

GLOBAL INSIGHT

PERSPECTIVES FROM THE GLOBAL PORTFOLIO ADVISORY COMMITTEE



GETTING PAST GREECE

Uncertainties raised by Greece will eventually be trumped by the strengthening performance of most developed economies led by the U.S.

JIM ALLWORTH | PAGE 4

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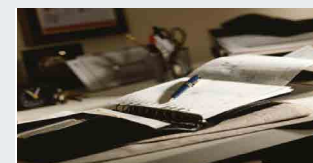
FOCUS ARTICLE
CANADIAN CONSUMER:
NOT DOWN & FAR FROM OUT



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RBC Wealth Management

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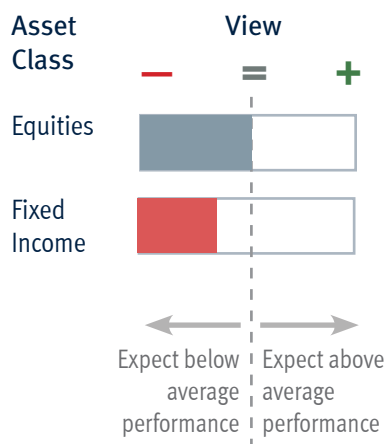
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All values in U.S. dollars and priced as of June 30, 2015, market close, EST, unless otherwise noted.

RBC's INVESTMENT STANCE

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See "Views Explanation" below for details

Source - RBC Wealth Management

EQUITIES – AVERAGE PERFORMANCE

- Monetary policies in North America, Europe, Japan, and China remain highly accommodative and supportive of equity prices. While the Federal Reserve's first rate hike of the tightening cycle could result in some bumps, historical data signals the equity market can deliver worthwhile returns in the early stage of the tightening cycle. Global and U.S. equities normally bypass long and deep downturns until late in the rate hike cycle when the Fed has tightened enough to threaten the continuation of the economic advance. That should be some ways off.
- We recommend investors with a 12-month or longer time horizon maintain at least their targeted, full allocation to equities. Earnings growth should persist and valuations for most markets, while slightly above average, are reasonable given the low interest rate environment.

FIXED INCOME – BELOW-AVERAGE PERFORMANCE

- With attention focused on the Federal Reserve, it is prudent to recognize the pace and magnitude of the overall tightening cycle, not the date of the first rate hike, are most important. Looking past the initial rate hike, which according to Fed officials will occur "later this year," we expect a gradual and shallow tightening cycle that leads to an eventual cresting of the Fed Funds rate at a lower level than in previous cycles.
- As government bond markets have stabilized, corporate bonds currently offer attractive investment opportunities. Credit spreads have widened such that intermediate-term securities provide a meaningful pickup in incremental yield. While the Fed's march toward a policy shift could bring about heightened volatility, we believe these securities would be more stable than shorter-dated bonds.

Views Explanation

(+/-/-) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

+ Positive 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.

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



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Markets largely
ignored Greece
until negotiations
collapsed.

GETTING PAST GREECE

The Greek debt negotiation blew up this past weekend and pushed equity markets into a correction that may take some time to fully play out. We expect this pullback will eventually give way to a resumption of the long-term uptrend that we think has longer to run on the back of strengthening economies in North America and in most of Europe.

In the near term, we recommend reviewing portfolios and bringing equity exposure back to strategic target weights. Some cash on hand could prove valuable in the event that markets over-correct.

Greece has been front and centre in the financial news for a couple of months. As of writing, the situation has not been resolved. Nor will the results of this Sunday's referendum necessarily make things any clearer. Nor too is any solution likely to be clean and final. It is conceivable that we could be reading and writing about the Greek situation for several more years to come.

Contradictory Politics

The Greek political situation is inherently contradictory: in the January election, voters gave the ruling party a mandate (if 36% of the vote can be called that) to stand up to creditors' demands for structural economic reforms even as public opinion polls have consistently shown a strong preference (70%+) for staying within the euro.

This is reflective of a fractious political mindset throughout much of Europe. The U.K.'s commitment to holding an "in/out" referendum on its EU membership by 2017, a challenging upcoming Spanish general election, and the growing polling strength of "euro-skeptic" parties across the region suggest that voters throughout Europe are restive.

Up until this week, one would have been hard-pressed to see this by looking at financial markets.

Since the middle of April, even as Greece dominated the headlines, the euro strengthened by 9% versus the U.S. dollar. The Eurostoxx index, after gaining 37% from October to April, had given back less than one-fifth of that advance.

European economic performance explained much of this market equanimity. Q1 GDP growth for almost every country in the EU exceeded market forecasts. Economists' estimates for the rest of the year were duly raised and may be boosted further. Importantly, European banks appear to be back in the business of lending money. Loans to the private sector have grown for five consecutive months after falling nonstop for three years.

Further, the Greek drama had no noticeable impact on North American markets. Pundits fretted endlessly about Fed intentions, but through this the S&P 500 managed to flirt with new highs. Meanwhile, the S&P/TSX was only about 5% off its September 2014 all-time high, despite the carnage visited on the heavyweight (approximately 30% of the index) energy, gold, and commodity sectors over that

Short of an
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period. Treasury and Government of Canada bond yields were moving higher, not falling as one would expect if there was growing risk aversion in the market.

Weekend Seismic Shift

That may have changed with the events of this past weekend. Our position is that markets are now correcting to reflect the much higher probability of a Greek exit from the euro or at least the unexpected interjection of a referendum. The latter carries with it a much longer interval before any deal with its eurozone partners could be concluded.

Short of an out-of-left-field agreement, which we don't expect to materialize, this period of uncertainty is likely to last several weeks, possibly months.

In order to become something worse than a correction, in our view, global credit conditions would have to deteriorate sufficiently to usher in a renewed global economic downturn. In particular, the U.S., Canada, the U.K., Germany, and the other core developed economies of the eurozone would have to be heading toward recession brought on by a sudden tightening of credit conditions.

