November 2016

RBC WEALTH MANAGEMENT

# Global Insight

Perspectives from the Global Portfolio Advisory Committee

## Turning down the heat

Will Canada's sweeping policy changes be able to cool off the country's housing market?

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All values in U.S. dollars and priced as of market close, October 31, 2016, unless otherwise stated.

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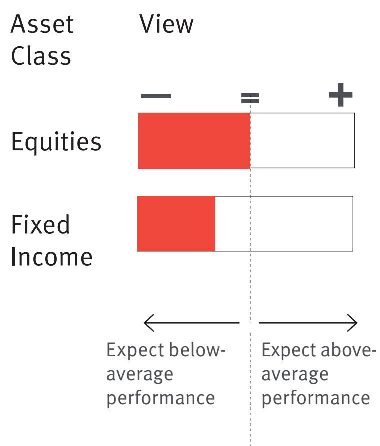


See "Views explanation" below for details

Source - RBC Wealth Management

## Equities

- We remain constructive on global equities and would hold positions at the recommended strategic (benchmark) level in portfolios. Developed economies are firming, led by the U.S. and Germany. Fresh fiscal stimulus initiatives, combined with ongoing accommodative monetary policies, should support global equities in 2017. China's economic stability and its more prudent regulatory regime are also positives.
- We would continue to tilt portfolio holdings toward North America. U.S. corporate earnings should accelerate in Q4 and grow in the mid to high-single digits in 2017. Canada's TSX should benefit from moderately higher oil prices. Valuations remain attractive in Asia. For the U.K. and Continental Europe, Brexit risks could resurface after Article 50 is triggered and banking sector headwinds linger.

## Fixed Income

- With inflation drifting moderately higher and major central banks increasingly willing to let their economies "run hot," the bias is toward moderately higher government bond yields over the near term, in our opinion.
- However, any increase in yields should be contained as policy seems set to remain accommodative in 2017. The European Central Bank and Bank of Japan are in no hurry to increase short-term rates. While the Federal Reserve could raise rates 25 basis points next month, it will likely be in the context of a slow and shallow rate hike cycle overall.
- We recommend reducing duration slightly in portfolios as long-term yields could rise moderately and yield curves could steepen. Corporate credit remains our favorite sector, but opportunities are limited following significant spread tightening. Select 5- to 7-year investment-grade corporates are attractive.

## 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.

= In-line implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

– Underweight implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.

Focus article

# Turning down the heat

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With frothy home prices in two of Canada's biggest cities threatening to spread into other markets, Ottawa recently introduced measures designed to encourage more prudent lending and borrowing as part of an effort to head off bigger problems down the road. We ask RBC Global Asset Management's chief economist for his take on the state of Canada's housing market and what effect the measures will have on Canada's economic prospects.

**Q. I feel we can observe some signs of the housing market in Canada wobbling. What is your current view?**

**A.** The Canadian housing market is indeed wobbling and looks to be at its most vulnerable since the financial crisis. There may actually be two different forces at work that are contributing to those challenges. The first is that when you see any financial asset rising in a parabolic manner, this usually cannot last for long and eventually needs to resolve itself. Arguably, that is what we are seeing in Vancouver and Victoria, the very hottest of Canadian housing markets. Even prior to the 15% foreign tax that came into effect on August 1 in Vancouver, we had observed a notable decline in resale activity starting in the spring. The second force is more obvious—tighter regulations—which have been applied at both the local and national level.

**Q. What do you feel the role of local regulations, particularly those in British Columbia, means for these markets, as well as others that may be considering whether to follow suit?**

**A.** The targeted rule changes are quite good in the sense that Canada has a highly varied housing market and so benefits from a tailor-made approach to each market. Some markets have been extraordinarily hot, such as Toronto, Vancouver, and Victoria, whereas others have been ice cold, like Calgary and Edmonton. This targeting helps to address the very hottest of markets.

Foreign buyers have been the first target in the Vancouver area, with a 15% tax coming on August 1, and this has been broadly positive. The affected group is disproportionately composed of speculators, and has arguably enjoyed an outsized influence over prices. Some analysis has suggested that if half of the foreign buyers go away, this could actually take up to 15% off home prices. While painful in the short run, this is arguably a desirable outcome given the poor present state of affordability. Overall, I think attempts at the local level to cool overheated markets are positive, but we have to acknowledge the execution will be imperfect.

## Q. What about the effect of policy changes at the national level?

**A.** Let's start with this basic premise: is it good if home prices rise less quickly?

At the household level and from a long-term perspective, it probably is a good thing for home prices to rise less quickly since the alternative is for affordability to continue deteriorating and for future generations to be priced out of the market. Housing shouldn't be viewed as just an asset but also as something that is consumed over time, meaning higher prices are undesirable just like anything else that people buy.

Housing shouldn't be viewed as just an asset but also as something that is consumed over time.

