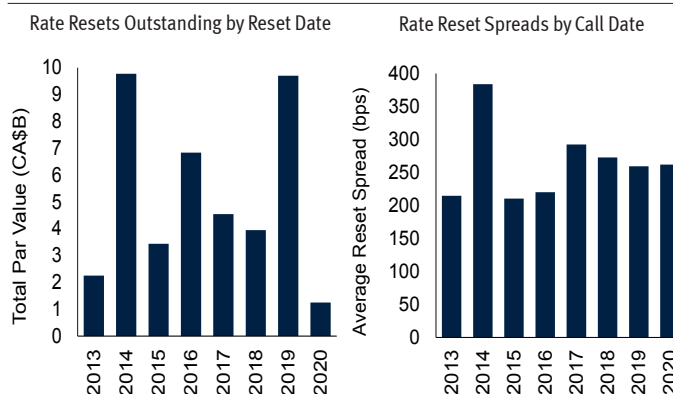
Q. How has the preferred share landscape shifted over the course of 2014? Does this sector offer attractive opportunities in 2015?

A. Redemptions by issuers provided a significant tailwind to the preferred share market in 2014. The combination of CA\$8B of redemptions since December of 2013 and muted new issue activity created a dynamic that broadly supported preferred share valuations.

Unfortunately, we expect 2015 to be more difficult.

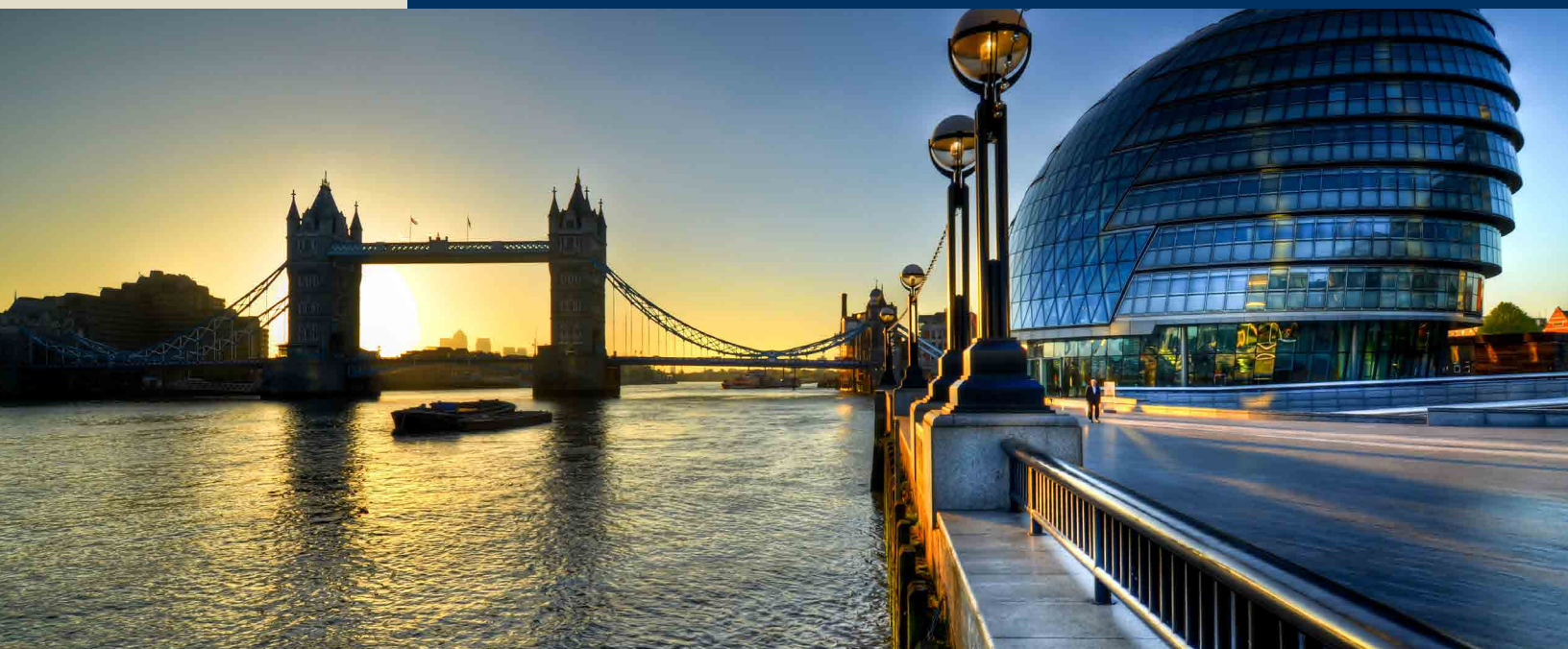
Issuers have less financial incentive to redeem those preferreds approaching their rate-reset date and, in fact, they are more likely to extend those issues. This could serve as a painful reminder to some investors that rate-reset securities should be viewed as perpetual securities with a redemption right in the hands (and favour) of the issuer. We would position portfolios in high reset-spread issues to take advantage of credit-positive events as we think the 2015 playbook is going to be much more about individual security selection.