We believe this is unlikely. Central banks are accommodative, and commercial banks are in much better shape than they have been in many years. Eurozone banks raised large amounts of new capital last year. And in December, the results of the European Central Bank's stress test revealed that all but a handful were in a position to withstand much greater turmoil than any Greek outcome is likely to deliver.

Unlike Lehman Brothers, whose debt obligations were spread throughout the financial system, about 80% of Greek debt is concentrated in the hands of eurozone central banks and the International Monetary Fund. Of the 20% in the hands of the private sector, a substantial piece is held by Greek banks, almost nothing by foreign banks.

So, by our reckoning, the systemic risks outside of Greece are not large.

And elsewhere, after a weather/port strike-induced Q1 blip, the important U.S. economy appears to be strengthening. Employment, wages, housing construction, autos, as well as consumer and business confidence are all on the upswing. This holds positive ramifications for its many trading partners and for global attitudes.

Risk Management Always Appropriate

Good portfolio management practice argues for building in a margin for error. In the period we have been living through, during which share prices have been mostly rising since the financial crisis lows of 2009, this has become progressively harder to do as risks have been consistently to the upside.

And our base case continues to be that notwithstanding corrections such as the one we think may be unfolding, share prices should move higher on balance over the next couple of years.

That said, we see at least two actions as always appropriate: rebalancing portfolios to bring overall equity exposure back toward long-term strategic targets and culling individual stocks that are no longer delivering the business results expected of them. We would use the coming days to ensure that portfolios are correctly balanced between acknowledging near-term risks and pursuing longer-term opportunity.



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THE CANADIAN CONSUMER: NOT DOWN AND FAR FROM OUT

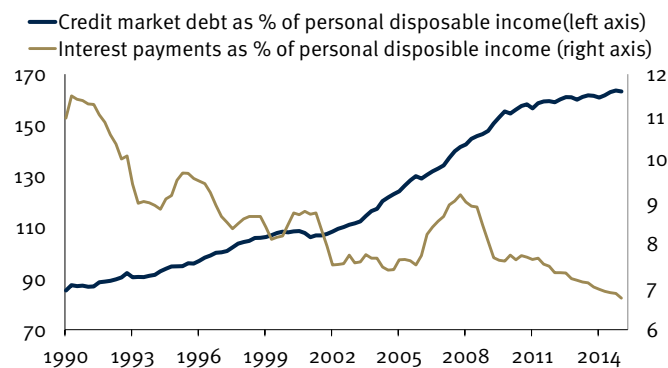
Based on the headlines, the future looks murky for the average Canadian household. Oil prices have collapsed, the housing market may be a bubble poised to burst, debt levels are unsustainably high and incomes are stagnating. However, a closer examination of the facts suggests that reality may not be as bad as headlines would suggest.

While household debt levels have risen, so have assets, with the result that the net wealth of Canadian households has reached record levels. Furthermore, the cost of servicing that debt is near record lows. Home prices may be frothy in certain markets but on a nationwide basis the housing market remains reasonably well balanced. Finally, the job market continues to tighten despite the energy market dislocation. Before declaring the demise of the Canadian consumer, we believe it is important to look beyond the headlines and explore these issues in greater detail.

CANADIAN HOUSEHOLD NET WEALTH AT RECORD LEVELS

Over the past several years, numerous reports have focused on the record high debt levels of Canadian households. The measure most often cited is household debt to disposable income.

Canadian Household Leverage and Debt Service Costs



Source - Statistics Canada, RBC Economics Research

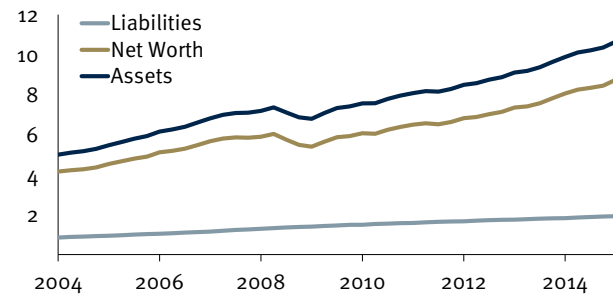
Household leverage is elevated but moderating while debt service costs are expected to remain near historical lows.

While the chart is intimidating, it fails to address the asset side of the consumer balance sheet. And while debt levels have indeed surged, so have assets, a fact that most analyses fail to acknowledge.

Over the past five years, the aggregate liabilities of Canadian households have grown at an annual rate of 5.2% from \$1.5 trillion to \$1.9 trillion. But, over that same time span, aggregate household assets have expanded an annual rate of 7.1% from \$7.6 trillion to \$10.7 trillion. The net effect of this growth has been an expansion in household net worth from \$6.1 trillion to \$8.7 trillion, a better than 7% annual clip. The growth in net worth has not just been a function of inflating home prices. In

Canadian Households Aggregate Balance Sheet

CA\$ Trillion



Source - Statistics Canada, RBC Economics Research

Growth in household assets has outpaced growth in liabilities over the past five years, leading to an expansion in net worth.

fact, according to Statistics Canada, the contribution of non-financial assets (i.e., real estate) to household net worth has actually declined modestly over the past decade.

It should also be noted that growth in household debt has been moderating. Part of this can be attributed to self-regulation in the face of higher debt burdens. This can also be attributed to macro-prudential rule changes such as those that have tightened mortgage lending rules in recent years.

A final item worth noting when it comes to household leverage levels is that the cost to service debt remains at historical lows. Further, RBC Economics analysis suggests that debt service costs are expected to stay low despite an expected increase in Government of Canada 5-year bond yields through its forecast horizon.