From my vantage point, I think it's fair to argue that some of the real estate gains in recent years have been excessive. Home price appreciation has significantly outpaced what can be explained by interest rates alone. The federal government and regulators find this problematic for a number of reasons. The federal government doesn't like that a disproportionate share of housing risk lands on the government rather than the banks. There has also been a surge in mortgage lending by small banks and non-bank financial institutions. This is problematic as these lenders generally operate in the riskiest part of the mortgage market but they are simultaneously the least capable of handling distress should it arrive.

To this end, Canada Mortgage and Housing Corporation (CMHC) has proposed and implemented a host of changes. For example, fixed-rate mortgage applications requiring insurance will now go through a rigorous stress test that will reduce the maximum credit available to borrowers. CMHC is also floating the idea of more explicit risk sharing with lenders. Similarly, the Office of the Superintendent of Financial Institutions is leaning on lenders more, and musing about higher capital requirements when the housing market is deemed "hot" and on mortgages that are particularly levered.

This adds up to a lot of change at the national level. Of all the attempts we have seen over the last decade to cool the housing market, this effort is the most aggressive and stands the best chance of materially cooling home prices going forward.

## Q. What is your outlook for housing in 2017?

**A.** Housing matters in two ways—price and activity. The imbalances in Canada are mainly with regard to home prices. Construction broadly matches demographic needs but prices and thus affordability are offside in certain markets. It's conceivable but unlikely that the housing market shrugs off these changes as it has with past government attempts to relieve pressure, meaning that the upward price ascent could continue. More likely, this is an inflection point for the housing market and we are in for a period of sideways price activity. This is the government's ideal outcome, and its efforts represent an attempt to engineer such a soft landing. I would argue it is tentatively on the way to achieving this in Vancouver. But the forecast depends on the region. In Alberta and Newfoundland, we could see another year of modest home price declines even if oil prices manage to continue clawing their way higher.

Toronto is the hardest to call. Affordability is less of an issue than for Vancouver but hardly inconsequential. The city has so far been resilient to tighter rules. Prices in this market may still rise but gains should be in the 2%–7% range (down from 10%+). Elsewhere in the country, I would expect prices to rise in the 0%–5% range, with a bias towards the lower end—down from national gains of 5%–10% per year recently.

**Q. What are the economic implications of a housing market behaving in a way you describe?**

**A.** At a minimum, the Canadian economy is losing a meaningful tailwind. To highlight the outsized importance of the housing market in Canada, it currently represents around 15% of GDP, which compares to the 10%–11% that would be more appropriate.

This is one more drag that keeps Canada in no better than slow growth mode over the coming few years.

There are two effects of a cooling housing market. First, a lower rate of construction will impact employment through the supply change. But, as we noted, the market is fairly balanced when we consider the supply coming to market and the country's demographics. The second effect, which will be more acute, is the impact of a reduced wealth effect. Consumer spending has been supported by a positive wealth effect as home prices rose. The combination of a diminished wealth effect and reduced construction could mean 2% less growth over the next few years, which would result in subpar growth but would not necessarily be outright recessionary. This is just one more drag that keeps Canada in no better than slow growth mode over the coming few years.

# Setting the table

Business activity indexes (PMIs) have begun to trend convincingly higher over the past couple of quarters. Rising new order levels accompanied by receding inventories suggest there is more of this to come. This should support the case for a moderate pickup in earnings growth over and above that which may be delivered by any sustained stabilisation of the Energy sector.

The forgoing has allowed most global equity markets to move above their January/February lows. For some, like the S&P 500 and Canada's TSX, the gains have been solidly in double digits. For some others, weaker local currencies have eaten heavily into the equity returns for a global investor.

This has all played out against a predictable backdrop of troubling investor concerns: Brexit, European politics, U.S. politics, fragile European banks, still weak oil prices, and mixed monetary policy signals. We don't expect that list to get any shorter.

That said, as long as credit conditions remain accommodative—and we think they will, a Fed rate hike or two notwithstanding—we expect the combination of moderate earnings growth and valuations that are not stretched should allow equities in most major markets to deliver worthwhile, all-in returns including dividends.

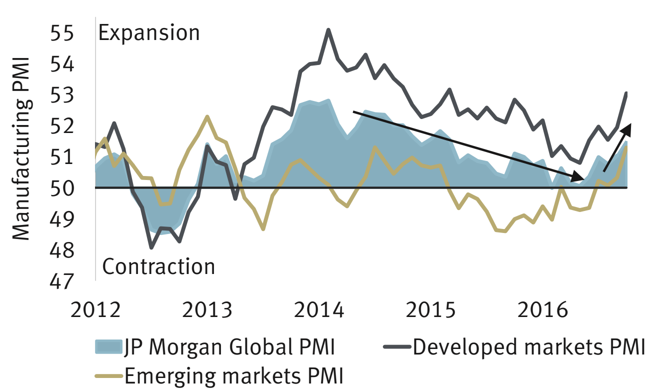
We recommend a neutral exposure to U.S. equities relative to a global benchmark and a modest Overweight in Canada where a better energy environment is positive not only for that sector, but also for investor perceptions around the heavyweight banking sector. We are Underweight Europe and the U.K. where we believe the difficult political calendar for the coming 12 months calls for a selective approach. For Asia our stance is neutral.

