May 2018

RBC WEALTH MANAGEMENT

Global Insight

Perspectives from the Global Portfolio Advisory Committee



The year of the tariff

Protectionism is back in play, and we assess the potential outcomes—good, bad, and ugly.

Eric Lascelles | Page 4



Focus article
The U.S. dollar in an era of protectionism



Focus article
Undervalued and under the radar



Global equity
Secular stamina



Global fixed income
Flat curves souring investor tastes

For important and required non-U.S. analyst disclosures, see page 28.

RBC Wealth Management

Table of contents

4 The year of the tariff

Markets have been re-introduced to volatility this year by way of a barrage of macro risks. Protectionism is one of the most cited culprits. RBC Global Asset Management's chief economist looks at how the "year of the tariff" could play out.

8 The U.S. dollar in an era of protectionism

The dollar has waded through the trade tensions of the past few months, and we think a backdrop of strengthening economic growth, moderately rising inflation, and a gradual tightening of monetary policy should support the dollar finding a floor in 2018.

12 Undervalued and under the radar

U.K. equities have been dogged by chronic underperformance for many years. But with several valuation metrics as low as we have seen them in a long time, U.K. equities should no longer be ignored. Given the compelling value case, we are upgrading our stance to Market Weight.

16 Global equity: Secular stamina

While equity markets are still working out the kinks wrought by this year's volatility, we believe that broad-based forward momentum should allow the long-term uptrend to be the dominant force driving equity prices for some time to come.

20 Global fixed income: Flat curves souring investor tastes

While flattening yield curves are bringing the bears out of the woodwork, we would remind investors that they shouldn't jump to the conclusion that a recession is around the corner. Yield curves could very well flatten further, but we explain why they may be just part of another "new normal."

Inside the markets

3 *RBC's investment stance*

16 *Global equity*

20 *Global fixed income*

23 *Commodities*

24 *Currencies*

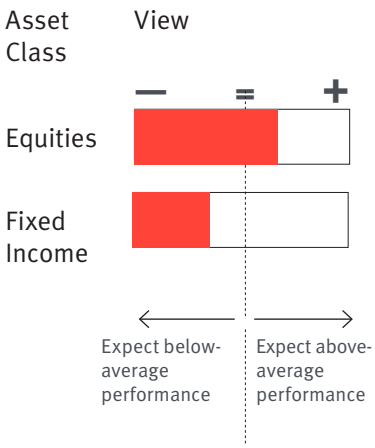
25 *Key forecasts*

26 *Market scorecard*

All values in U.S. dollars and priced as of market close, April 30, 2018, unless otherwise stated.

RBC's investment stance

Global asset views



See "Views explanation" below for details

Source - RBC Wealth Management

Equities

- The protectionist storm abated somewhat in late April, though worries regarding the flattening of the yield curve reappeared as investors searched for signs of a recession. Some turned to the ongoing earnings season to gauge the health of the corporate sector. Results in the U.S. are mostly encouraging so far and point in the right direction in Europe.
- While we concur with the importance of being vigilant at this later stage in the business cycle, we see no imminent signs of a recession. With valuation levels having retreated courtesy of the February correction, we would continue to maintain a modest Overweight position in equities.

Fixed income

- Central banks remain in focus, but the road to synchronicity isn't without a few wobbles as growth and inflation readings challenge early-year forecasts. We believe the Fed will hold policy steady this month in the face of slow growth and low inflation, but rapidly receding inflation readings are making the Bank of England's expected rate hike, also this month, less certain. With three rate hikes under its belt since last summer, the Bank of Canada has paused as growth prospects downshift. Meanwhile, the European Central Bank appears committed to winding down quantitative easing by year end. In our view, its first rate hike is unlikely to arrive before the second half of 2019.
- Yield curve and credit market dynamics continue to pose challenges, and while higher overall yields provide nice window dressing for the sector, tight spreads limit relative value opportunities. Hence, we remain Underweight fixed income and advise investors to remain selective.

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.

The year of the tariff

Financial markets are in a state of high alert, responding spasmodically to an onslaught of macro- and company-level shocks. Among them, protectionism has been a particularly central and recurring villain. Just how bad might the "year of the tariff" turn out to be? RBC Global Asset Management's chief economist tallies up the good, the bad, and the ugly.



Eric Lascelles
Toronto, Canada
eric.lascelles@rbc.com

The good

There are two sides to every ledger, and—believe it or not—some countries are still trying to deepen international trade rather than undermine it. The recently announced 11-nation Trans-Pacific Partnership (TPP) trade pact is a major step forward. The EU has also entered into important deals with Canada and Japan.

China, the world's other superpower, is opportunistically seeking to fill the void left by a retreating U.S. Doing so includes a gradual tempering of Chinese capital controls and a vision of China as the benefactor of a refreshed Marshall Plan, connecting (and enriching) central Asia and eventually much of the developing world via large-scale infrastructure projects.

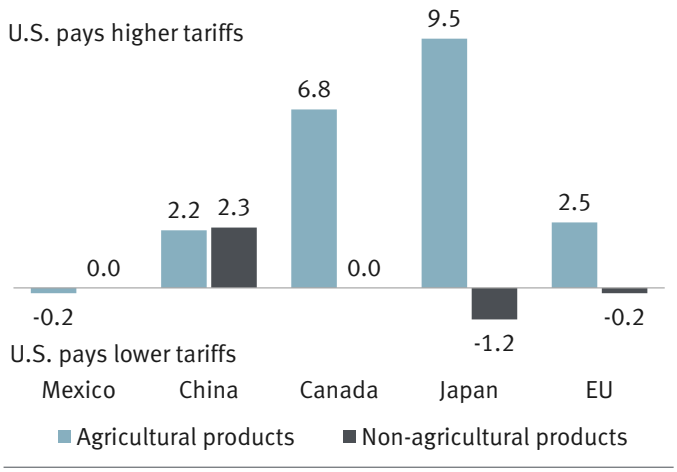
NAFTA negotiations, so far a long, grim affair, have suddenly bounded forward after the U.S. surprisingly eased its demands on the minimum domestic share of auto production. No less importantly, the comments from all three countries have suddenly become much more constructive, with each appearing to target a high-level deal this month.

Granted, there is more NAFTA work to be done. Key sticking points include a proposed sunset clause, the nature of the pact's dispute resolution system, and government procurement rules. It remains unclear what concessions Canada and Mexico have made. Furthermore, there could yet be a last-minute hitch (whether premeditated by U.S. negotiators or via a wrench thrown by the executive branch). But suffice it to say that whereas we rated the risk of NAFTA's destruction as high as 40% at one point, in our assessment it has fallen to just 15%. That doesn't guarantee the final deal is economically positive or even benign, but it does limit the potential for damage.

Let us also recognize that the U.S. is not entirely incorrect in its trade grievances. American exporters do, on average, pay higher tariffs than foreign firms do when entering the U.S. market. If the recent barrage of U.S. tariffs is instead viewed as being a temporary wedge designed to pry open foreign markets, globalization could actually be advanced rather than impeded by these unorthodox tactics. This is unquestionably a best-case interpretation, but not an impossible one based on White House comments. In fact, there is some evidence of the U.S. succeeding with this approach in the past:

U.S. gets bad tariff deal versus partners

Tariff rate differential between U.S. and partner countries, 2017 (ppt)



U.S. trade complaints not without some foundation.

Note: Difference between tariff rates U.S. pays on its exports to partner countries and rates partner countries pay on exports to U.S.
Source - WTO/ITC/UNCTAD World Tariff Profiles 2017, RBC Global Asset Management, RBC Wealth Management

- President Nixon imposed a blanket 10% tariff on imports in 1971, removing it four months later when other countries agreed to depreciate their exchange rates against the U.S.
- The Plaza Accord of 1985 was not technically a protectionist action, but the currency negotiations therein were motivated in part by U.S. firms agitating for trade protection. Instead, the world's major nations agreed to devalue the dollar and, in so doing, obviate the need for damaging protectionist actions.
- Across the 1980s, President Reagan implemented a number of tariffs and import controls. These did not seriously interfere with economic growth, were eventually lifted, and prompted Japanese automakers to shift more of their production onto U.S. shores.

Recently proposed trade barriers are set to inflict surprisingly little economic damage, according to most estimates.

Lastly, it is some relief to learn that recently proposed trade barriers are set to inflict surprisingly little economic damage, according to most estimates. For instance, based on the actions taken so far, the trade spat between the U.S. and China will cost each economy less than a quarter of one percent of their economic output. The effective U.S. tariff rate on imports will rise from just 1.6% to 2.1%—a far cry from an average tariff rate above 20% for much of the 1920s and 1930s. The world is still a much friendlier place to trade now than at almost any other point in time.

The bad

Whenever protectionism is in play, there is also going to be a considerable amount of "bad" news.

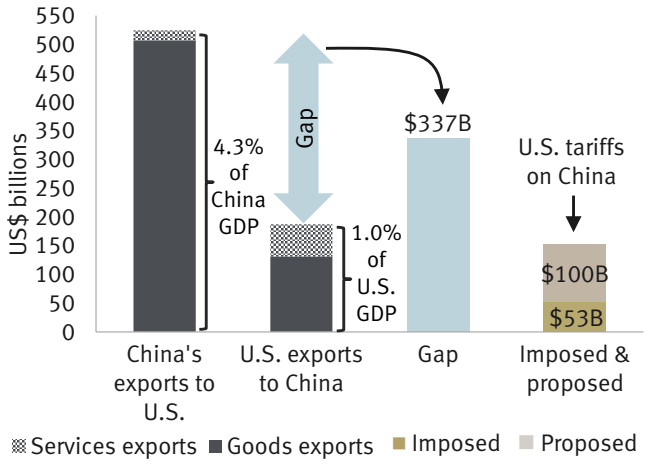
First, protectionism has long since morphed from words into action, with U.S. tariffs now in place on softwood lumber, washing machines, solar panels, steel, and aluminum. As much as President Trump promised and then delivered tax cuts, he is now clearly acting upon his protectionist mandate. The odds of further action are hardly trivial given the extent to which his more moderate advisors have fallen by the wayside.