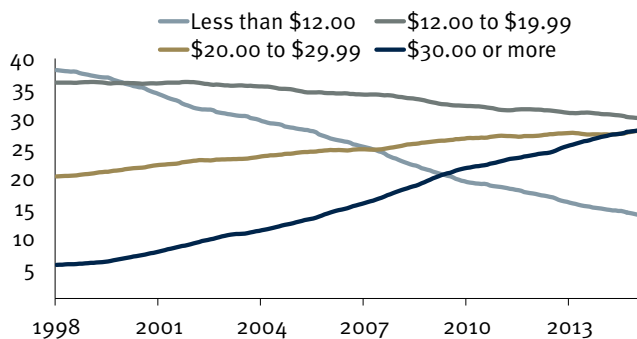
LABOUR MARKET MAKING STEADY GAINS

Beyond an incomplete characterization of household balance sheets, we believe another often overlooked aspect of the Canadian consumer's story is firming labour market conditions. In the first four months of 2015, 43,000 jobs were created with the unemployment rate holding steady at 6.7% despite the dislocation in the energy market.

With growth in employment have come signs that wage growth is starting to accelerate. Wage data indicates that a rising proportion of jobs are higher-wage positions. In 1998, over 35% of Canadian workers made less than \$12/hour. Today, that proportion is less than 15%. Conversely, just over 5% of Canadian workers made more than \$30/hour in 1998. Today, that proportion is 25%.

Employment Distribution by Hourly Wage

Share of all employees, 12-month moving average



Source - Statistics Canada, RBC Economics Research

An increasing proportion of jobs are higher-wage positions.

In addition to firming employment and wage growth, Canadian consumers are still benefitting from relief at the gas pump while core inflation has largely trended at or below the Bank of Canada's 2% target.

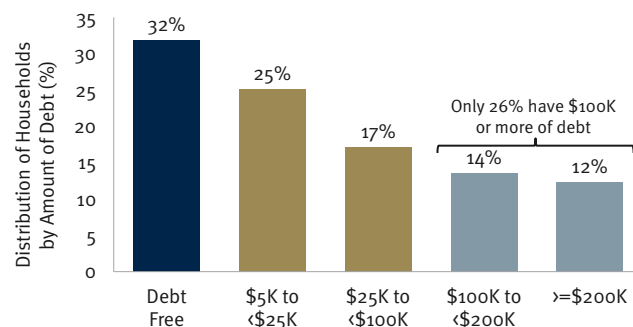
AVERAGES OBFUSCATE KEY DETAILS ON CANADIANS' DEBT BURDEN

When it comes to the debt burden of Canadian households, we believe it is important to further unpack the details hidden beneath average leverage levels. Namely, it is important to understand who specifically is responsible for Canadian household debt and where most of the debt has gone.

The use of proceeds matters. In any instance where a loan is arranged, among the first questions asked is "what the use of proceeds?" In the short term, a loan earmarked for consumption will boost economic growth regardless of what is purchased. Longer-term, however, how the money is spent matters greatly. For instance, mortgage loans, which constitute ~70% of total outstanding household credit, are more beneficial as they contribute to asset accumulation, which helps provide a more sustainable economic lift. On the other hand, loans geared to discretionary spending offers little long-term benefit.

Also hidden beneath the averages are the specific income demographics responsible for Canadian household debt. The majority of Canadian households have little to no debt (i.e. less than \$25,000). Further, the minority of households that owe the majority of the aggregate household debt fit a favourable income demographic profile with respect to their ability to service and repay their borrowings. Higher-income Canadians carry more debt than their lower-income counterparts while credit growth in recent years has been slanted to those with higher credit scores. Indeed, the heaviest debt burdens are borne by those households that are early- to mid-career that often have the benefit of dual incomes and a lengthy time in the workforce ahead.

Most Canadian Households Not Too Heavily Indebted



The majority of Canadian households carry little to no debt.

Source - Ipsos Reid, RBC Global Asset Management; data as of 2014

CONCLUSION

Household debt accumulation is justifiably closely followed, though its current level does not portend impending ruin. While the energy market dislocation and housing affordability in certain markets may pose a challenge, the underlying health of the Canadian consumer is better than is often portrayed. Wealth levels are on the rise, labour market conditions are improving, and the composition of and demographics responsible for Canadian household credit appear sustainable. As such, we believe the Canadian consumer is poised to continue to be a substantial contributor to economic growth.



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JAPAN: THE ROAD TO REFLATION

EXECUTIVE SUMMARY

We upgraded Japanese equities to Overweight in June 2013, and updated our thesis last June in our report *Abe, Abe, & Away*. We revisit the core of the thesis, introduce several new items for the consideration of equity investors, and provide an outlook for the equity market. We maintain our Overweight stance.

Following is an executive summary of a special report, *Japan: The Road to Reflation*. Please find the full report [here](#).

HARD TIMES

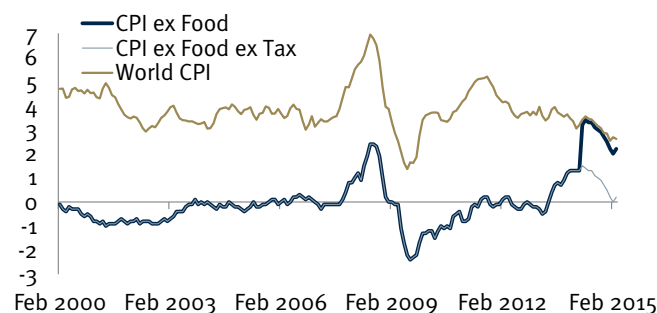
It has been two-and-a-half years since Shinzo Abe took the reins as Japan's prime minister and, aided by Haruhiko Kuroda, Bank of Japan (BoJ) governor, introduced his aggressive policy regime with one purpose above all: to clear the Dickensian fog of deflation that had engulfed Japan, the world's third-largest economy, for close to a generation. It has been a bumpy ride. Growth has been uneven and sometimes negative.