### Equity views

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

Source - RBC Wealth Management

### Global Purchasing Managers Indexes




PMIs have turned convincingly higher.

Note: PMI refers to Purchasing Managers Index for manufacturing sector, a measure for economic activity. Source - Haver Analytics, RBC Global Asset Management

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# Global equity

## Regional highlights

### United States

- With solid Q3 results putting the "earnings recession" in the rear view mirror, we believe profit growth will return to a more-normal mid to high single-digit pace. RBC Capital Markets forecasts the S&P 500 will earn $124 per share in 2017, a 5.7% y/y increase. We believe earnings could exceed that level if the Fed raises rates by at least 50 basis points next year, which would boost bank earnings, and if oil prices drift higher, which would push the Energy sector comfortably into the black.

- We advise staying the course with an In-line (benchmark) allocation to U.S. equities heading into the November 8 election, as discussed in our special report, *Vote of Confidence*. This translates into holding a full allocation to the market at the recommended strategic weight. Market performance relies on many other factors than who might occupy the White House.

- We continue to favor the Technology sector due to its growth prospects and reasonable valuation. Banks stocks are also attractive given the potential for improving net interest margins. We are warming up to biotech and pharmaceutical stocks, and would view them more favorably should Republicans maintain control of the House, as this would diminish drug pricing risks.

### Canada

- We maintain our Overweight stance for Canadian equities. The S&P/TSX Composite has outpaced its global equity peers in 2016, and we believe conditions are in place for positive performance to persist.

- The banks remain reasonably valued relative to historical levels and to U.S. peers. Should energy prices continue to trend higher, analyst earnings estimates could be revised higher in anticipation of oil- & gas-related credit losses proving to be overly conservative.

- In response to rising prices and affordability concerns, the federal government introduced policy changes designed to establish more uniform mortgage insurance standards and improve tax fairness. Uniform stress tests for insured mortgages are likely to have the biggest impact in the mortgage market. RBC Capital Markets estimates residential mortgage originations will decline by 12.5% over the next year.

- We expect the earnings impact for Canada's largest banks will be gradual and modest. The banks boast diversified businesses and the ability to fund uninsured mortgages on balance sheet, which will help them navigate the new environment. RBC Capital Markets reduced its 2018 EPS estimates for the banks by just 2% on average in response to the new rules.


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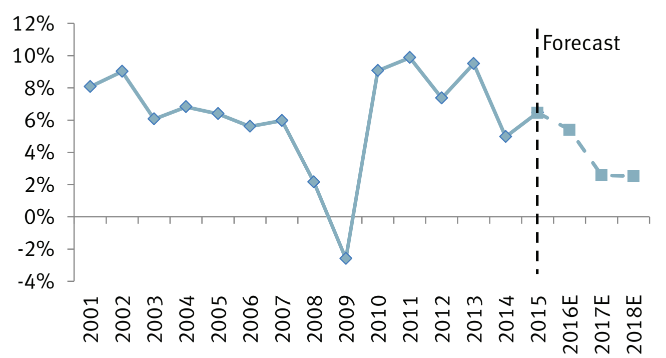
**Average Canadian bank residential mortgage growth**




Source - Company reports, RBC Capital Markets

RBC Capital Markets expects the new mortgage insurance rules will hasten the slowdown in the Canadian residential mortgage market.

- RBC Capital Markets moderated its outlook for crude oil prices and now forecasts average North American benchmark prices of $56 and $63 per barrel in 2017 and 2018, respectively. We believe a slow grind higher in energy prices could ultimately prove more durable than a near-term spike, providing support to equity values in the Energy sector.

### Continental Europe & U.K.

- Signs of a slowdown are appearing in the U.K. The Chancellor of the Exchequer Philip Hammond may announce some fiscal stimulus at the November 23 autumn statement, but any initiative could be restricted by the high fiscal deficit (4% of GDP) and inflation expectations which are creeping up with the weak pound.

- This environment directs us toward defensive sectors with an international revenue base, namely Consumer Staples and pharmaceuticals. Commodities and Energy will also likely benefit from a weak GBP and should also enjoy earnings upgrades. Conversely, we are more cautious on domestic sectors, even defensive ones such as Utilities where the risk of government interference is increasing, given Prime Minister Theresa May's recent comments regarding consumers being locked into high-priced contracts.

- With markets increasingly discounting the possibility of a "hard" exit, any emergence of a scenario which includes the retention of single markets access, or a "soft" exit scenario, could lead the GBP to bounce back and would lead us to revisit our investment strategy.

- In Europe, political risk over the next year is unusually high, and valuations are not particularly appealing. We prefer to stick to our focused strategy of investing in well-capitalized quality companies, with world-class franchises, which pay and grow dividends.

### Asia

- Japanese equities have reached a six-month high, helped in part by a weaker yen against the dollar. The strong, consistent appreciation of the yen throughout the year had formed a significant headwind for Japanese stocks. Japanese equity valuations relative to other developed markets remain attractive. However, the path of the yen remains a point of much debate.