Changing Landscape for Rate-Reset Preferred Shares



Expect a challenging market due to fewer redemptions and greater extension risk.

Source - RBC Dominion Securities, Bloomberg



STILL MUCH WORK TO BE DONE

ECB action to jump start the eurozone economy's flagging pulse and ward off deflation threats will be front and center in 2015. But credit spreads should compress further as the market factors in less default risk as banks have beefed up balance sheets.

Q. What are the big challenges facing the ECB and BoE in 2015?

A. It looks like both central banks will be contending with low inflationary pressure in 2015, but the expected severity as well as causes of the underlying problem are radically different.

For the BoE, inflation is likely to undershoot its target, mostly due to weak energy prices. Nonetheless, labour market improvements and economic growth will likely push the reported number up off its lows leaving the BoE, which is concerned about overheated real estate markets, with room to hike rates at least once in 2015. The timing of such hikes remains uncertain, but the consensus estimate has the first move penciled in for Q1 2015.

The ECB will likely remain focused on conditions in the peripheral countries and the threat of deflation becoming widespread across the euro area. We feel these concerns will likely result in further unorthodox measures from the ECB. We still don't foresee a rate hike from the ECB in the foreseeable future.

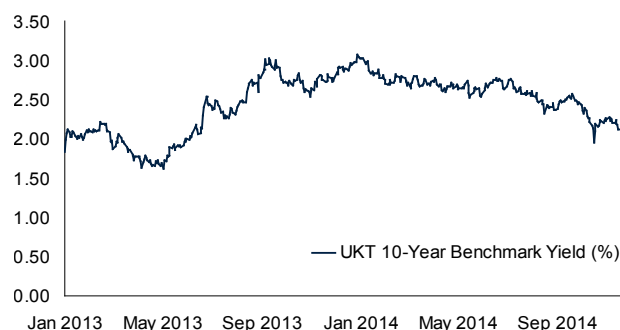


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All eyes are on the BoE and how successful it will be in the balancing act of raising short-term rates without upsetting long-term bondholders.

U.K. Yield Rally Likely to Run Out of Steam in 2015



Source - RBC Wealth Management, Bloomberg; data through 11/17/14

2015 is unlikely to see a repeat of 2014's surprise bond rally.

Q. Yields fell and spreads tightened in Europe, for the most part, in 2014. What type of market should we expect in 2015?

A. We expect to see yields on U.K. government bonds start rising in 2015. This is unlikely to stir up the market significantly as analysts and investors have been anticipating this for quite some time. In the eurozone, the picture is very different. Very low inflationary pressure accompanying tepid economic growth is likely to keep German yields at record lows. Depending on the success of the ECB's action to stoke inflation, peripheral sovereign yield levels will remain volatile. We see spread tightening between the yields of peripheral sovereigns and German benchmarks as the most likely outcome by the end of 2015, given the ECB's commitment to the single currency.