Yet, equity performance has been particularly good, despite equities no longer being at rock-bottom prices and with minimal movement in the USD/JPY exchange rate in the first quarter. We believe the inflation story remains the main pillar of support.

A TALE OF TWO INFLATION RATES

For equity investors, Japan's inflationary ambition is critical on a number of fronts. Have the authorities been successful in stoking prices? Japan's consumer price inflation (CPI) and core CPI were generally negative for 15 years before the current policy initiative began. Both CPI and core CPI hit bottom in Q1 2013, but have been rising since then. However, the pace of gains has slowed consistently over the past year. Moreover, if we remove the inflationary impact of the April 2014, sales tax increase, which by definition raised prices instantly, price increases have all but evaporated in recent months.

Consumer Price Inflation: Japan & Global



The recent downturn in Japanese inflation closely mirrors the global pattern.

Source - RBC Wealth Management, Bloomberg; data through March 2015

“Restoring Japan’s Earnings Power” is the first item listed in Abe’s *Japan Revitalization Strategy*.

One could characterize this as a policy failure. Such criticism would be harsh. In 2013, Governor Kuroda targeted a 2% inflation rate within roughly two years. However, the primary measure of success should surely be that policy has created sustained price increases of any size, even if below target.

Besides, waning inflation should be a transitory phenomenon, in our view. The slowdown in inflation over the past year almost mirrors the decline in global inflation over the same period.

Importantly, inflation expectations remain positive. Companies expect prices to rise by 1.5% over the next year and by 1.6% per annum over the next three and five years.

The BoJ expects to achieve its 2% target around mid-2016. If this does not occur, we believe investors should expect further stimulus from the BoJ.

GREAT WAGE EXPECTATIONS

A vital component of the reflationary effort is to promote wage inflation which has mirrored price deflation during the malaise.

Japan’s employment situation is quite robust, with its 3.2% unemployment rate the lowest since 1997. The Tankan survey indicates that employment conditions are continuing to tighten. For small and medium-sized enterprises (SMEs), the largest employers in the country, employment conditions are at their tightest levels since the early 1990s.

The bad news is that while nominal wages have started to rise, albeit at a modest pace, real wage growth has yet to materialize. In short, wages, which have been rising modestly over the past two years, have failed to match inflation.

However, we expect wage growth to improve. In March 2015, Kuroda said that “the environment is ready for wage hikes, considering recent employment conditions and corporate earnings.”

THE MYSTERY OF THE THIRD ARROW

Abe labeled the three overarching branches of his plan for economic revitalization as “three arrows.”

The first and second arrows of his policy are monetary and fiscal policy. The third arrow refers to 10 areas of structural reform, spanning the agricultural sector, corporate governance, the tax system, the labour market, immigration, health care, and free trade agreements. These reforms were set out in full by the government in an extensive report titled *Japan Revitalization Strategy* (revised in June 2014).

There is a clear focus on improved corporate performance. Indeed, the first policy measure listed in the *Strategy* is “Restoring Japan’s Earnings Power,” with subheadings such as “enhancing corporate governance.”

Corporate Taxes: At the start of 2015, Japan had an effective rate of around 35%. In March, the Diet approved a 3.29% reduction over a two-year period. The administration would like to reduce the rate to under 30% over a five-year period.

Labour Market: Labour market reform is extremely important. “Cultivating Human Resources – Promoting women’s social participation and reforming working styles” is listed as the second key policy measure in the *Strategy*.

Japan's female labour force participation is relatively low. And many women are employed in lower-paid part-time or contract positions. The government is already pushing forward measures to provide a substantial increase in childcare facilities by 2018, as well as to push companies to hire more women into senior positions.

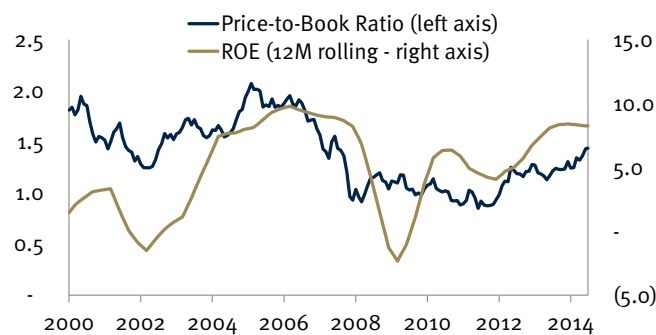
Public Fund Reform: In last year's report, we noted that the Government Pension Investment Fund (GPIF), the largest such fund in the world with approximately US\$1.1T of assets, would likely make significant changes to its asset allocation. In October 2014, the GPIF announced it would increase its equity allocation to 50% from 24%. The portion of domestic stocks would be raised to 25% from 12%. In March, three other pension funds announced they would shift their allocations to match the GPIF allocation.

EQUITY TWIST

Japanese equities have re-rated from a particularly low valuation base of 0.9x book value in 2009 to 1.4x at present. While this multiple is only one-half the S&P 500 price-to-book multiple, return on equity (ROE), an important measure of profitability, is only 8.7%. The large amount of cash held on corporate balance sheets is one reason for the low ROE in Japan. Cash and cash-equivalents account for over 20% of market capitalization of Japanese companies (excluding financials).

Japan's corporate cash pile could eventually lead to a change in dividend policies. The *Strategy* document does mention the distribution of dividends as a means of "returning the benefits of economic growth."

TOPIX Price-to-Book Valuations Versus Return on Equity



Source - RBC Wealth Management, Bloomberg; data through 5/15/15

TOPIX valuations are undemanding on a price-to-book basis, while ROE has moved higher in recent years.

LITTLE MERIT

Despite the solid performance of Japanese stocks, we still believe that investors are not giving enough credit to current developments. Earnings have already surpassed the prior cycle-high of 2007, and consensus forecasts are for further growth. Yet, the TOPIX remains well below its 2007 peak.