- The mainland Chinese equity market has been stable since February, moving moderately higher. There is a wide range of valuations among sectors and between small-, mid and large-cap stocks. The Chinese yuan continues to decline against the dollar at a modest pace.

- Leading economic indicators reveal a somewhat constructive outlook in the short- to medium-term. Indeed, China's economy grew by 6.7% y/y in Q3, as forecast, suggesting the government's target range of 6.5%–7% growth will be met. The increasingly important services sector, the largest part of the Chinese economy, expanded by 7.6% y/y over the first nine months of the year.

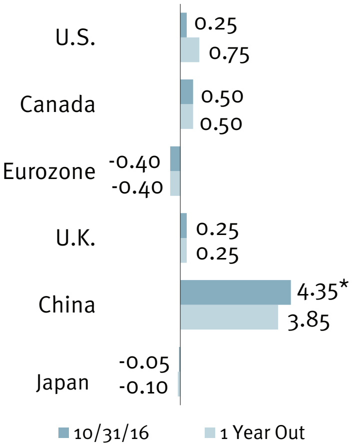
- Growth has also been bolstered by the overall strength in the housing market. This has been especially so in China's largest cities, at least 20 of which have implemented localized tightening measures following nearly two years of accommodative policy.

- It remains unclear what impact this localized policy tightening will have on the broader economy. China has well over 200 cities, most of which have shown only moderate movement in housing prices. Affordability is high at the national level as income growth has generally outstripped house price inflation.

Global
fixed income

# November winds come early

Central bank rate (%)




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

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Interest rates are on the move, inflation is showing signs of life, the U.S. appears set to jump into the fiscal stimulus pool after the election, and the Fed is preparing to hike rates in December—what a blustery start to November! Any one of these events is enough to keep investors on the edge of their seats, and while they pose challenges, we continue to see pockets of opportunity in the credit markets.

As the Fed prepares for its next rate hike, we believe investors should keep in mind that the monetary policy backdrop remains quite accommodative. Global central banks, while dithering on future policy moves, are expected to remain accommodative as global growth continues to be unimpressive. This should keep any move in yields largely contained. As for inflation, after spending five years well below the Fed's 2% target, signs of life in some indicators are fanning fears of growing price pressures. But it's important to remember Fed chair Janet Yellen's comments on running a "high-pressure economy," which signals the Fed's willingness to tighten gradually even after 2% inflation is reached. Finally, governments appear set to throw off the shackles of fiscal austerity in order to boost growth, a positive development for sure, but the benefits may not be immediate.

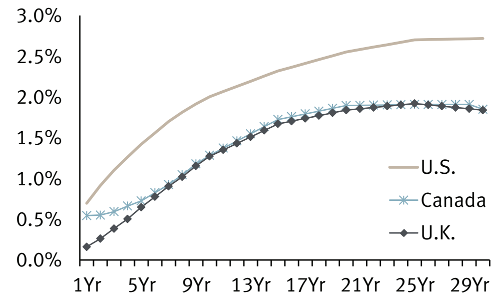
Investors should stay involved in the credit markets, but in light of the tempestuous market conditions our recommendation is to be selective and look, for the near term, to take shelter in shorter duration assets.

## Regional highlights

### United States

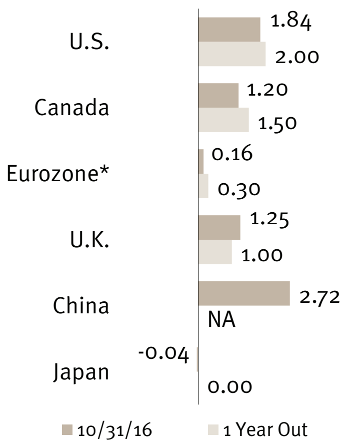
- The Fed will not be raising short-term rates at its November 2 meeting but the market is now pricing in a 71% chance of a move next month thanks to improving economic data. We see a bias toward higher longer-dated yields, which could get an election boost as both candidates have proposed some form of fiscal stimulus.
- Credit spreads continue to tighten and have now reached 16-month lows, which we believe is a vote of confidence for the economy. However, tight spreads and potential for volatility lead us to favor bank-issued fixed-to-float preferred shares which should outperform in this type of environment. Additionally, within the high-yield space, we see bank loans as a more defensive, short duration structure than high-yield bonds.
- October muni issuance of $54B set a new record and, with just two months remaining, issuance is forecast to top 2010's record of $435B. A surge in September and October issuance pushed yields on the benchmark 30-year muni index to 2.54%, a level not seen since April. Looking ahead, we see upward pressure on yields as prices feel the weight of a 30-day supply calendar in excess of $21B in the face of reduced support from mutual fund purchases and possibly foreign investors.