Q. Can credit spreads compress further in 2015 after significant tightening in 2014?

A. Credit spreads are likely to grind closer to pre-crisis marks from today's still historically wide levels. Central banks conducted stress tests and asset purchases that have supported the financial sector as well as fixed income markets in 2014, and we expect these tailwinds to persist in 2015. Default rates are likely to remain low and underpinned by further improvement in the balance sheets of banks, modest economic growth, and improved financial market conditions. Finally, as banks move closer towards compliance with Basel III, we expect the liquidity conditions to actually improve thanks to lower uncertainty concurrent with the aforementioned balance sheet repair.

Q. Do high cash balances and accommodative monetary policy portend a fresh M&A cycle in 2015 that will be credit negative?

A. We have seen signs of M&A build-up during 2014, and we expect this to continue in 2015 as cash balances at the corporate level build up and become a drag on returns. Further, tax treatments in some countries may fuel additional M&A transactions. However, this expected build-up is unlikely to have a broad impact on credit spreads. Instead, M&A news is likely to have an impact at the issuer-specific level rather than affect the sector as a whole. Investors should adopt an opportunistic approach if such an M&A cycle emerges.

Q. Most European banks passed rigorous stress tests administered by the ECB and EBA in October 2014. Will 2015 be the year investors can stop worrying about a European banking crisis?

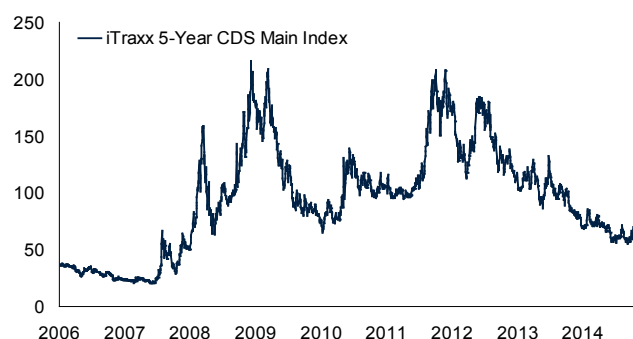
A. U.K. banks are likely to start looking forward after a number of difficult years stemming from the legacy of the financial crisis as well as litigation. Government ownership is likely to be dialled down further, and this will have a positive impact on investor sentiment. As a consequence, we see scope for further spread compression at current levels.

Eurozone banks may see further balkanisation between the core and/or large diversified banks and peripheral local banks. The first are likely to weather the eurozone problems well while accomplishing further strengthening of their balance sheets. By contrast, local banks in peripheral countries will still be dependant on ECB actions.

New Basel III compliant instruments are gaining momentum and should further support the strength of larger banks. But, these new instruments have not yet been tested in all market environments and could be sources of extra volatility during 2015. This is especially the case in the GBP-denominated market where Government benchmark yields are forecast to be rising.

Old-style (or legacy) subordinated bank capital instruments are likely to see better performance as the universe shrinks and their established history makes investors more comfortable. Deeply subordinated old-styled instruments could see some negative performance from the duration risk in a rising yield environment during 2015. All in all, we see continued value in the U.K. and large eurozone banks, which should experience further spread compression during 2015 in senior and “mildly” (Lower Tier 2) subordinated instruments.

iTraxx 5-Year CDS Main Index



Spreads have rallied since the height of the financial crisis, but may still have some scope for further tightening.

Source - RBC Wealth Management, Bloomberg; data through 11/14/14

Commodity Forecasts

	2014E	2015E
Oil (WTI \$/bbl)	86.50	85.00
Natural Gas (\$/mmBtu)	4.00	4.50
Gold (\$/oz)	1,285	1,300
Copper (\$/lb)	3.15	3.00
Corn (\$/bu)*	3.55	3.91
Wheat (\$/bu)*	5.20	5.67

* Corn and Wheat 2014 forecasts are for Q4 2014
Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (corn and wheat).

GET USED TO SOFT PRICES

GOLD

A rapid rise in the U.S. dollar has weakened investor sentiment around gold. On the supply side, mine production remains near the peak levels observed towards the end of last year. Meanwhile, demand trends are mixed-to-soft. Jewellery and central bank demand remain relatively robust, albeit towards the lower end of the range of the last two years. Coin and bar purchases have continued to slow. After a period of stabilization through much of this year, global ETF holdings have slid again since September.