The biggest risk, in our opinion, would be a return to a deflationary environment, which would be a hammer blow.

Whether this is a new dawn for Japanese equities depends largely on whether the policies of the third arrow are successfully implemented. Japan faces several herculean challenges, not least of which are its dwindling population and significantly unbalanced workforce. But, we do know that Abe has a strategy ... and some of it is already working.

REBALANCE

The growing likelihood of a Greek default and exit from the euro has been enough to push markets down sharply. Extreme volatility in the Shanghai market has been another source of concern. Both of these may linger as de-stabilizing issues long enough to keep global equity markets unsettled through the summer and into the fall. However, we regard them as unlikely to derail the long-term uptrend in most major markets that is being driven by strengthening economies in North America and much of developed Europe.

In the near term, we recommend reviewing portfolios and bringing equity exposure back to strategic target weights.

REGIONAL HIGHLIGHTS

UNITED STATES

- The S&P 500 has inched up 0.2% year to date. We expect better performance in the second half of the year as the economy gains momentum and earnings improve.
- Q2 should be the inflection point for S&P 500 earnings. The consensus forecast is calling for a modest year-over-year decline mainly due to another massive hit from the energy sector. Outside of energy, the outlook appears favorable. Seven of 10 S&P 500 sectors are forecast to deliver growth; financials will likely lead with double-digit profit gains. Overall, estimates have been trimmed to such a degree that Q2 earnings should exceed expectations, and profits should rise in Q3 and Q4 along with the economy. Among sectors, we continue to favor financials, health care, and technology.

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Equity Views

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

Source - RBC Wealth Management; see "Views Explanation" on [page 3](#) for details.

CANADA

We continue to recommend market weight exposure to Canadian stocks. On a sector-specific basis, we recommend the following:

- **Market weight financials:** Credit likely to deteriorate in back half of year; however, valuations appear compelling.
- **Underweight telecom:** Lack of secular drivers.
- **Overweight consumer:** Low oil prices are likely to provide some further stimulus for the consumer.
- **Overweight industrials:** Overreaction to weaker Q1 growth provides a compelling entry point for many names. Weaker loonie should provide a boost to sales and earnings.
- **Underweight energy and materials:** Slowing Chinese growth continues to weigh on demand for most commodities. Oil oversupply remains a concern.

Against this backdrop, we recommend domestic Canadian investors continue to allocate money to the U.S. market, which we believe offers more compelling opportunities.

CONTINENTAL EUROPE & U.K.

- June marked the return of macro-led equity markets, and this is likely to continue. Greek negotiations and the U.S. interest rate cycle should drive performance going forward.
- Market valuations no longer appear cheap on a price-to-earnings basis—Europe ex U.K. and the U.K. trade on 16.2x and 16.3x 2015 earnings, respectively. However, earnings are still at depressed levels and we see valuation room on a price-to-book value basis, suggesting more upside is possible. We are happy to remain invested, though a focus on robust fundamentals is key, in our view.
- While we maintain our bias towards quality stocks, some exposure to cheaper, recovering sectors is also warranted. We believe the telecoms sector, in particular, with its improving pricing dynamics, seems fertile ground for investor consideration.

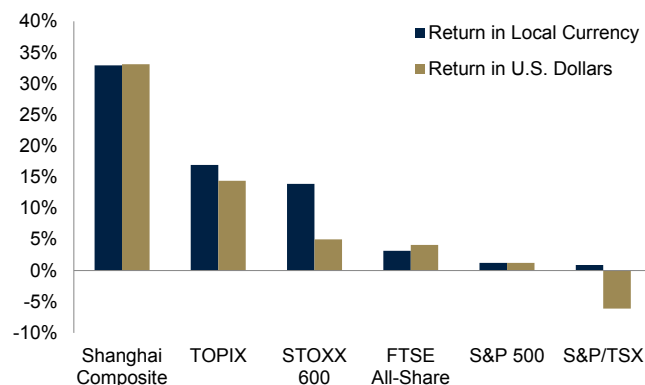
ASIA

- Mainland Chinese stocks corrected sharply in the middle of June. This was of little surprise following the dramatic gains in stocks earlier in the year. The rapid correction presents

the biggest test of the bull market to date, in our view. Valuations differ significantly among sectors in the mainland. Chinese H-shares listed in Hong Kong, which trade at more reasonable valuations, were less volatile.

- Directly after the pronounced, single-day decline in equities on June 26, the People's Bank of China reduced its benchmark lending and deposit rates and the reserve-requirement ratio for many banks. This was the fourth rate cut since November 2014 and the first that appears to have been a direct response to movements in the stock market. The 1-year benchmark lending rate is 4.85%, providing further scope for policy easing.
- Three Japanese pension funds announced plans to follow the change in asset allocation undertaken by the Government Pension Investment Fund, the largest such fund in the world with approximately \$1.1T in assets. Accordingly, these funds will significantly increase their exposure to both domestic and international stocks.

Year-to-Date Returns for Major Equity Indexes

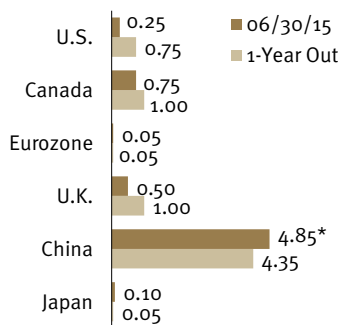


Asian markets have led through the first half of the year in local currencies and dollars.