Second, the latest Chinese tariffs are much more significant than anything that has come before, in part because of the size of the tariffs—a 25% tax on $50B of imports—and in part because China is proving to be an equally pugilistic adversary. Based on the orientation of the tariffs to date, on U.S. agricultural products versus Chinese technological products, the U.S. may take a disproportionate share of the economic hit this round because agricultural products can be more easily replaced than specialty manufactured goods. But Chinese vulnerability is ultimately significant given that the country exports three times as much to the U.S. as the other way around.

U.S.-China antagonism is hardly brand new.

Third, U.S.-China antagonism is hardly brand new. The two have been scrapping over control of the Pacific for some time. Foreign direct investment between the two fell by one-third last year and appears on track to decline further this year. Such frictions are unsurprising—the transition from a hegemonic to a multipolar world classically results in friction between the ebbing and ascending nations.

U.S. slaps tariffs on imports from China



Opening shot or a basis for discussion?

Note: 2017 exports shown in chart. Actual tariffs on China include tariffs on steel and aluminum products estimated based on 2017 imports and tariffs on $50B of goods from China announced on April 3, 2018.
Source - U.S. Census Bureau, Haver Analytics, RBC Global Asset Management, RBC Wealth Management

Fourth, even for aggrieved countries that seek redress through the proper channels—filing a dispute with the World Trade Organization (WTO)—any remedy is typically slow to come and the medicine might just be worse than the disease. The complainant is often told by the WTO to impose its own tariff on the "trade bully."

Fifth, both the U.S. and China have taken to ignoring the WTO anyway, threatening to undermine the existing scaffolding of global trade. While U.S. courts and Congress could try to impede the president's trade actions, the laws of the land grant him extensive powers that would be hard to neutralize.

Sixth, the U.S. is even further off the globalization course than its recent tariffs would suggest. On a counterfactual basis, it has also failed to sign on to several deals that were previously full steam ahead, including the aforementioned TPP and a deal with Europe. True, President Trump spoke recently of rejoining the TPP, but that is not a realistic aspiration given the concessions he would likely demand.

Seventh, the protectionist trend is not limited to the U.S. The British decision to flee the EU is another prominent example. Subtly, quite a number of countries have also been skirting trade rules by fortifying their non-tariff barriers. This appears to be the newest trick in the protectionist arsenal. With tariffs and import quotas now frowned upon, countries have found more subtle ways to give a (Pyrrhic) victory to the home team.

Eighth, and turning to Canada, the prospect of a NAFTA deal, even a slightly sour one, is undeniably a marked improvement on expectations from just a month ago. But it does not get Canada completely off the "bad competitiveness" hook, which has even more to do with divergent tax policy, labour laws, and the broader regulatory environment.

The ugly

Our best guess is that protectionism will merely act as a pesky drag on global growth, avoiding outright economic carnage.

One must acknowledge something like a 20% chance of a rather uglier outcome—a full-blown trade war.

But alternate scenarios abound, and one must acknowledge something like a 20% chance of a rather uglier outcome—a full-blown trade war. This might not be outright recessionary based on the modelling done to date, but it could certainly suck all of the juice out of recent U.S. tax cuts.

The scenario goes as follows: It is far from clear that the U.S. is done conjuring up Chinese tariffs. To the contrary, the tariffs thus far merely respond to China's steel glut and the country's questionable intellectual property practices. China can also be accused of subsidizing and shielding a slew of other sectors.

From a broader perspective, China is responsible for much of the gaping U.S. trade deficit that the White House finds so objectionable. President Trump is already threatening another round of Chinese tariffs that would be twice as big as the prior round. And while it takes two to wage a trade war, China has proven its willingness to punch back.

Bottom line

To reiterate, a trade disaster should not be anyone's base case. Given a number of positive tailwinds still blowing from other points on the compass, the global growth story looks capable of surviving a modest trade drag. U.S. dalliances with protectionism in the 1970s and 1980s ultimately did little damage, and there is still the chance that U.S. pressure manages to dismantle some foreign barriers.

But one cannot speak with precision about these things, and the potentially deleterious effects of second-order considerations such as uncertainty and skittish financial markets are hard to model. We are inclined instead to acknowledge this threat by flagging protectionism, alongside an aging business cycle (for what it's worth), as the key macro risks for the coming year at least.

The U.S. dollar in an era of protectionism

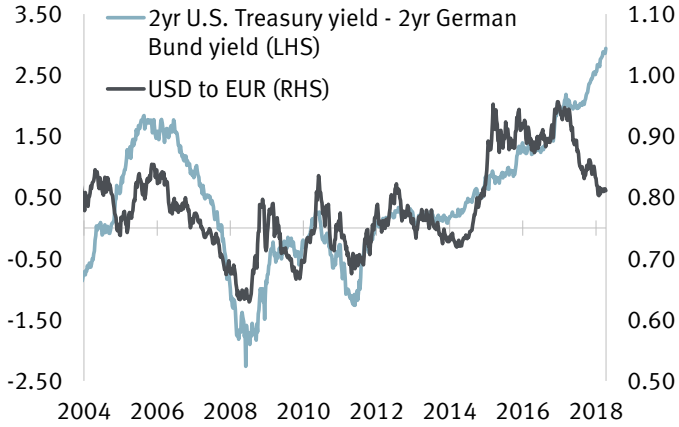


Laura Cooper
London, United Kingdom
laura.cooper@rbc.com

The rise of protectionism has added a new risk to the equation, forming cracks in the dollar's nascent recovery. While we think the trade tensions will prove to be more bark than bite, and that the dollar will sidestep the cracks and keep its recovery intact, investors should still consider what protectionism could mean for the dollar.

Despite heightened trade uncertainty, currency markets seem to be taking recent developments in stride. Currency market volatility is sitting at multi-month lows. The dollar has waded through the tensions of the past few months, trending broadly sideways against a basket of currencies. What negative U.S. dollar sentiment remains appears to stem from external factors, namely improved economic growth conditions outside of the U.S., and financial market caution around the extent to which the Federal Reserve will raise rates.

Sentiment has seen the dollar break away from traditional drivers



Negative sentiment has contributed to a breakdown between the dollar and its relationship with interest rates.

Source - RBC Wealth Management, Bloomberg; data through 4/13/18

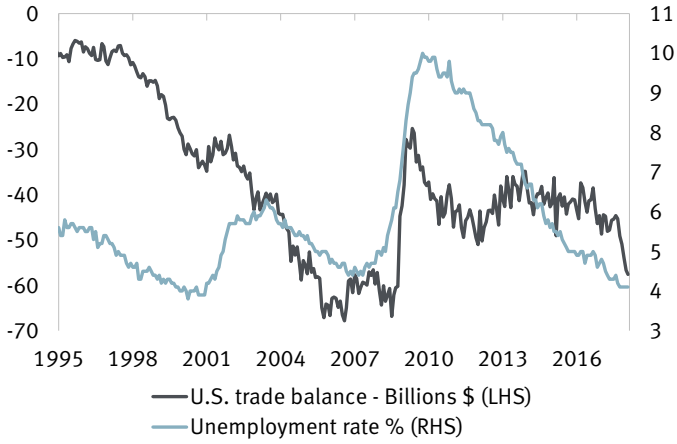
Recent trade tensions, in our view, largely reflect posturing with an easing of the aggressive tone likely to prevail and a global trade war unlikely to occur. This would allow for a renewed focus on a backdrop of strengthening economic growth, moderately rising inflation, and a gradual tightening of monetary policy, all of which would support the dollar finding a floor in 2018.

However, the confluence of factors at play in the current environment—notably, the injection of fiscal stimulus at a time of economic strength and a widening in the trade and budget deficits, all amidst Fed tightening—warrants a closer look at what protectionism could mean for the dollar.

Trade snapshot

The U.S. runs a large trade deficit with the rest of the world, with the bulk of the imbalance coming from trade with China, followed by Germany and Mexico. Importantly, a trade deficit does not naturally confer a position of economic weakness upon a country. A stronger economy with falling unemployment and rising incomes positions consumers to afford a greater amount of goods, both domestic and imported.

Strong labour market enables consumers to afford a greater amount of goods



A stronger economy with rising household incomes positions consumers for higher spending, both domestic and imported.

Source - RBC Wealth Management, Bloomberg; data through 3/31/18

Tariffs are not a panacea

Trade deficits are typically little changed following the imposition of tariffs.

If a country buys more goods and services from the rest of the world than it sells, it must effectively "borrow" from abroad to pay for the purchases. It does this by selling financial assets such as stocks, corporate bonds, and government securities (Treasuries) to foreigners, and then uses the proceeds to fund the extra goods and services it wishes to purchase. The currency exchange rate ensures that demand for investment funds balances with the flow of goods and services.

Tariffs distort this process. Goods entering a country become more expensive as the extra cost from the tariff (tax) can be passed on to consumers. While the rationale behind tariffs is to shift demand towards relatively cheaper domestically produced products and thereby stimulate domestic sectors, in practice, this is often not the outcome. Trade deficits are typically little changed following the imposition of tariffs.[1]

The recent U.S. tariffs on steel and aluminum are likely to have only a negligible effect because of the small size of these industries relative to the U.S. economy. However, a tit-for-tat escalation could leave the Fed weighing the inflationary

[1] Consensus points to tariffs being inflationary; they can push up the prices of imports with the resulting rise in demand for domestic goods spurring higher prices as well. The higher import prices effectively lower demand for imports. This implies less demand for foreign funds used to pay for the goods. The domestic currency strengthens as a result, and a country's goods become relatively more expensive for the rest of the world, leading to an export pullback. On net, theory suggests that the trade balance would thus be little affected by tariffs, yet volumes would be lower and consumers would face higher prices.

impact of tariffs against the need to not stifle economic growth. The net effect could be increased interest rate policy uncertainty, which would likely constrain the dollar.

A unique position

The savings and investment behaviours of countries tend to play a greater role in trade balances than trade policy alone. Countries with a surplus of domestic savings, like China, which save more than they invest within their own borders, essentially "lend" the excess funds to countries abroad by purchasing foreign assets, such as U.S. Treasuries. This, in turn, provides a surplus of funds for the U.S. to purchase foreign goods, resulting in a current account deficit (includes goods and services and net income/transfers from abroad). Appetite for U.S. Treasuries remains strong amongst China, Europe, and Japan, and the inflow of foreign capital enables the U.S. to fund its current account deficit.