While we expect bullion to trade broadly within the band of \$1,150–\$1,400 observed over the last 18 months, we remain somewhat cautious on the metal. With macroeconomic risks fading, generally strong mine supply, and mixed-to-soft demand trends the order of the day, investor interest in gold as an alternative investment vehicle is likely to remain subdued, especially given the strength in equity markets.

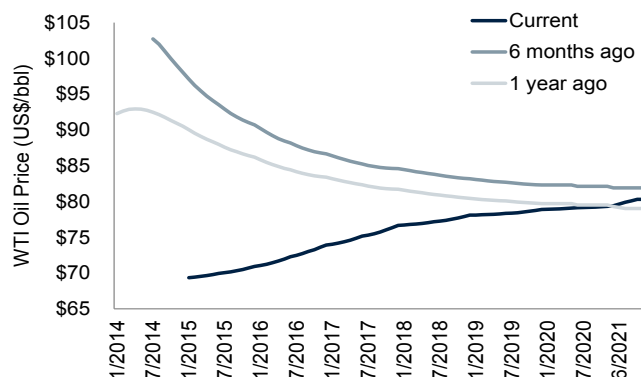
ENERGY

OIL

Demand weakness for oil amid ever higher U.S. shale production has led to a steep price decline following a flush of production from Libya, the risk of higher flows from Iran, and an uptick in the dollar.

Provided global demand growth remains consistent with the levels observed in recent years, we would look to marginal supply costs at \$54–\$87/bbl for major U.S. shale plays to provide medium-term cost support. However, the adjustment period and bottom are difficult to predict. We see a price range of \$60–\$80/bbl (WTI) as reasonable; however, commodities often overshoot reasonable cost support levels in the short term. Catalysts such as talks with Iran, any reaction from OPEC ahead of its next meeting in June 2015, and other supply-side unknowns in the Middle East could move prices sharply.

Oil Futures Curve



Oil futures have plummeted in the near term, but remain little changed for 2020.



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Source - RBC Wealth Management, Bloomberg

NATURAL GAS

With winter arriving, we have entered the drawdown season for natural gas with U.S. storage at 3.6 tcf, about 5%–7% below the seasonal norm observed in recent years. While this tight storage situation would normally be viewed as bullish for the commodity, production levels have ramped up on strong pricing in H1 2014.

The latest data show production up nearly 4 bcf/d year-over-year, and we expect more production gains with new pipeline infrastructure coming into service in the Marcellus region. We continue to view \$3.50–\$5.00/mmBtu as a reasonable range for natural gas prices. In the short term, winter weather will be the primary driver.

COPPER

The copper market has been broadly balanced for the last two years with periods of modest deficit and surplus. RBC Capital Markets forecasts a slight surplus in 2015, followed by a deficit in 2016 as a sharp slowdown in mine supply growth should tighten the market.

In this balanced market, copper prices have remained around the \$3/lb mark and we would expect this to be sustained, supported by a continued shortage of scrap, and ongoing production disruptions. The property market correction in China does represent a risk to copper prices. If demand conditions were to deteriorate, we could see renewed weakness, but would expect some stabilization of the market around the \$2.40–\$2.50/lb level given the industry cost profile.

CORN AND AGRICULTURAL COMMODITIES

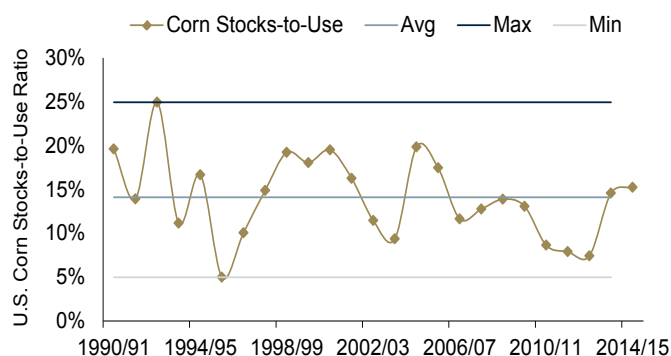
CORN

A bumper crop for corn has swamped the market again this year, sending prices down sharply through the summer months. In this environment, many regions will be priced out of the market and we are likely to see more acres shift away from corn towards other crops such as soybeans. While weather conditions are difficult to predict, a third straight year of bumper crops seems unlikely to us. We would not be surprised to see the recent weakness in corn prices represent a trough.