Source - RBC Wealth Management, Bloomberg

POSITIONED FOR LIFE AFTER LIFTOFF

Central Bank Rate (%)



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

We believe trading could be volatile for shorter-dated bonds ahead of the July Federal Open Market Committee's (FOMC) policy meeting (concludes July 29). We expect the statement to provide further clarification on whether or not the Federal Reserve will exit its zero interest rate policy (ZIRP) at some point in 2015. The eventual end of ZIRP has global implications across asset classes, which suggests to us that investors should focus more on the longer-term implications (i.e., the tightening cycle) of such a move rather than the exact timing of it.

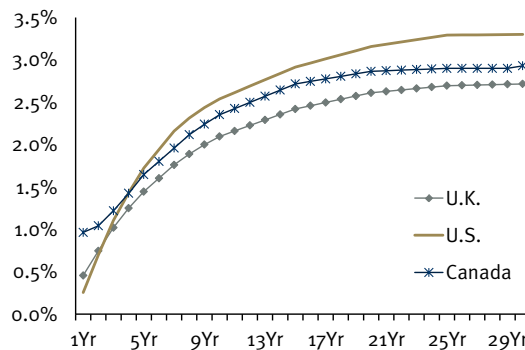
The stabilization in government bond markets has provided investors an opportunity to add exposure to corporate bonds given the attractive pick-up in incremental yield. While shorter-dated bonds are likely to be volatile, intermediate and longer-dated securities should remain comparatively stable. Yields in the 7- to 10-year part of the yield curve sit close to fair value, in our opinion. It was our position entering June that bond yields were unlikely to continue a march higher given growth and inflation did not justify such a move. Yields have since stabilized and we expect them to remain close to current levels in the near term.

REGIONAL HIGHLIGHTS

UNITED STATES

■ While the consensus views the July 29 FOMC meeting as potentially signaling that September will be the stepping off point for the first Fed rate hike in seven years, we believe December remains the more likely targeted date. The Fed

Sovereign Yield Curves



Source - RBC Wealth Management, Bloomberg

has made it clear that its decisions will be data dependent and with only one jobs report between now and the July confab, and Fed Chair Janet Yellen indicating that she plans to skip August's Jackson Hole Economic Symposium (a frequent launching point for Fed policy announcements in past years), we see the September "bar" as extremely high.

- Investment-grade credit spreads continued to widen in June to reach the highest levels in nearly two years. Though the Treasury bond selloff is a primary driver, we are also seeing early signs of deteriorating credit metrics as greater corporate confidence has boosted share buyback and merger activity, and the additional debt to finance it.
- Investors pulled nearly \$9B out of investment-grade and high-yield bond funds in the first two weeks of June following the stronger-than-expected payrolls report. Outflows turned to inflows following the "dovish" FOMC meeting; we expect Fed sentiment to continue to drive "seesaw" action in bond fund flows into year-end.

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CANADA

- The Canadian preferred share market reached new all-time lows. Supply, including the first perpetual preferred shares in over a year, rates volatility, and investor uncertainty continued to weigh on the market. We believe the valuations on certain preferred shares are attractive at current levels. However, the external pressures could persist for some time.
- Recent economic data has been mixed, with May retail sales coming in slightly weaker than expected while headline inflation moved slightly higher to 0.9%. The core rate, excluding the most volatile components, eased to 2.2%.
- Ratings downgrades have become more prevalent in the Canadian corporate credit market as the low rate environment has incited many companies to add more debt. The BBB segment now represents 34% of the Canadian investment-grade bond market, up from 15% in 2007.

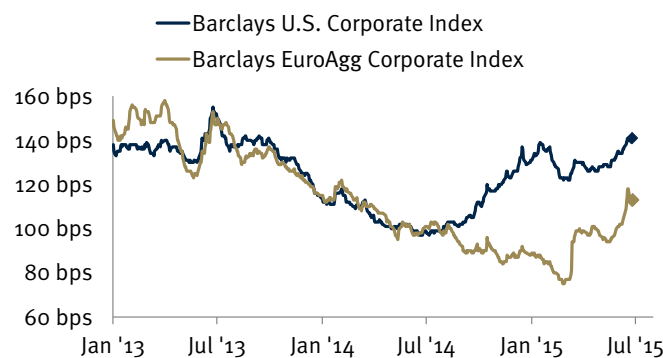
CONTINENTAL EUROPE & U.K.

- Greece and its European partners had not finalized a bailout agreement as the end of June approached, but we doubt this will represent the resolution to the country's debt crisis. The willingness of the European Central Bank (ECB) to provide further liquidity to Greece's banks has become a pivot point for the

next stage of the crisis after a full bank run in June was avoided only because of emergency support from the central bank. We expect heightened volatility in European bond markets to persist through July.

- A potential referendum in the U.K. on its membership in the EU, which was a key campaign pledge of Prime Minister David Cameron during his reelection campaign, is unlikely to affect the gilt market despite the topic remaining a focus of the media. S&P recently placed the U.K., which is rated AAA, on Negative Outlook given risks the agency sees associated with a potential referendum. Yet, we believe financial markets will continue to look past the risk of a referendum and instead focus on economic data, especially given a recent uptick in inflation. We continue to see value in shorter-duration positioning versus the benchmark positioning as longer-term rates may be vulnerable to an increase.
- Corporate spreads have widened in response to the broader global government bond selloff and the crisis in Greece. In fact, many sectors are currently trading at levels not seen since 2013. We expect spreads to compress in reflection of economic conditions in Europe. We see good value in many sectors, including financials, at current spread level.

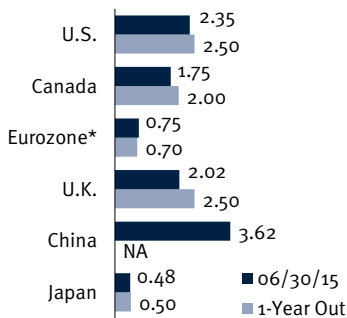
U.S. and European Investment-Grade Corporate Bond Spreads



A shift in focus back to solidifying fundamentals in the U.S. and Europe could bias spreads tighter.