A sizeable sale of foreign holdings of U.S. Treasuries—China is the largest holder—would likely spur higher U.S. interest rates and tighter financial conditions, slowing U.S. economic activity and dragging down the dollar. This is not our base-case scenario, but it presents a meaningful risk, which highlights the threats posed by retaliatory tariff actions and the potential knock-on effect to U.S. assets. These could further weigh on already negative dollar sentiment.

Add a larger budget deficit to the mix

The current fiscal injection is coming at a time when economic momentum is strong and surplus capacity is rapidly diminishing, potentially overheating the U.S. economy.

The added challenge in the current environment is that the U.S. federal budget (fiscal) deficit is almost certain to widen given the implementation of tax cuts, and would increase further if an infrastructure spending program is passed. With a reliance on capital from China and other countries to cover part of this budget shortfall, all else equal, this implies a larger U.S. current account deficit.[2]

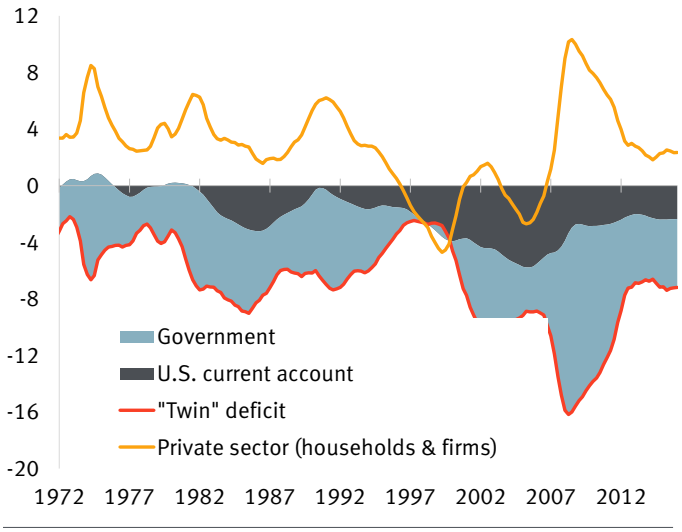
Another concern of markets is that the current fiscal injection is coming at a time when economic momentum is strong and surplus capacity is rapidly diminishing, potentially overheating the U.S. economy.

At the same time, heightened uncertainty around protectionist objectives could cause investors in U.S. securities to demand to be compensated for taking that extra risk, potentially making U.S. financial assets less attractive to some foreign investors.

Historically, the dollar's performance has been mixed under conditions of rising trade and fiscal deficits, and largely dependent on the actions of the Fed. In the current environment, the fiscal deficit may be less problematic for the dollar. Private savings from households could provide some offset to rising fiscal deficits given the relatively better financial position of households compared to previous periods. This alongside a Fed that has signaled it could raise rates beyond current market expectations could limit the dollar downside against a protectionist backdrop.

[2] U.S. Net Saving = minus Rest of World Net Saving; so a decline in the government budget balance (decline in U.S. net saving) must correspond with a decline in the U.S. current account or equivalently a rise in net borrowing from the rest of the world.

Widening deficits may be less problematic for the dollar this time around



Private savings from households could get a lift from tax cuts, providing some offset to rising fiscal deficits.

Source - RBC Wealth Management, Bloomberg

Dollar recovery intact

While protectionism raises uncertainties, our view remains that the dollar will navigate the cracks in its newly formed floor.

Confidence in the economic outlook saw the Fed raise its key interest rate in March, for the sixth time this recovery cycle. The Fed's optimism about the economic expansion led it to adopt a modestly higher rate hike forecast path beyond 2018. The robust economy, augmented by fiscal stimulus, argues for an uptick in inflationary pressures, which could provide scope for the Fed to raise rates somewhat faster than currently planned. Were that to occur, it would provide an additional tailwind to the nascent dollar recovery.

More aggressive protectionist and tariff strategies by the U.S. administration and its trading partners could, however, add a layer of uncertainty to this outlook. First, a potential exodus of capital flows from the U.S. at a time when the country will need to rely on these funds to finance ballooning deficits would inevitably be dollar-negative. Second, a more cautious Fed on account of a clouded economic outlook related to trade uncertainty could also weigh on dollar performance.

While protectionism raises these and other uncertainties, our view remains that the dollar will navigate these cracks in its newly formed floor. The trade disputes are ultimately likely to be handled reasonably and rationally, rather than degenerate into aggressive back-and-forth implementations of tariffs across a wide range of goods.

Undervalued and under the radar



Frédérique Carrier
London, United Kingdom
frederique.carrier@rbc.com

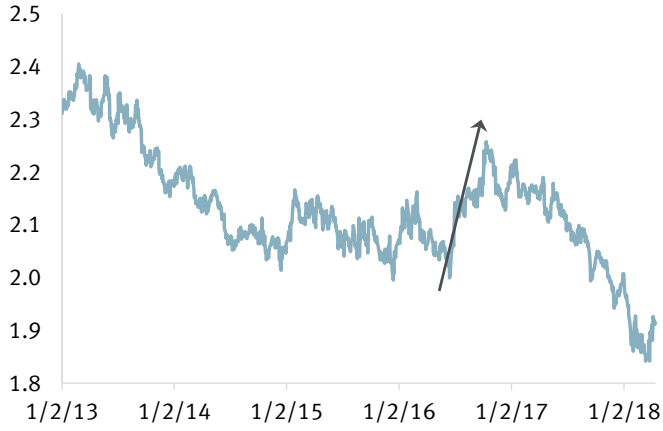
We are upgrading our U.K. position to Market Weight from our long-held Underweight. Our decision rests on several key factors: the U.K. equity market's prolonged underperformance; institutional positioning which is overwhelmingly underweight; extreme valuation levels; and the defensive characteristics of U.K. equities. It is not predicated on expectations of an improving macroeconomic backdrop.

Chronic underperformer

While U.K. equities weathered the storm of the great financial crisis relatively well, they have lagged since the recovery took hold. In particular, since the Brexit referendum in June 2016, investors have voted with their feet.

Other than a brief spell of outperformance in local currency terms in the wake of the vote as the weak pound boosted exporters, to which the FTSE All-Share Index is heavily exposed, U.K. equities have suffered substantial outflows. The positioning of institutional funds has become overwhelmingly underweight as investors have been attracted to regions with clearer upside potential, such as the U.S. with its tax reform, Japan with Abenomics, and Europe and its cyclical upswing.

The FTSE All-Share's painful underperformance



The Brexit vote boost was short-lived.

Source - RBC Wealth Management, Bloomberg; data through 4/13/18

A value case emerges

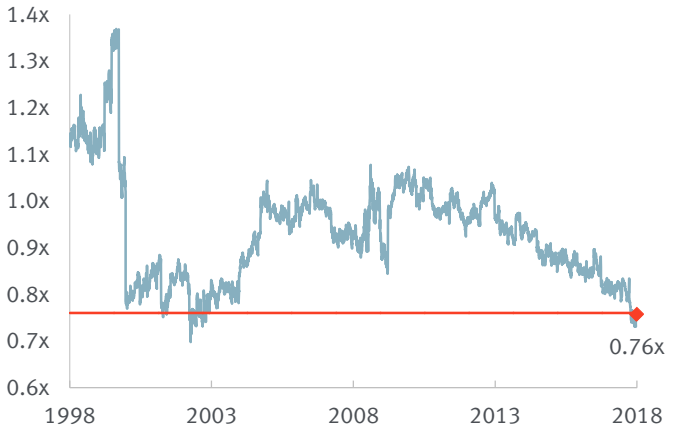
As a result of poor performance, several valuation measures are now as low as they have been for a long time.

The dividend yield in particular has caught our attention. For the U.K. equity market as a whole, the yield is now above 4%, a threshold which traditionally has

indicated healthy performance going forward. The yield has seldom been so high, exceeding the 4% level on only five occasions since the market trough of 2009. Moreover, the gap between the U.K.'s dividend yield and the average yields offered in other regions has widened considerably, with the U.K. offering more than 1.5x the average yield of other developed markets.

Other measures also point to undemanding valuations. The U.K.'s 12-month forward price-to-earnings (P/E) ratio relative to the MSCI World Index's P/E is in line with its 15-year average. The valuation argument is more starkly favourable on a price-to-book value (P/BV) basis, with U.K. equities trading at a 15-year low relative to global equities. This relative cheapness could be attributed to the U.K.'s comparatively large exposure to Resources and Financials, two sectors which have de-rated over the past 10 years, but even excluding them, the P/BV of the U.K. relative to global equities is below its 10-year average.

The FTSE All-Share P/BV relative valuation to MSCI World



Relative valuation is at its lowest level in 15 years.

Source - RBC Wealth Management, Bloomberg; data through 4/11/18

U.K. equities tend to underperform when global leading indicators improve, but to outperform when they have peaked.

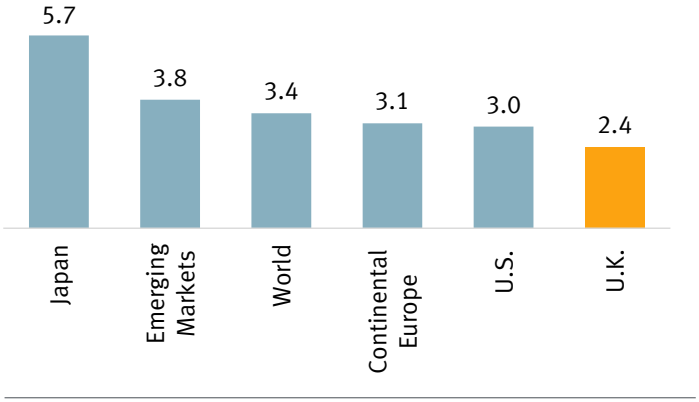
Finally, from a bottom up perspective, free cash flow yields for many sectors, including Resources, Technology, Retail, and Pharmaceuticals, are above 6%, another sign that more compelling value is emerging.

These relatively low valuation levels suggest investors have been discounting fears of an economic slowdown and the impact on earnings of a now stronger pound relative to the U.S. dollar.