Sovereign yield curves




Source - Bloomberg

## 10-year rate (%)




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

### Canada

- By communicating that Bank of Canada (BoC) officials had "actively discussed the possibility of adding more monetary stimulus" at its October policy meeting, BoC Governor Stephen Poloz made clear that the central bank is unlikely to hike rates anytime soon. Recent measures by the federal government to rein in the housing sector are the latest headwind to face the economy as residential investment is expected to decline. We expect the BoC to keep its benchmark rate steady at 0.5%, but see the potential for further stimulus in early 2017 should the pace of growth slow further. Given the potential for a rate cut in the coming months, we believe investors should lock in yields with high-quality 2- to 5-year bonds and Guaranteed Investment Certificates.

- The preferred share market has remained well supported, despite a decline in government bond yields, and robust investor demand for yield has led to further spread compression. We continue to see some pockets of value, but investors need to be discerning given valuations. Additionally, within the high-yield space, we see bank loans as a more defensive, short duration structure than high-yield bonds.

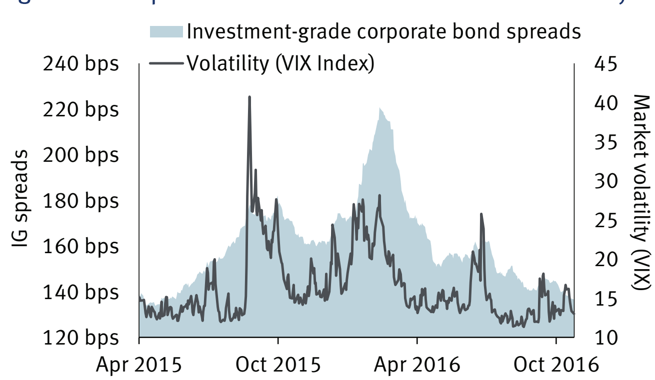
### Continental Europe & U.K.

- In the U.K., we would be reluctant to take on too much duration or domestic credit risk. We still see the 5-year part of the curve as the best relative value for conservative clients. At a yield level that garners about 1% and the potential for volatility in coming months, we are underwhelmed by the longer end of the Gilt curve. Recent steepening does little to change this view.

- The European Central Bank (ECB) once again pushed important policy decisions to next month, when it will update economic forecasts. As has been our view for some time, we expect the ECB to keep monetary policy ultraloose, although the recent pickup in expected inflation will be very welcome if maintained. This would also be the catalyst to push the benchmark bund yield higher, otherwise it will likely remain at its current low levels.

- Within credit, we would focus on corporate issuers with a global balance sheet. For U.K. names, we prefer conservative sectors of the domestic market, such as Utilities, that attract the Bank of England as a natural buyer but offer a good spread to comparable gilt yields. We are cautious on U.K. retailers and banks. For the latter, the possible headwinds of an acceleration in nonperforming loans due to economic difficulties, extended regulatory fines, and squeezed net interest margins are all causes for concern.

## Tight credit spreads a vote of confidence for economy




Credit spreads at 16-month lows and potential for increased volatility lead us to favor fixed-to-float preferred shares.

Source - RBC Wealth Management, Bloomberg; data as of 2:30 pm GMT 10/26/16

# Red-hot bulk materials

## Commodity forecasts

| | 2016E | 2017E |
|---|---|---|
| Oil (WTI $/bbl) | 44.00 | 56.00 |
| Natural Gas ($/mmBtu) | 2.50 | 3.15 |
| Gold ($/oz) | 1,275 | 1,500 |
| Copper ($/lb) | 2.15 | 2.25 |
| Corn* ($/bu) | 3.38 | 3.61 |
| Wheat* ($/bu) | 4.21 | 4.71 |

*Corn and wheat 2016 forecasts are for Q4 2016.

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

Fiscal stimulus and the rebound of China's real estate market have led to higher steel production and a price surge for both key steelmaking inputs—iron ore and metallurgical (met) coal.

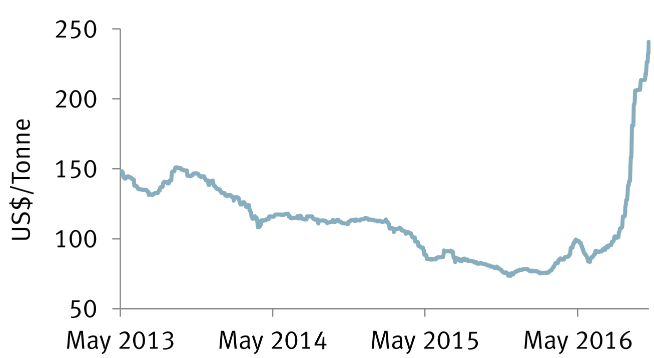
Their prices had declined substantially when a multi-year period of mine expansion ran headlong into the property market correction in China starting about two years ago. The subsequent oil industry collapse delivered a second blow to global steel consumption resulting in heavily oversupplied markets for these steel inputs. Met coal, for example, saw price levels at which roughly half of mine production globally was losing money and major industry participants were filing for bankruptcy.

With steel production in China back to robust levels, iron ore prices are up some 50% and met coal prices about three-fold from the recent lows. Support for met coal has also stemmed from supply reform in China with a statutory reduction of working days for mines to 276 per year from 330. More recently, met coal prices have spiked as BHP Billiton has declared force majeure (temporary shutdown) at Australia's largest met coal mine due to adverse weather. These conditions have driven the market to settle the quarterly contract price at $200 per tonne, its highest since late 2012.