Source - RBC Wealth Management, Bloomberg, Barclays

10-Year Rate (%)



*Eurozone utilizes German bunds.
Source - RBC Investment Strategy Committee, RBC Capital Markets, GPAC

Commodity Forecasts

	2015E	2016E
Oil (WTI \$/bbl)	54.00	74.00
Natural Gas (\$/mmBtu)	2.97	3.45
Gold (\$/oz)	1,250	1,300
Copper (\$/lb)	2.75	2.75
Corn (\$/bu)	3.86*	4.18
Wheat (\$/bu)	5.17*	5.56

*H2 2015

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

OIL

- We expect WTI and Brent prices to stay largely range-bound in coming months as supply concerns continue to weigh on the market, offset partly by nascent demand growth.
- At its June 5 meeting, OPEC reaffirmed the collective 30 million bbl/day production quota and its commitment to allow market forces to rebalance the market. The decision was expected by industry analysts and met with much less price volatility than that associated with the November meeting. We would note that OPEC has consistently exceeded its quotas over the past several quarters to the tune of about 1–2 million bbl/day.
- RBC Capital Markets updated its production forecast for Canada's oil sands through 2020. While it expects continued production growth, the forecast has been moderated to reflect lower crude oil prices. RBC Capital Markets projects average annual growth of approximately 220,000 bbl/day through the end of the decade versus its prior forecast of around 312,000 bbl/day.

COPPER

- Despite weaker-than-anticipated demand year to date, RBC Capital Markets expects the copper market to

remain roughly balanced in 2015 and 2016 followed by a deficit in 2017 and beyond.

- RBC Capital Markets toned down its price forecasts to reflect a more gradual tightening in the copper market. The key risk to its forecast is the strength of the global economy and China's economy in particular.

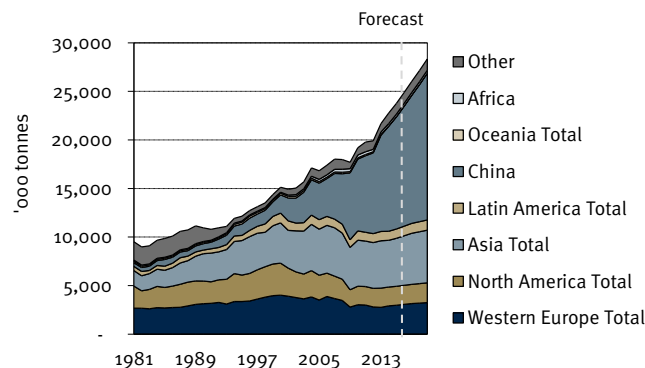
METALLURGICAL COAL & IRON ORE

- RBC Capital Markets estimates a total of 34 million tonnes of metallurgical coal production curtailments taking effect in 2014 and 2015. Despite this, the seaborne market is forecast to be in a 26.6 million tonne surplus next year.
- Iron ore prices have recovered from their recent lows. However, RBC Capital Markets does not believe the rally is sustainable without improved steel fundamentals.

GOLD

- Bullion struggled to find sustained price direction as U.S. dollar weakness in June failed to provide a tailwind.
- We continue to see \$1,150–\$1,400 as a reasonable expectation for gold's trading range. The status of Greece's negotiations with its creditors continues to be a key near-term catalyst for the gold market.

Global Refined Copper Consumption by Region



Copper demand has been weaker-than-expected in 2015 with slowing economic growth in China compounding the effect of weak demand growth elsewhere.

Source - Wood Mackenzie, International Copper Study Group, RBC Capital Markets estimates

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Currency Forecasts

Currency Pair	Current Rate	Forecast Jun 2016	Change*
USD Index	95.49	93.36	-2%
CAD/USD	0.80	0.78	-2%
USD/CAD	1.25	1.28	2%
EUR/USD	1.11	1.16	5%
GBP/USD	1.57	1.63	4%
USD/CHF	0.94	0.97	3%
USD/JPY	122.50	126.00	3%
AUD/USD	0.77	0.74	-4%
NZD/USD	0.68	0.67	-1%
EUR/JPY	136.54	146.16	7%
EUR/GBP	0.71	0.71	0%
EUR/CHF	1.04	1.13	8%
Emerging Currencies			
USD/CNY	6.20	6.80	10%
USD/INR	63.65	66.00	4%
USD/SGD	1.35	1.53	13%
USD/TRY	2.68	2.80	4%
USD/PLN	3.76	3.34	-11%
USD/MXN	15.74	14.25	-9%
USD/BRL	3.10	3.65	18%

* 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

- If the U.S. economy continues its recent improving trend, particularly with respect to consumer-related data, such as employment, housing, and wages, we expect looming inflation pressures to trigger the market's long-awaited interest rate hikes.
- This may increase volatility in currency markets, but we still expect the dollar to end the year higher, albeit with much more modest gains than in 2014.

EURO

- While the Greek drama has been dominating headlines, the euro seems to be following the stock market, in its own fashion (see chart).
- Since the advent of QE in Europe in January 2015, the euro has been weak when local stocks are strong, and vice versa. One factor may be that when foreign traders buy European stocks, much of the flow is currency-hedged, which entails euro selling. The hedges are unwound when stocks are sold, which partly explains the negative correlation.
- When the Greek crisis resolves, however, we expect relative interest rates to re-emerge as the main driver, which should continue to pressure the euro.

JAPANESE YEN

- We expect the yen to be one of the most sensitive G10 currencies to changes in U.S. monetary policy. This is due to a likely change in behavior by Japanese bond investors as they manage their foreign bond portfolios.
- In the current low interest rate environment, currency hedges are cheap, and this obviates the need to sell the yen outright to buy foreign bonds. But as U.S. rates rise, we expect the yen to lose this safety net, triggering further weakness.