A defensive market

We also note that the U.K. corporate sector's earnings respond comparatively less to changes in global industrial production, given the relatively large exposure to defensive sectors, with Pharma, Consumer Staples, Telecom, and Utilities making up more than one-third of total market capitalisation. As such, U.K. equities tend to underperform when global leading indicators improve, but to outperform when they have peaked, as seems to be the case today.

Change in EPS given change in global industrial production



The U.K. corporate sector is the least sensitive to changes in global industrial production.

Source - RBC Wealth Management, national research correspondent

Risks to our view

We shy away from upgrading to Overweight, however, as we continue to be cautious regarding the U.K.'s short-term economic prospects.

The economy has been relatively resilient since the Brexit vote, thanks to the Bank of England's (BoE) injection of monetary stimulus shortly after the referendum. RBC Europe Limited Senior UK Economist Sam Hill points out that this came not only in the form of a 25 basis point (bps) cut in the Bank Rate, but also as a quantitative easing programme in which £65B of Gilts and £10B of corporate bonds were purchased, in addition to the Term Funding Scheme[1] that is now worth £127B. Moreover, the U.K. benefited from an improving global economic backdrop during the period.

The U.K.'s economic resilience may be tested in the future as the BoE has started to unwind its monetary stimulus.

Yet the U.K.'s economic resilience may be tested in the future as the BoE has started to unwind its monetary stimulus. RBC Capital Markets expects 25 bps rate hikes in Q2 2018, Q1 2019, and Q4 2019.

Business investment is likely to continue to be compromised as Brexit uncertainty is far from being resolved. A Brexit transition deal has been agreed upon between the U.K. and the EU27 that would guarantee a continuation of the status quo, though without any voting rights for the U.K. However, it has no legal basis and the agreement will not be confirmed until the Withdrawal Treaty is ratified by the U.K. Parliament, the European Union Parliament, and each EU member-state's parliament, a process which could take until early 2019.

As such, there is still an uncomfortably high risk of a "hard" or no deal Brexit, which we would put at between 20% and 25%. Such an outcome would be a negative shock to the U.K. economy, though the full impact would depend on arrangements regarding tariffs, regulation, and immigration.

Consumers may benefit from inflation having peaked and no longer eroding disposable incomes, but with household balance sheets somewhat stretched and given Brexit uncertainty, a splurge in consumption to offset weak investment is unlikely, in our view.

[1] The Term Funding Scheme provides funding to financial institutions at rates close to the Bank Rate in order to encourage them to provide loans at lower rates to households and businesses.

Finally, given the U.K. economy is dominated by the service sector, future trade deals struck by the U.K. after Brexit would need to target openness in the service sector in order to materially improve the U.K.'s trade outlook. But these complex arrangements are difficult and time-consuming to arrange.

Strategy

Thus, as long as there is no growth shock to the economy—either through Brexit or an escalation in protectionism—the underweight institutional positioning, extreme valuation levels, and defensive nature of the equity market all pave the way for better relative performance for U.K. equities going forward, in our view.

We maintain our bias towards exporters or companies which generate a significant portion of revenues abroad.

We maintain our bias towards exporters or companies which generate a significant portion of revenues abroad. The pound has been strong against the dollar since early 2017, but on a trade-weighted basis it is still 12% below its peak 2015 level, and therefore provides a tailwind to revenue growth. Growth in the U.K.'s important markets (Europe, Asia) also should help. Protectionism is a headwind, but revenues from the U.S. make up some 20% of the U.K.'s total revenues, with much of those U.S. revenues deriving from operations located in the U.S., rather than via exports.

Secular stamina

In the U.S. Labor Department's latest weekly report (issued April 26), U.S. initial unemployment insurance (UI) claims dropped to yet another cycle low (another all-time low when adjusted for the size of the labor force). Typically, UI claims set their final cycle low more than a year before a U.S. recession gets underway.

In our view, there is no reason to believe that final low has been set. A recent Labor Department report showed more than six million job vacancies—an all-time high and almost three times the 2010 level. In fact, corporate surveys in Europe, the U.K., Canada, Japan, and the U.S. all cite an inability to fill existing job vacancies with qualified employees as one of the biggest constraints to business growth.

In fact, all the leading indicators of recession we monitor would suggest the next economic downturn remains a long way off—at least a year, conceivably much longer.

We can add to this the very large fiscal stimulus arriving in the U.S. by way of tax cuts, new spending in the budget bill, and any infrastructure spending that arrives on the way to November's midterm elections. If that weren't enough, the new German coalition has promised to increase spending, while the U.K., France, and Italy are all expected to back away from planned further spending cuts. Together these all yield a mix likely to produce rising wages and corporate earnings as well as consumer, corporate, and investor confidence.

The only policy lever remaining, strong enough to reverse this broad-based forward momentum, would be a shift toward tighter credit conditions wherein loans become difficult to access and prohibitively expensive. Arguably, monetary policy is gradually moving in that direction. But the rate hike trajectories offered by the major central banks are so deliberate and measured that, in our judgment, it could be two years before credit conditions become sufficiently restrictive to challenge the economic expansion.

Valuations in all major equity markets are not demanding. The correction underway since January may have not yet fully run its course, but we expect the long-term uptrend, in place since 2009, will be the dominant force driving equity prices for some time yet to come.

We are raising our recommended exposure to U.K. equities to Market Weight from a very longstanding Underweight (see "Undervalued and under the radar" on page 12). This change should not be interpreted as any revived enthusiasm for the U.K.'s economic prospects. Rather, it stems from unusually compelling valuations (e.g., a 4%+ dividend yield) coupled with what appears to be a unanimous,

Equity views

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

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

Jim Allworth
Vancouver, Canada
jim.allworth@rbc.com

Kelly Bogdanova
San Francisco, United States
kelly.bogdanova@rbc.com

Patrick McAllister, CFA
Toronto, Canada
patrick.mcallister@rbc.com

Frédérique Carrier
London, United Kingdom
frederique.carrier@rbc.com

Jay Roberts, CFA
Hong Kong, China
jay.roberts@rbc.com

deep underweight exposure to U.K. stocks in institutional portfolios.

Europe remains our only regional Overweight.

Regional highlights

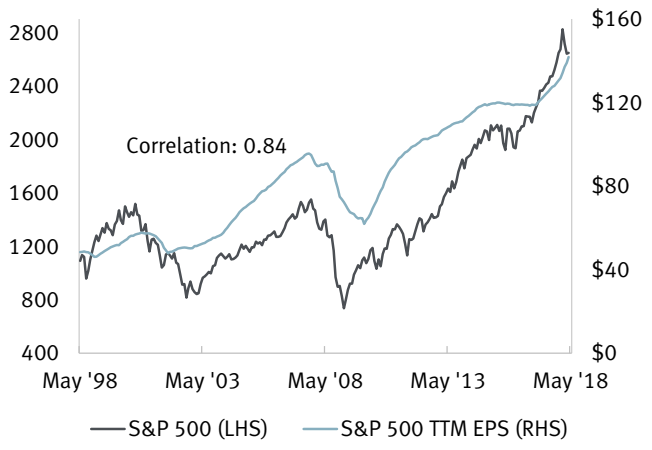
United States

- As the U.S. equity correction persists, the list of perceived risks gets longer, which is typical during such periods. The upward drift in Treasury yields and related concerns about inflation, the flattening yield curve, and Federal Reserve policy have kept the equity market off balance. Add to that, protectionist risks and geopolitical uncertainties linger. Even economic and earnings momentum—heretofore considered rock solid—have come into doubt.
- While concerns about rates, tariffs, and the other outside forces could keep equity market conditions choppy for a while longer, we think hand-wringing about the economy and corporate profits is excessive. Q1 GDP growth of 2.3% was softer than the 3.1% average of the previous three quarters, but conforms to the seasonal cooling pattern seen in previous years. Leading economic indicators are signaling the expansion will persist, and momentum should pick up as the fiscal stimulus kicks in. Q1 S&P 500 earnings and revenue growth have been impressive thus far. Even when tax cut benefits are excluded, earnings growth is pacing in the mid-double digits. Corporate executives' constructive forward guidance supports our view that the profit outlook remains bright.
- We would continue to hold a Market Weight position in U.S. equities and would look for opportunities as the correction plays out.

Canada

- We maintain a Market Weight recommendation on Canadian equities as the relative attractiveness of the TSX's valuation is balanced against a number of domestic uncertainties. We believe the valuation discount will persist until such time as investors have better visibility on key issues including the impact of higher interest rates on consumer and home loans, trade policy uncertainty, and energy transportation constraints.

S&P 500 and trailing twelve-month (TTM) earnings, 20 years



Despite the pickup in perceived risk during the current U.S. equity correction, the S&P 500 remains correlated to earnings, and earnings continue to grow in the first quarter.

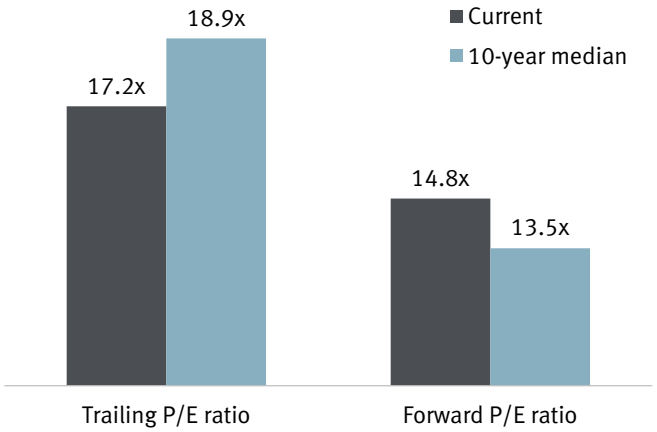
Note: A correlation of 1 indicates a perfectly positive relationship, a correlation of 0 indicates no relationship
Source - RBC Wealth Management, FactSet; data through 4/30/18

- Negotiations around a revamped NAFTA accord have intensified with the U.S. hoping to present a comprehensive agreement to Congress in coming weeks. Several sticking points remain, but a general air of optimism surrounding negotiations prompted RBC Global Asset Management to lower its estimated probability of NAFTA's termination to 15% from 30%.
- Trade policy uncertainty is a risk to Canada's competitiveness and, by extension, to the economic outlook whether that risk comes from NAFTA or U.S./China trade tensions. Additionally, we believe the combination of higher domestic interest rates and tighter mortgage regulation will limit the consumer's contribution to economic growth. The extent to which business investment is able to offset a slowdown in consumption should in large part determine the trajectory of Canada's economy over the next two years.
- Western Canadian oil producers have benefitted from lower discounts on heavy crude production in recent weeks as upstream maintenance has provided temporary relief to overwhelmed pipeline infrastructure. However, structural capacity constraints and wider discounts appear poised to reassert themselves as volumes return to trend once maintenance turnarounds are concluded.