There are some risks prices could weaken. For iron ore, seaborne supply growth is expected in the low to mid single-digit range in the next couple of years according to our research sources. RBC Capital Markets forecasts a modestly oversupplied market next year. For met coal, a loosening of Chinese production restrictions has already begun allowing hundreds of mines to return to their previously registered 330-day capacity levels. China imports only about 10% of its total met coal requirements. This may result in downward pressure on seaborne demand as domestic mine production picks up. In the near term, weather conditions in Australia will be likely the key driver of market tightness. RBC Capital Markets forecasts an undersupplied met coal market for the next two years.

RBC Capital Markets recently raised its 2017 met coal price forecast to $165 per tonne (from $100), expecting price declines thereafter toward a long-term price forecast of $120 per tonne. For iron ore, it forecasts prices at $59 per tonne in 2017 declining modestly the year after before rising to the long-term forecast of $65 per tonne.

## Metallurgical coal price




Chinese steel production is up on fiscal stimulus but government reform to reduce steelmaking capacity is targeted over the medium to longer term.

Source - Bloomberg, RBC Dominion Securities, Inc.

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# Currencies

## Currency forecasts

| Currency pair | Current rate | Forecast Sep 2017 | Change* |
|---|---|---|---|
| Major currencies | | | |
| USD Index | 98.45 | 99.44 | 1% |
| CAD/USD | 0.75 | 0.75 | 0% |
| USD/CAD | 1.34 | 1.34 | 0% |
| EUR/USD | 1.10 | 1.06 | -4% |
| GBP/USD | 1.22 | 1.16 | -5% |
| USD/CHF | 0.99 | 1.03 | 4% |
| USD/JPY | 104.82 | 95.00 | -9% |
| AUD/USD | 0.76 | 0.74 | -3% |
| NZD/USD | 0.72 | 0.77 | 7% |
| EUR/JPY | 115.10 | 101.00 | -12% |
| EUR/GBP | 0.90 | 0.91 | 1% |
| EUR/CHF | 1.09 | 1.09 | 0% |
| Emerging currencies | | | |
| USD/CNY | 6.78 | 7.40 | 9% |
| USD/INR | 66.78 | 72.00 | 8% |
| USD/SGD | 1.39 | 1.58 | 14% |
| USD/PLN | 3.92 | 3.96 | 1% |

* Defined as the implied appreciation or depreciation of the first currency in the pair quote.
Examples of how to interpret data found in the Market Scorecard.
Source - RBC Capital Markets, Bloomberg

### U.S. dollar

Dollar strength has been a noteworthy theme over the past month, with the greenback marking solid gains across the board. Stronger U.S. data and even stronger Fed rate hike comments have helped to fuel the rally, which has further helped drive market sentiment (currently around 70%) for a December U.S. rate hike. RBC continues to expect the next rate hike in Q1 2017. There are two more critical payroll reports and a U.S. election sandwiched ahead of the Fed's December meeting.

### Euro

The mere mention of a possible reduction in quantitative easing purchases by the ECB roiled markets in early October, and although this was later denied by key ECB members, the move still caused a mini "Taper Tantrum." Indeed, the ECB will be conducting a review of asset purchases, but this is likely to be in relation to extending the programme beyond March 2017. In the meantime, the single currency has moved lower of late, especially against the USD breaking back under 1.1000, but we view this is as more a consequence of broader dollar strength.

### British pound

Sterling's weakness continued throughout October, even accelerating after Prime Minister Theresa May suggested the U.K. is set to pursue a "hard Brexit" from the EU during the Conservative Party conference. This announcement has unsettled businesses and investors who have seen the U.K. as a gateway to Europe. Looking ahead, it seems likely to us U.K. economic data will deteriorate going forward with further weakness for the pound seemingly inevitable into 2017.

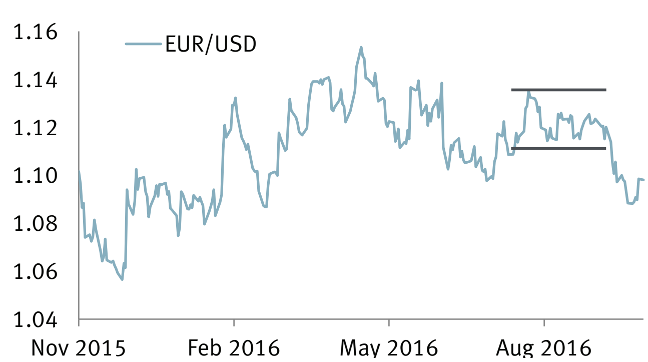
### Canadian dollar

Despite CAD being supported by the potential Russia-OPEC oil output freeze, October was a bad month for the loonie due to the reduction of the BoC's growth outlook, and the fact that it was a close decision to keep monetary stimulus on hold for now. The decision to hold ultimately came down to uncertainties regarding the impact of new housing measures and looser fiscal policies in place. Given the risks on the horizon, we favour a gradual weakening of CAD against USD, a weakness that should be relatively contained given the backdrop of stimulus already in place.