BRITISH POUND

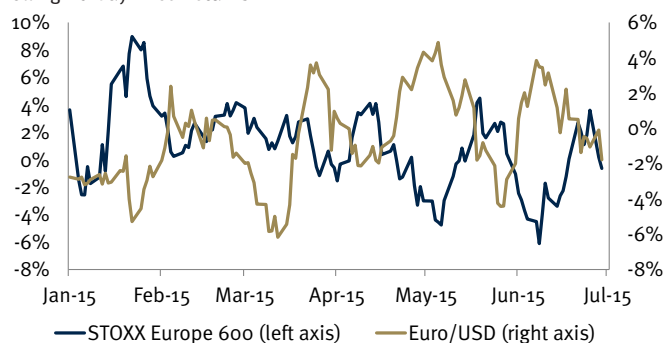
- U.K. economic data surprises to the upside, but we expect any rate hikes to come after those in the U.S., particularly if the new Conservative government introduces a tighter fiscal policy in its upcoming budget.
- However, sterling should continue to firm given that interest rate differentials are likely to widen against the currencies of most trading partners.

CANADIAN DOLLAR

- We expect the loonie to stabilize at slightly weaker levels against the dollar by Q3 2015 if and when energy prices stabilize. But recent solid economic data should lend support to the currency.

European Stocks Negatively Correlated to the Euro

Rolling 10-day Price Returns



Stocks have moved counter to the euro this year, partly due to currency hedging by foreign buyers.

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Source - RBC Wealth Management, Bloomberg, Thomson Reuters

Market Scorecard

Index (local currency)	Level	1 Month	YTD	12 Months
S&P 500	2,063.11	-2.1%	0.2%	5.2%
Dow Industrials (DJIA)	17,619.51	-2.2%	-1.1%	4.7%
NASDAQ	4,986.87	-1.6%	5.3%	13.1%
Russell 2000	1,253.95	0.6%	4.1%	5.1%
S&P/TSX Comp	14,553.33	-3.1%	-0.5%	-3.9%
FTSE All-Share	3,570.58	-6.0%	1.1%	-0.8%
STOXX Europe 600	381.31	-4.6%	11.3%	11.5%
German DAX	10,944.97	-4.1%	11.6%	11.3%
Hang Seng	26,250.03	-4.3%	11.2%	13.2%
Shanghai Comp	4,277.22	-7.3%	32.2%	108.8%
Nikkei 225	20,235.73	-1.6%	16.0%	33.5%
India Sensex	27,780.83	-0.2%	1.0%	9.3%
Singapore Straits Times	3,317.33	-2.2%	-1.4%	1.9%
Brazil Ibovespa	53,080.88	0.6%	6.1%	-0.2%
Mexican Bolsa IPC	45,053.70	0.8%	4.4%	5.4%

Retail investors jump ship.

Bond Yields	6/30/15	12/31/14	6/30/14	12-mo. Chg
US 2-Yr Tsy	0.643%	0.605%	0.457%	0.19%
US 10-Yr Tsy	2.353%	2.121%	2.530%	-0.18%
Canada 2-Yr	0.484%	0.569%	1.105%	-0.62%
Canada 10-Yr	1.683%	1.624%	2.237%	-0.55%
UK 2-Yr	0.562%	0.509%	0.867%	-0.31%
UK 10-Yr	2.024%	1.813%	2.670%	-0.65%
Germany 2-Yr	-0.227%	-0.225%	0.028%	-0.26%
Germany 10-Yr	0.764%	0.487%	1.245%	-0.48%

10-yr yields rose in June on Fed-induced volatility.

Commodities (USD)	Price	1 Month	YTD	12 Months
Gold (spot \$/oz)	1,172.42	-1.5%	-1.0%	-11.7%
Silver (spot \$/oz)	15.74	-6.1%	0.2%	-25.2%
Copper (\$/metric ton)	5,754.75	-4.2%	-9.6%	-18.3%
Uranium (\$/lb)	36.50	4.3%	-8.8%	29.2%
Oil (WTI spot/bbl)	59.47	-1.4%	11.6%	-43.6%
Oil (Brent spot/bbl)	63.59	-3.0%	10.9%	-43.4%
Natural Gas (\$/mmBtu)	2.83	7.2%	-2.0%	-36.5%
Agriculture Index	326.59	16.5%	1.3%	-6.6%

June marks seasonal low.

Currencies	Rate	1 Month	YTD	12 Months
US Dollar Index	95.49	-1.5%	5.8%	19.7%
CAD/USD	0.80	-0.3%	-7.0%	-14.6%
USD/CAD	1.25	0.3%	7.5%	17.1%
EUR/USD	1.11	1.5%	-7.9%	-18.6%
GBP/USD	1.57	2.8%	0.9%	-8.1%
AUD/USD	0.77	0.8%	-5.7%	-18.3%
USD/CHF	0.94	-0.5%	-5.9%	5.5%
USD/JPY	122.50	-1.3%	2.3%	20.9%
EUR/JPY	136.54	0.1%	-5.7%	-1.6%
EUR/GBP	0.71	-1.3%	-8.6%	-11.3%
EUR/CHF	1.04	0.8%	-13.4%	-14.2%
USD/SGD	1.35	0.0%	1.7%	8.1%
USD/CNY	6.20	0.1%	-0.1%	0.0%
USD/BRL	3.10	-2.4%	16.8%	40.1%

Dollar rally slows in 1H 2015.

Rate hike talk persists.

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 0.80 means 1 Canadian dollar will buy 0.80 U.S. dollar. CAD/USD -14.6% return means the Canadian dollar has fallen 14.6% vs. the U.S. dollar during the past 12 months. USD/JPY 122.50 means 1 U.S. dollar will buy 122.50 yen. USD/JPY 20.9% return means the U.S. dollar has risen 20.9% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 6/30/15.

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