Continental Europe & U.K.

- We maintain our Overweight stance for European equities despite decelerating economic momentum. Poor weather and inventory effects seem largely to blame and should prove temporary. Economic growth this year and next should continue to be above trend.
- Moreover, monetary conditions should remain relatively loose, with the ECB widely expected to continue with its quantitative easing programme for much of this year and to begin raising interest rates much further out in the autumn of 2019. Fiscal easing is also increasingly likely with Germany's new coalition government having pencilled in increased fiscal spending of up to 2% of national GDP, while French President Emmanuel Macron is delaying austerity plans now that

Continental Europe price-to-earnings (P/E) ratios



Source - RBC Wealth Management, Bloomberg; data through 4/30/18

Continental European valuations appear reasonable on both a trailing and forward basis in light of anticipated double-digit earnings growth in 2018 and 2019.

the country's budget deficit is below the EU's required target of 3% of GDP. Finally, although there is no government yet at the helm of Italy, either party that is likely to eventually govern has promised to loosen the national purse strings.

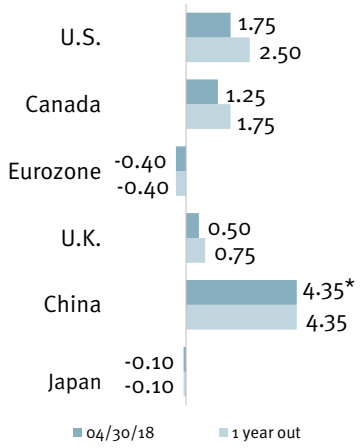
- Consensus earnings expectations in the region of 11% and 10% for this year and next, respectively, are achievable, in our view, and could be exceeded if the euro remains stable. Moreover, valuations are not demanding, either on an absolute basis or relative to the U.S.
- We continue to favour well-capitalised European banks which should benefit from better loan growth and lower nonperforming loans. We would be more selective with economically sensitive (cyclical) companies which have already enjoyed a price-to-earnings multiple re-rating. There are some opportunities in defensive stocks, many of which have been left behind while the recovery was gathering pace.

Asia

- Asian equities remain directionless, still digesting the global equity correction in February and how trade tensions between the U.S. and China will evolve.
- Mainland China equity indexes are close to a one-year low. The Hang Seng Index in Hong Kong is struggling after the Hong Kong Monetary Authority, the de facto central bank, intervened in currency markets for the first time since 2005 in order to support the Hong Kong dollar. The currency is pegged tightly to the U.S. dollar and had been weakening as interest rate differentials between the U.S. and Hong Kong expanded. Currency intervention is causing interest rates to rise finally in Hong Kong, pressuring property-related stocks.
- The popularity of Japan's prime minister, Shinzo Abe, and his cabinet has fallen sharply due to a domestic scandal involving government members and the sale of government-owned land at a significant discount. The steep decline in popularity casts doubt on whether Abe will win September's leadership election, held every three years, for the ruling Liberal Democratic Party.
- Even so, the bulk of Japanese economic data is constructive, with some indicators at the highest levels since the early 1990s. The yen has also reversed recent strength against the U.S. dollar, ending what had been a stiff headwind for the time being.

Flat curves souring investor tastes

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, RBC Global Asset Management

Yield curve dynamics have returned as a "noisy" issue. Pundits are quick to warn that flattening curves tend to lead to inverted yield curves, which in the past have suggested a recession would soon occur. But yield curve events aren't like dominoes. It can be many months and/or years from curve flattening to inversion to recession.

The U.S. Treasury yield curve has been flattening since the current tightening cycle's first rate hike in December 2015. Since then there have been five additional hikes and 2-year yields have risen by approximately 150 basis points (bps), while 10-year yields are up by about 70 bps. Lately, or so it seems, when the 2-year/10-year curve narrows inside of 50 bps, curve inversion/recession fears spike. A broader measure, the 3-month/10-year curve, has narrowed to around 100 bps three times since last September, which ignites similar concerns.

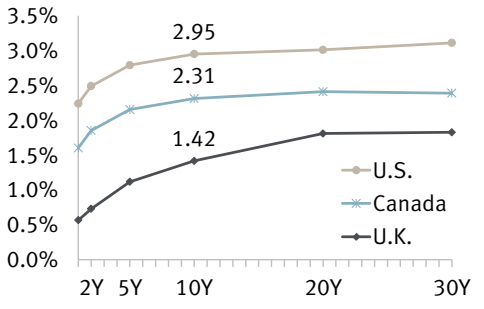
Flattening yield curves aren't just a U.S. phenomenon. As major central banks throttle back on various quantitative easing measures and/or begin to gradually hike rates, short-term rates have been on the rise. Lower-than-expected inflation, however, has helped anchor long-term rates. But continued economic growth has major central banks confident in their 2% inflation forecasts and when combined with reduced central bank purchases of sovereign debt and larger budget deficits in the U.S., increased debt issuance could unleash longer-dated yields. With respect to the Treasury yield curve, the Treasury's decision to meet

Fixed income views

Region	Gov't Bonds	Corp. Credit	Duration
Global	–	+	5–7 yr
United States	–	+	7–10 yr
Canada	=	=	3–5 yr
Continental Europe	=	+	5–7 yr
United Kingdom	–	=	5–7 yr

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

Sovereign yield curves



Source - Bloomberg

rising budget deficits with significantly higher issuance of shorter-dated issues is exerting added upward pressure on short-term yields, possibly distorting the curve's traditional message. Markets, by nature, tend to be anticipatory, and we suggest that the approximate 100 bps increase in the 10-year yield since September 2017 signals that the greater part of the move higher in yields could be over.

Yield curves could very well flatten further, but without a negative change in the global growth outlook and an

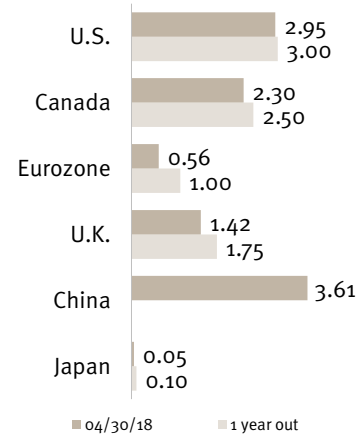
Craig Bishop
Minneapolis, United States
craig.bishop@rbc.com

Sam Renikoff
Minneapolis, United States
sam.renikoff@rbc.com

Christopher Girdler, CFA
Toronto, Canada
christopher.girdler@rbc.com

Alastair Whitfield
London, United Kingdom
alastair.whitfield@rbc.com

10-year rate (%)



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

10-year Treasury minus 3-month T-bill yield spread



Source - RBC Wealth Management, Bloomberg; data through 4/26/18

100 bps and done for the 3-month/10-year curve flattening trend since September 2017.

accompanying downshift in central bank policies, investors shouldn't be quick to assume a recession is around the corner. Flat curves could be just another "new normal" for this cycle.

Regional highlights

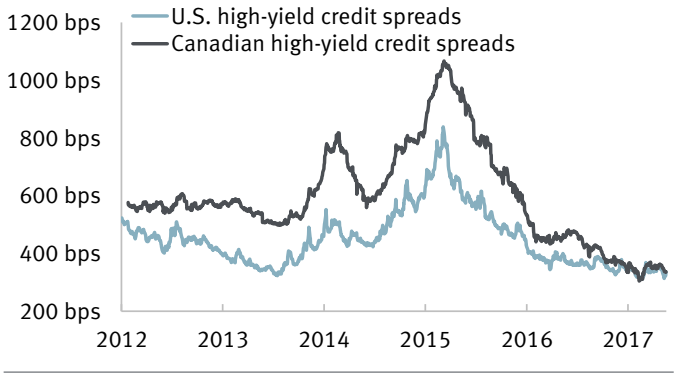
United States

- The minutes from the March FOMC meeting indicated that Federal Reserve officials expect a significant boost to economic growth following the passage of tax reform, prompting higher forecasts for rate hikes in 2019 and 2020. Yet, the minutes indicated that officials have already begun to discuss adjusting their messaging to reflect that monetary policy may no longer be accommodative, and instead neutral or even restrictive. To us this suggests that the peak fed funds rate is likely to be historically low, at or below 3%, which should help maintain a lid on long-term yields and continue flattening pressure on the yield curve.
- Yield compensation over Treasuries, or corporate credit spreads, have declined for corporate bonds in recent weeks, specifically in the high-yield (HY) sector. HY issuers generally have less international exposure than larger investment-grade (IG) issuers, and are therefore less subject to the trade-related volatility that has impacted IG markets. Yet, strong investor demand for yield has pushed HY spreads to the tightest levels since 2007, and we continue to favor increasing credit quality through IG bonds with duration between 7 and 10 years. For the first time since 2016, BBB-credits yield in excess of 4%, in our view opening up an attractive entry point.
- Preferred shares are trading near the cheapest levels in five years, and as a result, remain our favorite subsector of fixed income. We expect the 10Y Treasury to stay in a 2.70%–3.00% range for the foreseeable future, which should provide price stability in addition to the most attractive yields in fixed income.

Canada

- The Government of Canada (GoC) curve re-steepened modestly in April following a more balanced outlook from the Bank of Canada (BoC) and higher yields in the U.S. Treasury market. The BoC increased its estimate of the potential growth rate of the economy over the next couple of years but actually lowered its growth forecast for 2018, reducing any expectation of an aggressive hiking cycle. Despite the steepening, the GoC curve continues to be one of the flattest across developed markets. This keeps our attention on short-to-intermediate maturities, especially those that are trading at heavy discounts to par.