### Japanese yen

After September's Bank of Japan meeting dominated headlines, the yen has not had any real impetus for change through October. We still believe the changes to monetary policy last month will not offer enough flexibility for any further broad-based yen weakening action to be taken, and this should ultimately allow the currency to hold firm for now.

### EUR/USD broken out of recent range to post-Brexit low




Euro proving vulnerable to a broad based USD rally.

Source - Bloomberg, RBC Wealth Management; data as of 1:05 pm GMT 11/1/16

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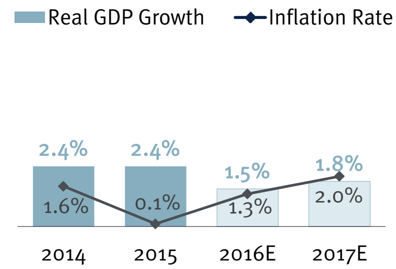
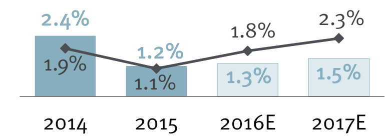
# Key forecasts

## United States — sustained, slow growth



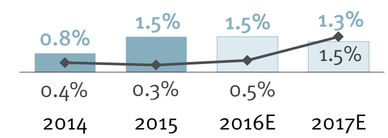

- Q3 GDP growth rebounded to 2.9% largely due to continued inventory liquidation. Mfg. PMI rose again in October, as did new orders. Consumer balance sheets, income growth, employment, confidence all strong. Real spending growth eased a bit to +2.1%, saving solid. Housing steady. Capex soft but showing signs of bottoming, exports strengthening. Leading indicators, confidence point to sustained, but slow, domestic growth.

## Canada — in transition



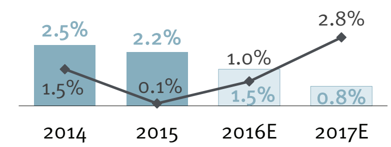

- Q2 growth collapsed to -1.6%. Ex-Fort McMurray effect, data not bad. July/August data suggest rebound in Q3. House construction firm, PMI off its high, but still positive. Energy capex weak. Consumer attitude restrained by resource sector weakness/housing market uncertainty. Mfg. sales ex-petroleum products softer recently due in part to one-time issues. Tourism strong helped by weak loonie.

## Eurozone — plateauing



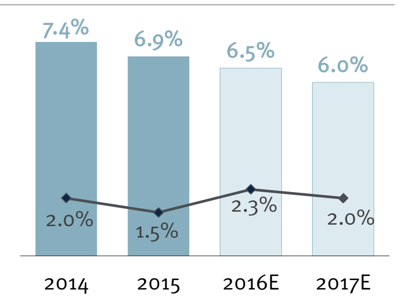

- Q3 growth steady at 1.6% Y/Y. Germany and Spain leading the way. France picked up, Italy lagging. Bank loans to private sector up year over year. PMIs improving again. Refugee crisis, fractious politics, Brexit weighing on consumer and business sentiment. Tourism bookings down sharply. Italian banks keeping ECB ultra-loose, euro soft. Full-year GDP growth steady in 2016, slipping modestly in 2017.

## United Kingdom — period of adjustment



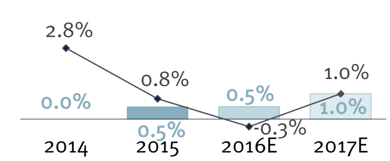

- PMIs, new orders slumped in July following Brexit vote, rebounded in August, consolidated in Sept. as weak pound spurred exports, services. Construction weak as is business confidence. Unemployment steady at 4.9% following vote, real growth in household earnings eased slightly. Mild recession expected. Brexit drain more in evidence next year. Inflation surging with weak pound.

## China — stabilizing




- Q3 growth steady at +6.7% y/y. Loans still growing faster than GDP. PMIs improved further in October, as did business confidence. Services sector PMI weakened fractionally. Employment, wages, retail sales, car registrations all growing. Exports, industrial production flattish in Sept. Fixed asset investment slowing. Currency weaker. House prices higher year over year in major centers.

## Japan — conflicted, few catalysts




- GDP growth regained positive territory in Q1 and maintained it in Q2. Leading indicators and PMIs improving. Corporate earnings solid, but business confidence weak. Wage growth has faded, household spending weak but consumer confidence rising. Low oil prices, strong currency putting inflation targets in jeopardy. Planned sales tax increase has been put off until 2018.