POTASH

Potash market conditions have improved with demand currently forecast by an industry leader at 58–60 million tonnes per annum, at the upper end of recent years. Recent flooding at a key Russian potash mine has removed about 5% of global production.

Corn Stocks-to-Use



Corn prices are rebounding off sentiment lows early this fall following two bumper crop years.

Source - RBC Wealth Management, RBC Capital Markets

Currency Forecasts

Currency Pair	Current Rate	Forecast Dec 2015	Change*
USD Index	88.36	93.08	5%
CAD/USD	0.88	0.85	-4%
USD/CAD	1.14	1.18	4%
EUR/USD	1.25	1.17	-6%
GBP/USD	1.56	1.43	-8%
USD/CHF	0.97	1.06	9%
USD/JPY	118.63	120.00	1%
AUD/USD	0.85	0.85	0%
NZD/USD	0.78	0.75	-4%
EUR/JPY	147.72	140.40	-5%
EUR/GBP	0.80	0.82	2%
EUR/CHF	1.20	1.24	3%

Emerging Currencies

USD/CNY	6.15	6.20	1%
USD/INR	62.03	65.00	5%
USD/SGD	1.30	1.32	2%
USD/TRY	2.22	2.20	-1%
USD/PLN	3.36	3.38	1%
USD/MXN	13.93	12.55	-10%
USD/BRL	2.57	2.60	1%

* Defined as the implied appreciation or depreciation of the first currency in the pair quote. The USD Index measures the U.S. dollar 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 0.88 means 1 Canadian dollar will buy 0.88 U.S. dollar. A CAD/USD -4% change means the Canadian dollar is forecast to fall 4% vs. the U.S. dollar over the next 12 months. USD/JPY 118.63 means 1 U.S. dollar will buy 118.63 yen. A USD/JPY 1% change means the U.S. dollar is forecast to rise 1% vs. the yen over the next 12 months.

Source - RBC Capital Markets, Bloomberg



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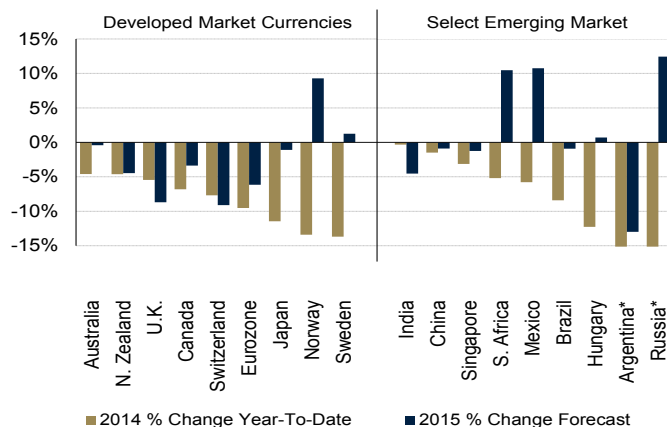
DOLLAR RALLY LESS ONE-SIDED

U.S. DOLLAR

2014 was the year the dollar confirmed its bull market status. As we went to press, none of the 25 currencies followed by RBC Capital Markets were up against the dollar year to date. There were two principal drivers to this rally—a realization that steady U.S. GDP growth might result in a 2015 rate hike and a willingness to tolerate weaker currencies on the part of foreign central banks worried about their own economies' tepid growth.

Fundamentals argue that the strong dollar trend should continue in 2015, albeit at a slower pace. This is because the Fed is likely to be cautious with the path of its rate hikes, and since other developed nation interest rates cannot go much lower, interest rate spreads between currencies are unlikely to balloon, which should put a cap on dollar strength, in our view. Additionally, our strong dollar view is becoming the consensus opinion, and this brings the risk of position covering should the dollar rally stall.