North American credit spreads continue to tighten



With compensation for credit risk at cycle lows, we recommend investors upgrade to higher-quality credit.

Source - RBC Wealth Management, Bloomberg; data through 4/25/18

- Corporate credit spreads tightened in April, in line with more positive sentiment toward other risk assets, after spending the early stages of the month at the widest levels in six months. Nevertheless, credit spreads remain close to the tightest levels in a decade, and we continue to think it is a good environment to be upgrading credit quality within portfolios, seeking diversification, not yield.
- Preferred shares steadied in April, after two months of weaker performance, thanks to a higher 5-year GoC yield and improved sentiment to risk. We remain constructive on their outlook but recommend an increasing allocation to more defensive issues as spreads normalise.

Continental Europe & U.K.

- The second half of 2019 is likely to welcome the European Central Bank's first move away from its -0.40% deposit rate. In its own words, rates will begin to be lifted "well past" the termination of net asset purchases—for context, the Fed waited a year after asset purchases before raising rates.
- Other factors that should keep European rates contained include modest inflation expectations and an increase in reinvestment flows for maturing assets.
- After European corporate credit spreads widened in February and March, which we believe was exacerbated by supply and technical factors, spreads tightened in April. European credit should continue to be supported by fundamentals and the gradual wind-down of accommodative monetary policy. We believe BBB bonds offer decent spread compensation relative to single-A names.
- U.K. inflation data for March was a surprisingly low 2.5%. The fall in inflation has been faster than the Bank of England had predicted and is down 0.5% in two months. Additionally, we think weaker-than-expected Q1 GDP data calls into question the likelihood of a rate hike this month.
- We believe that the possibility of a May hike has been diminished somewhat by the above-mentioned inflation decrease plus the GDP data, which may confine the Bank of England to just one hike in 2018. Any premature tightening will also ultimately weigh on consumption, further compounding deterioration in U.K. economic fundamentals, and deterring any tightening beyond this point.
- We retain a preference for sterling corporate credit to Gilts given the valuation premium attached relative to euro and U.S. dollar peers, and the degree to which international investors are underweight sterling assets.

The forces of gold

Commodity forecasts

	2018E	2019E
Oil (WTI $/bbl)	63.00	65.00
Natural Gas ($/mmBtu)	2.89	2.85
Gold ($/oz)	1,307	1,300
Copper ($/lb)	3.24	3.25
Corn ($/bu)	3.80	4.00
Wheat ($/bu)	4.65	4.80

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

Increased market volatility and less accommodative monetary policies have certainly been headline themes in recent months. Rising bond yields and elevated geopolitical risks are also factors. While investors tend to look to gold as a portfolio hedge in times of uncertainty, we're not convinced it will do the job this go-around.

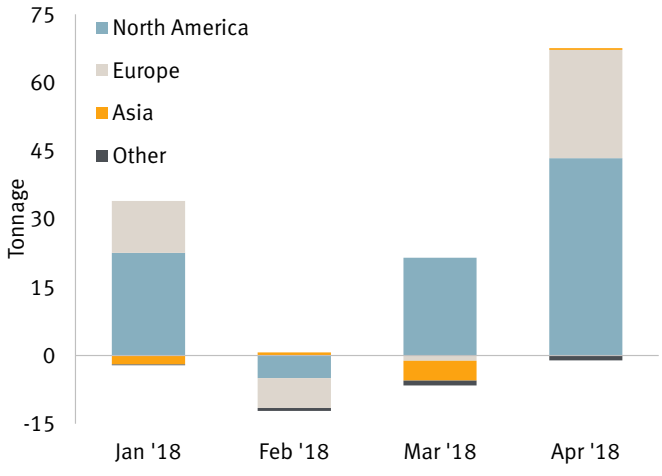
Despite trading within a fairly tight $1,311–$1,358 per ounce range year to date, the gold market has been relatively choppy. Gold has managed to edge above the elusive $1,350 level on five separate occasions so far this year, only to fall back quickly thereafter. RBC Capital Markets believes two forces are at play here. The first involves the notion that investors flock to perceived safe havens during times of crisis (i.e., the potential trade war between the U.S. and China), thereby causing prices to rally. The second involves macroeconomic headwinds such as central banks hiking rates, which raises the holding cost of bullion.

It is interesting to note that while spot prices have been choppy, monthly flows into gold ETFs (in tonnage terms) have remained relatively strong with the exception of February—prior to significant rallies in gold, there has generally been an influx of healthy ETF inflows. In spite of the accumulation of optimism within the ETF flows, RBC Capital Markets' near-term view is that gold will consolidate until there is more sustainability in current inflows.

The market is looking for at least three rate hikes in 2018. Looking at June, the market is discounting a 92.7% probability that a hike will occur. The combination of rising interest rates and a strengthening U.S. dollar is likely to keep gold prices under wraps through the first half at least.

Correlation of gold with market volatility

Monthly gold ETF flows



Monthly gold inflows have remained strong with the exception of February.

Source - Bloomberg, exchange-traded product issuers, RBC Capital Markets Commodity Strategy

Richard Tan
Toronto, Canada
richard.tan@rbc.com

Currency forecasts

Currency pair	Current rate	Forecast Jun 2019	Change*
Major currencies			
USD Index	91.84	91.70	0%
CAD/USD	0.77	0.79	3%
USD/CAD	1.28	1.26	-2%
EUR/USD	1.20	1.22	2%
GBP/USD	1.37	1.31	-4%
USD/CHF	0.99	1.02	3%
USD/JPY	109.34	115.00	5%
AUD/USD	0.75	0.73	-3%
NZD/USD	0.70	0.69	-1%
EUR/JPY	13.05	140.00	973%
EUR/GBP	0.87	0.93	7%
EUR/CHF	1.19	1.24	4%
Emerging currencies			
USD/CNY	6.33	7.20	14%
USD/INR	66.66	65.20	-2%
USD/SGD	1.32	1.46	11%

* 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: Navigating uncertain waters – Heightened trade uncertainty overshadowed the strengthening U.S. economic outlook over the past month, keeping the nascent U.S. dollar recovery fragile. An easing of elusive protectionist rhetoric should allow financial markets to shift focus back to inflationary pressures and the robust economic backdrop, which prompted the Federal Reserve to raise its key interest rate in March (the first time in 2018). Fed optimism about the economic expansion yielded a higher projected rate path beyond this year, bolstering our expectation for a sustained dollar recovery in 2018.

Euro: Drifting lower as sentiment wanes – Earlier euro strength is showing signs of waning as indications point to an easing of the robust pace of economic growth seen in 2017. With the persistence of subdued inflation alluding to a rate rise still more than a year away, there is little to lift the euro as rates in the U.S. continue to march higher. Lingering political risks add an additional layer of uncertainty. We expect the euro will slip lower before gaining upward traction in 2019.

British pound: Pressures mounting – Sterling has moved higher this spring as a confluence of factors proved positive for the currency. Markets reacted favorably to a provisional Brexit transition deal while an upswing in wage growth alongside reports indicating inflation likely reached a peak earlier this year afforded a further tailwind. Caution from the Bank of England on the timing of the next rate hike dampened some of the enthusiasm, and we look for the currency to drift lower before resuming an uptrend in 2019.

Canadian dollar: Wind in its sails – Earlier Canadian dollar headwinds shifted to tailwinds in late March as some U.S. flexibility emerged in NAFTA negotiations. Trade disruptions remain a key risk to the currency, yet a still-healthy pace of economic expansion alongside confirmation that inflation pressures are firming is supportive of the Bank of Canada further tightening monetary policy in 2018 after keeping rates unchanged in April. Buoyant oil prices should provide additional currency upside before competitiveness pressures begin to weigh on the dollar in 2019.

Japanese yen: Rally takes a breather – The return of global risk appetite in April prompted a pause in the sharp yen rally that took hold earlier this year. Going forward, we believe a repatriation of foreign assets held by Japanese domestic investors against a constructive economic backdrop should deliver another upswing in yen performance before rising hedging costs begin to pressure the currency in 2019.

U.S. dollar navigating cracks in its newly formed floor



Source - RBC Wealth Management, Bloomberg

Trade uncertainty has kept the nascent U.S. dollar recovery fragile for now.

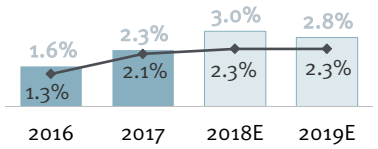
Laura Cooper
London, United Kingdom
laura.cooper@rbc.com

Key forecasts

Real GDP Growth — Inflation Rate

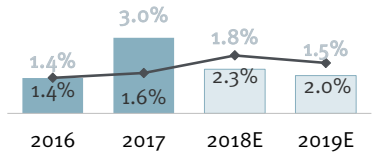
United States — Spending-led slowdown

- Q1 ’18 GDP fizzled to 2.3% y/y from 2.9% in Q4 ’17 on seasonal weakness and a slowdown in consumer spending. Inflation moving higher on easy year-over-year comps. Manufacturing activity remains robust as tax policy encourages business investment. Consumer sentiment at 18-year high despite fears of a trade war. Hiring slowed down from February’s blockbuster pace, unemployment rate held at 4.1%.



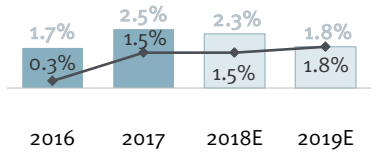
Canada — Dovish hold by BoC

- Core inflation unchanged at 2.0% y/y, but the closing output gap is expected to put upward pressure on prices. The BoC held rates in April, and forward guidance was more dovish than expected. New housing remained robust despite weaker resale market. Hiring still steady, and the unemployment rate held at 5.8%. NAFTA uncertainty weighing on business investment.



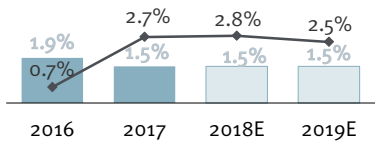
Eurozone — Waiting on inflation

- Regional purchasing manager surveys showed a slightly less optimistic outlook as trade talks spook decision-makers. Core inflation stayed at 1.0% y/y, but ECB remains confident inflation will converge toward its target. Producer prices increased as commodity costs rose; however, manufacturing output slowed as trade war fears weighed on investment.