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

# Market scorecard

| Index (local currency) | Level | 1 Month | YTD | 12 Month |
|---|---|---|---|---|
| S&P 500 | 2,126.15 | -1.9% | 4.0% | 2.3% |
| Dow Industrials (DJIA) | 18,142.42 | -0.9% | 4.1% | 2.7% |
| NASDAQ | 5,189.14 | -2.3% | 3.6% | 2.7% |
| Russell 2000 | 1,191.39 | -4.8% | 4.9% | 2.5% |
| S&P/TSX Comp | 14,787.27 | 0.4% | 13.7% | 9.3% |
| FTSE All-Share | 3,768.14 | 0.3% | 9.4% | 8.1% |
| STOXX Europe 600 | 338.97 | -1.2% | -7.3% | -9.7% |
| German DAX | 10,665.01 | 1.5% | -0.7% | -1.7% |
| Hang Seng | 22,934.54 | -1.6% | 4.7% | 1.3% |
| Shanghai Comp | 3,100.49 | 3.2% | -12.4% | -8.3% |
| Nikkei 225 | 17,425.02 | 5.9% | -8.5% | -8.7% |
| India Sensex | 27,930.21 | 0.2% | 6.9% | 4.8% |
| Singapore Straits Times | 2,813.87 | -1.9% | -2.4% | -6.2% |
| Brazil Ibovespa | 64,924.52 | 11.2% | 49.8% | 41.5% |
| Mexican Bolsa IPC | 48,009.28 | 1.6% | 11.7% | 7.8% |
| **Bond yields** | **10/31/16** | **9/30/16** | **10/30/15** | **12 mo chg** |
| US 2-Yr Tsy | 0.841% | 0.762% | 0.724% | 0.12% |
| US 10-Yr Tsy | 1.826% | 1.594% | 2.142% | -0.32% |
| Canada 2-Yr | 0.547% | 0.521% | 0.576% | -0.03% |
| Canada 10-Yr | 1.196% | 0.996% | 1.542% | -0.35% |
| UK 2-Yr | 0.263% | 0.102% | 0.626% | -0.36% |
| UK 10-Yr | 1.245% | 0.746% | 1.922% | -0.68% |
| Germany 2-Yr | -0.618% | -0.683% | -0.315% | -0.30% |
| Germany 10-Yr | 0.163% | -0.119% | 0.517% | -0.35% |
| **Commodities (USD)** | **Price** | **1 Month** | **YTD** | **12 Month** |
| Gold (spot $/oz) | 1,277.30 | -2.9% | 20.3% | 11.8% |
| Silver (spot $/oz) | 17.91 | -6.6% | 29.2% | 15.2% |
| Copper ($/metric ton) | 4,841.00 | -0.1% | 2.9% | -5.6% |
| Uranium ($/lb) | 20.00 | -15.8% | -41.9% | -45.6% |
| Oil (WTI spot/bbl) | 46.86 | -2.9% | 26.5% | 0.6% |
| Oil (Brent spot/bbl) | 48.30 | -1.5% | 29.6% | -2.5% |
| Natural Gas ($/mmBtu) | 3.03 | 4.1% | 29.5% | 30.4% |
| Agriculture Index | 301.95 | 2.6% | 6.5% | 2.3% |
| **Currencies** | **Rate** | **1 Month** | **YTD** | **12 Month** |
| US Dollar Index | 98.45 | 3.1% | -0.2% | 1.5% |
| CAD/USD | 0.75 | -2.1% | 3.2% | -2.5% |
| USD/CAD | 1.34 | 2.1% | -3.1% | 2.5% |
| EUR/USD | 1.10 | -2.3% | 1.1% | -0.2% |
| GBP/USD | 1.22 | -5.6% | -16.9% | -20.7% |
| AUD/USD | 0.76 | -0.7% | 4.4% | 6.6% |
| USD/CHF | 0.99 | 1.8% | -1.3% | 0.1% |
| USD/JPY | 104.82 | 3.4% | -12.8% | -13.1% |
| EUR/JPY | 115.10 | 1.0% | -11.9% | -13.3% |
| EUR/GBP | 0.90 | 3.6% | 21.7% | 25.7% |
| EUR/CHF | 1.09 | -0.5% | -0.2% | -0.1% |
| USD/SGD | 1.39 | 2.1% | -1.9% | -0.7% |
| USD/CNY | 6.78 | 1.6% | 4.3% | 7.3% |
| USD/BRL | 3.19 | -2.1% | -19.4% | -17.2% |

Select Asian markets outperformed as China's economy improved and the weak yen boosted Japanese stocks.

Government yields rose across regions, especially at the long end, as inflation drifted higher and the dollar rallied.

Oil pulled back despite reports OPEC could strike a production deal.

The dollar surged as Fed rate hike expectations increased and inflation ticked higher.

Equity returns do not include dividends, except for the German DAX. 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 0.75 means 1 Canadian dollar will buy 0.75 U.S. dollar. CAD/USD -2.5% return means the Canadian dollar has fallen 2.5% vs. the U.S. dollar during the past 12 months. USD/JPY 104.82 means 1 U.S. dollar will buy 104.82 yen. USD/JPY -13.1% return means the U.S. dollar has fallen 13.1% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 10/31/16.

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|---|---|---|---|---|
| Rating | Count | Percent | Count | Percent |
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| Hold [Sector Perform] | 719 | 42.93 | 133 | 18.50 |
| Sell [Underperform] | 108 | 6.45 | 10 | 9.26 |

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