Expect a Strong Dollar Again in 2015 But Not as One-Sided as 2014



Bars show change in value of each currency against the U.S. dollar.

*Argentina's (-24%) and Russia's (-34%) 2014 currency performance truncated.

Source - RBC Wealth Management, RBC Capital Markets forecasts, Factset

For 2015, we expect the U.S. dollar to continue the rally seen in 2014, but at a slower pace, and with a handful of currencies gaining against the dollar.

EURO

We expect negative sentiment toward the euro to continue in 2015. Growth in the eurozone is weak, and deflation remains an ongoing risk. Quantitative easing and a weaker euro would help on both counts, but a lack of political consensus across the Continent may frustrate such expectations.

However, speculative short positioning on the euro remains near multi-year highs, suggesting much of the bad news may already be priced in. While we expect further euro weakness against the dollar, we are less bearish against other major currencies than is the consensus.

CANADIAN DOLLAR

Renewed weakness in industrial commodities over H2 2014 has put further pressure on an already fragile Canadian dollar. The decline in oil in particular has impacted Canadian terms-of-trade, or the ratio of export prices to import prices, and we expect the loonie to continue to fall against the dollar as a consequence.

An additional concern is Canada's persistent current account deficit. When commodity prices were rising, foreign investment served to fund this gap, but as overseas flows dry up, we believe currency depreciation is the most likely market response and remedy to this stubborn deficit.

BRITISH POUND

The Bank of England's final quarterly inflation report of 2014 slammed the door shut on the chance of an early interest rate hike. In the report, growth and inflation projections through 2016 were lowered, driven by slowing economic data.

The U.K.'s current account deficit now runs at more than 5% of GDP, having overtaken those of both Canada and Australia in 2014. We believe that with a general election scheduled for May 2015, it is unlikely that the deficit will be addressed during the year and may even widen on a change in government. Political uncertainty may be compounded by a referendum on EU membership, and adds to our bearish stance on sterling.

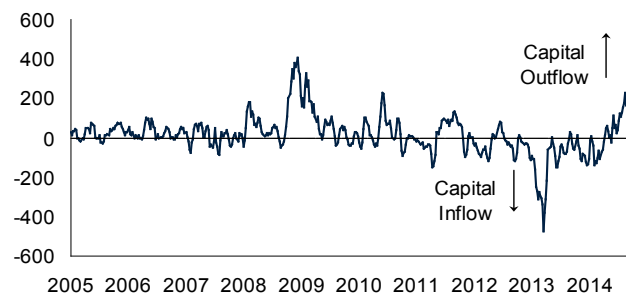
JAPANESE YEN

We remain bearish on the yen against most major currencies through 2015. The Bank of Japan surprised the market in 2014 with its willingness to expand the monetary base, and Prime Minister Shinzo Abe has made no secret of his desire for higher inflation.

However, we think the main driver of a weaker yen will be asset flows into foreign markets. With global interest rates near zero, most of these flows so far have taken advantage of cheap hedging and, therefore, avoided outright yen sales. But as global rates normalize, Japanese investors will likely sell the yen outright to fund their foreign asset purchases.

It's Not Just the Foreigners; Domestic Selling of the Yen on the Rise

Japanese Investors' Net Purchases of Foreign Stocks, Billions of Yen



Mid-2014 saw the start of concerted buying of foreign stocks by Japanese institutions.

Source - RBC Wealth Management, Japanese Ministry of Finance

EMERGING MARKET CURRENCIES

Our forecasts for emerging market currencies in 2015 are much less one-sided than they are for their developed-market counterparts. We believe structural reforms will be the key theme for outperformance. The Mexican peso should benefit from this theme, with faster growth prompting firmer monetary policy.

The BRIC currencies look less bullish to us. China's slower growth should moderate any gains in the yuan, while we believe a more market-friendly approach to economic development will be needed to slow the decline in the Brazilian real.

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			Count	Percent
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