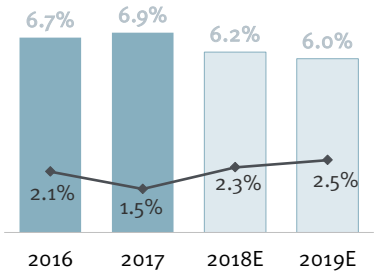
United Kingdom — Rate hike in question

- Comments from BoE Governor Mark Carney and unexpected drop in inflation have put a May rate hike in question. Inflation decelerated for the 3rd time in 4 months, to 2.5% y/y, and Q1 GDP surprised at just 0.1%. Labor market could pressure BoE to tighten, as little slack remains with unemployment at 4.2%, the lowest since the 1970s, and wages excluding bonuses edged up to 2.8% y/y from 2.6% y/y.



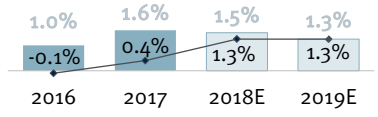
China — Consumers carry growth

- GDP growth remains steady at 6.8% year to date, with March gains in retail sales (10.1%) outweighing slowing industrial production (6.0%). For the first time since 2015, private fixed asset investment has outpaced government infrastructure spending, as fiscal policy slowly tightens. Inflation pressures eased with CPI falling to 2.1% y/y from 2.9% y/y and PPI decelerating to 3.1% y/y, the slowest pace since 2016.



Japan — A slow start

- Core inflation dipped to 0.9% y/y from 1.0% y/y previously, and price growth in Tokyo decelerated for a second straight month. Unemployment rate of 2.5% near lowest since 1990s and jobs-to-applicants ratio indicates tight labor market, which should help drive inflation but has yet to do so. Tepid end to Q1 with a 0.7% m/m decline in retail sales and deceleration in industrial production in March.



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

Market scorecard

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	2,648.05	0.3%	-1.0%	11.1%
Dow Industrials (DJIA)	24,163.15	0.2%	-2.2%	15.4%
NASDAQ	7,066.27	0.0%	2.4%	16.8%
Russell 2000	1,541.88	0.8%	0.4%	10.1%
S&P/TSX Comp	15,607.88	1.6%	-3.7%	0.1%
FTSE All-Share	4,127.68	6.0%	-2.2%	4.2%
STOXX Europe 600	385.32	3.9%	-1.0%	-0.5%
EURO STOXX 50	3,536.52	5.2%	0.9%	-0.6%
Hang Seng	30,808.45	2.4%	3.0%	25.2%
Shanghai Comp	3,082.23	-2.7%	-6.8%	-2.3%
Nikkei 225	22,467.87	4.7%	-1.3%	17.0%
India Sensex	35,160.36	6.6%	3.2%	17.5%
Singapore Straits Times	3,613.93	5.4%	6.2%	13.8%
Brazil Ibovespa	86,115.50	0.9%	12.7%	31.7%
Mexican Bolsa IPC	48,358.16	4.8%	-2.0%	-1.8%
Bond yields	**4/30/18**	**3/30/18**	**4/28/17**	**12 mo. chg**
US 2-Yr Tsy	2.488%	2.266%	1.262%	1.23%
US 10-Yr Tsy	2.953%	2.739%	2.280%	0.67%
Canada 2-Yr	1.893%	1.775%	0.721%	1.17%
Canada 10-Yr	2.307%	2.091%	1.547%	0.76%
UK 2-Yr	0.776%	0.823%	0.075%	0.70%
UK 10-Yr	1.418%	1.350%	1.085%	0.33%
Germany 2-Yr	-0.586%	-0.602%	-0.733%	0.15%
Germany 10-Yr	0.559%	0.497%	0.317%	0.24%
Commodities (USD)	**Price**	**1 month**	**YTD**	**12 month**
Gold (spot $/oz)	1,315.35	-0.7%	0.9%	3.7%
Silver (spot $/oz)	16.33	-0.2%	-3.6%	-5.1%
Copper ($/metric ton)	6,770.00	1.4%	-6.1%	18.6%
Uranium ($/lb)	20.90	-0.5%	-12.6%	-7.7%
Oil (WTI spot/bbl)	68.57	5.6%	13.5%	39.0%
Oil (Brent spot/bbl)	75.17	7.0%	12.4%	45.3%
Natural Gas ($/mmBtu)	2.76	1.1%	-6.4%	-15.7%
Agriculture Index	308.61	4.5%	9.4%	6.7%
Currencies	**Rate**	**1 month**	**YTD**	**12 month**
US Dollar Index	91.8410	2.1%	-0.3%	-7.3%
CAD/USD	0.7786	0.4%	-2.1%	6.3%
USD/CAD	1.2843	-0.4%	2.2%	-5.9%
EUR/USD	1.2078	-2.0%	0.6%	10.9%
GBP/USD	1.3763	-1.8%	1.9%	6.3%
AUD/USD	0.7530	-1.9%	-3.6%	0.6%
USD/JPY	109.3400	2.9%	-3.0%	-1.9%
EUR/JPY	132.0500	0.8%	-2.4%	8.7%
EUR/GBP	0.8775	-0.2%	-1.2%	4.3%
EUR/CHF	1.1967	1.8%	2.3%	10.4%
USD/SGD	1.3259	1.1%	-0.8%	-5.1%
USD/CNY	6.3323	0.9%	-2.7%	-8.1%
USD/MXN	18.7141	2.9%	-4.8%	-0.6%
USD/BRL	3.5072	6.1%	6.0%	10.4%

Canadian stocks surged on the back of higher oil prices.

Rising inflation expectations pushed the 10-year Treasury to new year-to-date highs.

Geopolitical conflict in the Middle East drove oil to the highest levels since 2014.

The euro underperformed the dollar as a result of moderating economic data in the eurozone.

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 6.3% return means the Canadian dollar has risen 6.3% vs. the U.S. dollar during the past 12 months. USD/JPY 109.34 means 1 U.S. dollar will buy 109.34 yen. USD/JPY -1.9% return means the U.S. dollar has fallen 1.9% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 4/30/18.

Research resources

This document is produced by the Global Portfolio Advisory Committee within RBC Wealth Management's Portfolio Advisory Group. The RBC Wealth Management Portfolio Advisory Group provides support related to asset allocation and portfolio construction for the firm's investment advisors / financial advisors who are engaged in assembling portfolios incorporating individual marketable securities. The Committee leverages the broad market outlook as developed by the RBC Investment Strategy Committee, providing additional tactical and thematic support utilizing research from the RBC Investment Strategy Committee, RBC Capital Markets, and third-party resources.

Global Portfolio Advisory Committee members:

Jim Allworth – Co-chair; Investment Strategist, RBC Dominion Securities Inc.

Kelly Bogdanova – Co-chair; Portfolio Analyst, RBC Wealth Management Portfolio Advisory Group – Equities, RBC Capital Markets, LLC

Frédérique Carrier – Co-chair; Managing Director, Head of Investment Strategies, Royal Bank of Canada Investment Management (U.K.) Limited

Mark Bayko, CFA – Head, Portfolio Management, RBC Dominion Securities Inc.

Craig Bishop – Lead Strategist, U.S. Fixed Income Strategies Group, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Laura Cooper – Head of FX Solutions and Strategy, Royal Bank of Canada Investment Management (U.K.) Limited

Janet Engels – Head of Portfolio Advisory Group U.S., RBC Wealth Management, RBC Capital Markets, LLC

Tom Garretson, CFA – Fixed Income Portfolio Strategist, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Christopher Girdler, CFA – Fixed Income Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group, RBC Dominion Securities Inc.

Patrick McAllister, CFA – Canadian Equities Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group – Equities, RBC Dominion Securities Inc.

Jay Roberts, CFA – Head of Investment Solutions & Products, RBC Wealth Management Hong Kong, RBC Dominion Securities Inc.

Alan Robinson – Portfolio Analyst, RBC Wealth Management Portfolio Advisory Group – U.S. Equities, RBC Capital Markets, LLC

Alastair Whitfield – Head of Fixed Income - British Isles, Royal Bank of Canada Investment Management (U.K.) Limited

The RBC Investment Strategy Committee (RISC) consists of senior investment professionals drawn from individual, client-focused business units within RBC, including the Portfolio Advisory Group. The RISC builds a broad global investment outlook and develops specific guidelines that can be used to manage portfolios. The RISC is chaired by Daniel Chornous, CFA, Chief Investment Officer of RBC Global Asset Management Inc.

Additional Global Insight authors:

Eric Lascelles – Chief Economist, RBC Global Asset Management Inc.

Sam Renikoff – Fixed Income Portfolio Associate, U.S. Fixed Income Strategies Group, RBC Wealth Management Portfolio Advisory Group, RBC Capital Markets, LLC

Richard Tan – Canadian Equities Associate Portfolio Advisor, RBC Wealth Management Portfolio Advisory Group – Equities, RBC Dominion Securities Inc.

Required disclosures

Analyst Certification
All of the views expressed in this report accurately reflect the personal views of the responsible analyst(s) about any and all of the subject securities or issuers. No part of the compensation of the responsible analyst(s) named herein is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the responsible analyst(s) in this report.

Important Disclosures

In the U.S., RBC Wealth Management operates as a division of RBC Capital Markets, LLC. In Canada, RBC Wealth Management includes, without limitation, RBC Dominion Securities Inc., which is a foreign affiliate of RBC Capital Markets, LLC. This report has been prepared by RBC Capital Markets, LLC which is an indirect wholly-owned subsidiary of the Royal Bank of Canada and, as such, is a related issuer of Royal Bank of Canada.

Non-U.S. Analyst Disclosure: Jim Allworth, Mark Bayko, Christopher Girdler, Patrick McAllister, Jay Roberts, and Richard Tan, employees of RBC Wealth Management USA's foreign affiliate RBC Dominion Securities Inc.; and Frédérique Carrier, Laura Cooper, and Alastair Whitfield, employees of RBC Wealth Management USA's foreign affiliate Royal Bank of Canada Investment Management (U.K.) Limited; and Eric Lascelles, an employee of RBC Global Asset Management Inc.; contributed to the preparation of this publication. These individuals are not registered with or qualified as research analysts with the U.S. Financial Industry Regulatory Authority ("FINRA") and, since they are not associated persons of RBC Wealth Management, they may not be subject to FINRA Rule 2241 governing communications with subject companies, the making of public appearances, and the trading of securities in accounts held by research analysts.

In the event that this is a compendium report (covers six or more companies), RBC Wealth Management may choose to provide important disclosure information by reference. To access current disclosures, clients should refer to http://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2 to view disclosures regarding RBC Wealth Management and its affiliated firms. Such information is also available upon request to RBC Wealth Management Publishing, 60 South Sixth St, Minneapolis, MN 55402.

References to a Recommended List in the recommendation history chart may include one or more recommended lists or model portfolios maintained by RBC Wealth Management or one of its affiliates. RBC Wealth Management recommended lists include the Guided Portfolio: Prime Income (RL 6), the Guided Portfolio: Dividend Growth (RL 8), the Guided Portfolio: ADR (RL 10), the Guided Portfolio: All Cap Growth (RL 12), and former lists called the Guided Portfolio: Large Cap (RL 7), the Guided Portfolio: Midcap 111 (RL 9), and the Guided Portfolio: Global Equity (U.S.) (RL 11). RBC Capital Markets recommended lists include the Strategy Focus List and the Fundamental Equity Weightings (FEW) portfolios. The abbreviation 'RL On' means the date a security was placed on a Recommended List. The abbreviation 'RL Off' means the date a security was removed from a Recommended List.

Distribution of Ratings
For the purpose of ratings distributions, regulatory rules require member firms to assign ratings to one of three rating categories - Buy, Hold/Neutral, or Sell - regardless of a firm's own rating categories. Although RBC Capital Markets, LLC ratings of Top Pick (TP)/Outperform (O), Sector Perform (SP) and Underperform (U) most closely correspond to Buy, Hold/Neutral and Sell, respectively, the meanings are not the same because our ratings are determined on a relative basis.

Distribution of Ratings - RBC Capital Markets, LLC Equity Research
As of March 31, 2018

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	865	53.49	275	31.79
Hold [Sector Perform]	667	41.25	147	22.04
Sell [Underperform]	85	5.26	7	8.24

Explanation of RBC Capital Markets, LLC Equity Rating System
An analyst's "sector" is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst's view of how that stock will perform over the next 12 months relative to the analyst's sector average.

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

Risk Rating: The **Speculative** risk rating reflects a security's lower level of financial or operating predictability, illiquid share trading volumes, high balance sheet leverage, or

limited operating history that result in a higher expectation of financial and/or stock price volatility.

Valuation and Risks to Rating and Price Target
When RBC Wealth Management assigns a value to a company in a research report, FINRA Rules and NYSE Rules (as incorporated into the FINRA Rulebook) require that the basis for the valuation and the impediments to obtaining that valuation be described. Where applicable, this information is included in the text of our research in the sections entitled "Valuation" and "Risks to Rating and Price Target", respectively.

The analyst(s) responsible for preparing this research report received compensation that is based upon various factors, including total revenues of RBC Capital Markets, LLC, and its affiliates, a portion of which are or have been generated by investment banking activities of the member companies of RBC Capital Markets, LLC and its affiliates.

Other Disclosures

Prepared with the assistance of our national research sources. RBC Wealth Management prepared this report and takes sole responsibility for its content and distribution. The content may have been based, at least in part, on material provided by our third-party correspondent research services. Our third-party correspondent has given RBC Wealth Management general permission to use its research reports as source materials, but has not reviewed or approved this report, nor has it been informed of its publication. Our third-party correspondent may from time to time have long or short positions in, effect transactions in, and make markets in securities referred to herein. Our third-party correspondent may from time to time perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this report.

RBC Wealth Management endeavors to make all reasonable efforts to provide research simultaneously to all eligible clients, having regard to local time zones in overseas jurisdictions. In certain investment advisory accounts, RBC Wealth Management will act as overlay manager for our clients and will initiate transactions in the securities referenced herein for those accounts upon receipt of this report. These transactions may occur before or after your receipt of this report and may have a short-term impact on the market price of the securities in which transactions occur. RBC Wealth Management research is posted to our proprietary Web sites to ensure eligible clients receive coverage initiations and changes in rating, targets, and opinions in a timely manner. Additional distribution may be done by sales personnel via e-mail, fax, or regular mail. Clients may also receive our research via third-party vendors. Please contact your RBC Wealth Management Financial Advisor for more information regarding RBC Wealth Management research.

Conflicts Disclosure: RBC Wealth Management is registered with the Securities and Exchange Commission as a broker/dealer and an investment adviser, offering both brokerage and investment advisory services. RBC Wealth Management's Policy for Managing Conflicts of Interest in Relation to Investment Research is available from us on our Web site at http://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2. Conflicts of interests related to our investment advisory business can be found in Part II of the Firm's Form ADV or the Investment Advisor Group Disclosure Document. Copies of any of these documents are available upon request through your Financial Advisor. We reserve the right to amend or supplement this policy, Part II of the ADV, or Disclosure Document at any time.

The authors are employed by one of the following entities: RBC Wealth Management USA, a division of RBC Capital Markets, LLC, a securities broker-dealer with principal offices located in Minnesota and New York, USA; by RBC Dominion Securities Inc., a securities broker-dealer with principal offices located in Toronto, Canada; by RBC Investment Services (Asia) Limited, a subsidiary of RBC Dominion Securities Inc., a securities broker-dealer with principal offices located in Hong Kong, China; and by Royal Bank of Canada Investment Management (U.K.) Limited, an investment management company with principal offices located in London, United Kingdom.

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and Standard & Poor's Financial Services LLC ("S&P") and is licensed for use by RBC. Neither MSCI, S&P, nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

Disclaimer

The information contained in this report has been compiled by RBC Wealth Management, a division of RBC Capital Markets, LLC, from sources believed to be reliable, but no representation or warranty, express or implied, is made by Royal Bank of Canada, RBC Wealth Management, its affiliates or any other person as to its accuracy, completeness or correctness. All opinions and estimates contained in this report constitute RBC Wealth Management's judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Every province in Canada, state in the U.S., and most countries throughout the world have their own laws regulating the types of securities and other investment products which may be offered to their residents, as well as the process for doing so. As a result, the securities discussed in this report may not be eligible for sale in some jurisdictions. This report is not, and under no circumstances should be construed as, a solicitation to act as securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. Nothing in this report constitutes legal, accounting or tax advice or individually tailored investment advice. This material is prepared for general circulation to clients, including clients who are affiliates of Royal Bank of Canada, and does not have regard to the particular circumstances or needs of any specific person who may read it. The investments or services contained in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about the suitability of such investments or services. To the full extent permitted by law neither Royal Bank of Canada nor

any of its affiliates, nor any other person, accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. No matter contained in this document may be reproduced or copied by any means without the prior consent of Royal Bank of Canada. In the U.S., RBC Wealth Management operates as a division of RBC Capital Markets, LLC. In Canada, RBC Wealth Management includes, without limitation, RBC Dominion Securities Inc., which is a foreign affiliate of RBC Capital Markets, LLC. This report has been prepared by RBC Capital Markets, LLC. Additional information is available upon request.

To U.S. Residents: This publication has been approved by RBC Capital Markets, LLC, Member NYSE/FINRA/SIPC, which is a U.S. registered broker-dealer and which accepts responsibility for this report and its dissemination in the United States. RBC Capital Markets, LLC, is an indirect wholly-owned subsidiary of the Royal Bank of Canada and, as such, is a related issuer of Royal Bank of Canada. Any U.S. recipient of this report that is not a registered broker-dealer or a bank acting in a broker or dealer capacity and that wishes further information regarding, or to effect any transaction in, any of the securities discussed in this report, should contact and place orders with RBC Capital Markets, LLC. International investing involves risks not typically associated with U.S. investing, including currency fluctuation, foreign taxation, political instability and different accounting standards.

To Canadian Residents: This publication has been approved by RBC Dominion Securities Inc. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. ®Registered trademark of Royal Bank of Canada. Used under license. RBC Wealth Management is a registered trademark of Royal Bank of Canada. Used under license.

RBC Wealth Management (British Isles): This publication is distributed by Royal Bank of Canada Investment Management (U.K.) Limited and RBC Investment Solutions (CI) Limited. Royal Bank of Canada Investment Management (U.K.) Limited is authorised and regulated by the Financial Conduct Authority (Reference number: 146504). Registered office: Riverbank House, 2 Swan Lane , London, EC4R 3BF, UK. RBC Investment Solutions (CI) Limited is regulated by the Jersey Financial Services Commission in the conduct of investment business in Jersey. Registered office: Gaspé House, 66-72 Esplanade, St Helier, Jersey JE2 3QT, Channel Islands, registered company number 119162.

To Hong Kong Residents: This publication is distributed in Hong Kong by Royal Bank of Canada, Hong Kong Branch which is regulated by the Hong Kong Monetary Authority and the Securities and Futures Commission ('SFC'), and RBC Investment Services (Asia) Limited, which is regulated by the SFC. Financial Services provided to Australia: Financial services may be provided in Australia in accordance with applicable law. Financial services provided by the Royal Bank of Canada, Hong Kong Branch are provided pursuant to the Royal Bank of Canada's Australian Financial Services Licence ('AFSL') (No. 246521).

To Singapore Residents: This publication is distributed in Singapore by the Royal Bank of Canada, Singapore Branch, a registered entity granted offshore bank licence by the Monetary Authority of Singapore. This material has been prepared for general circulation and does not take into account the objectives, financial situation, or needs of any recipient. You are advised to seek independent advice from a financial adviser before purchasing any product. If you do not obtain independent advice, you should consider whether the product is suitable for you. Past performance is not indicative of future performance. If you have any questions related to this publication, please contact the Royal Bank of Canada, Singapore Branch. Royal Bank of Canada, Singapore Branch accepts responsibility for this report and its dissemination in Singapore.

© 2018 RBC Capital Markets, LLC - Member NYSE/FINRA/SIPC
© 2018 RBC Dominion Securities Inc. - Member Canadian Investor Protection Fund
© 2018 RBC Europe Limited
© 2018 Royal Bank of Canada
All rights reserved
RBC1253