APRIL 2012

RBC Wealth Management | Global Insight

This Month's Issue: China in Focus

Pay Attention to Policy

China is too big to ignore, yet not too opaque to figure out. Government rhetoric should provide a road map for investors to evaluate the impact of the country's economic slowdown. *— see page 6*

Commodities: Waiting on the Dragon

Commodity producers and distributors may have underestimated Chinese government policies. Commodity prices could remain vulnerable until this period of "gearing down" is over. *— see page 8*

In this issue

Priced as of March 30, 2012, unless otherwise stated.

RBC Wealth Management™

Global Insight is a monthly publication by the Global Portfolio Advisory Committee

Global Overview

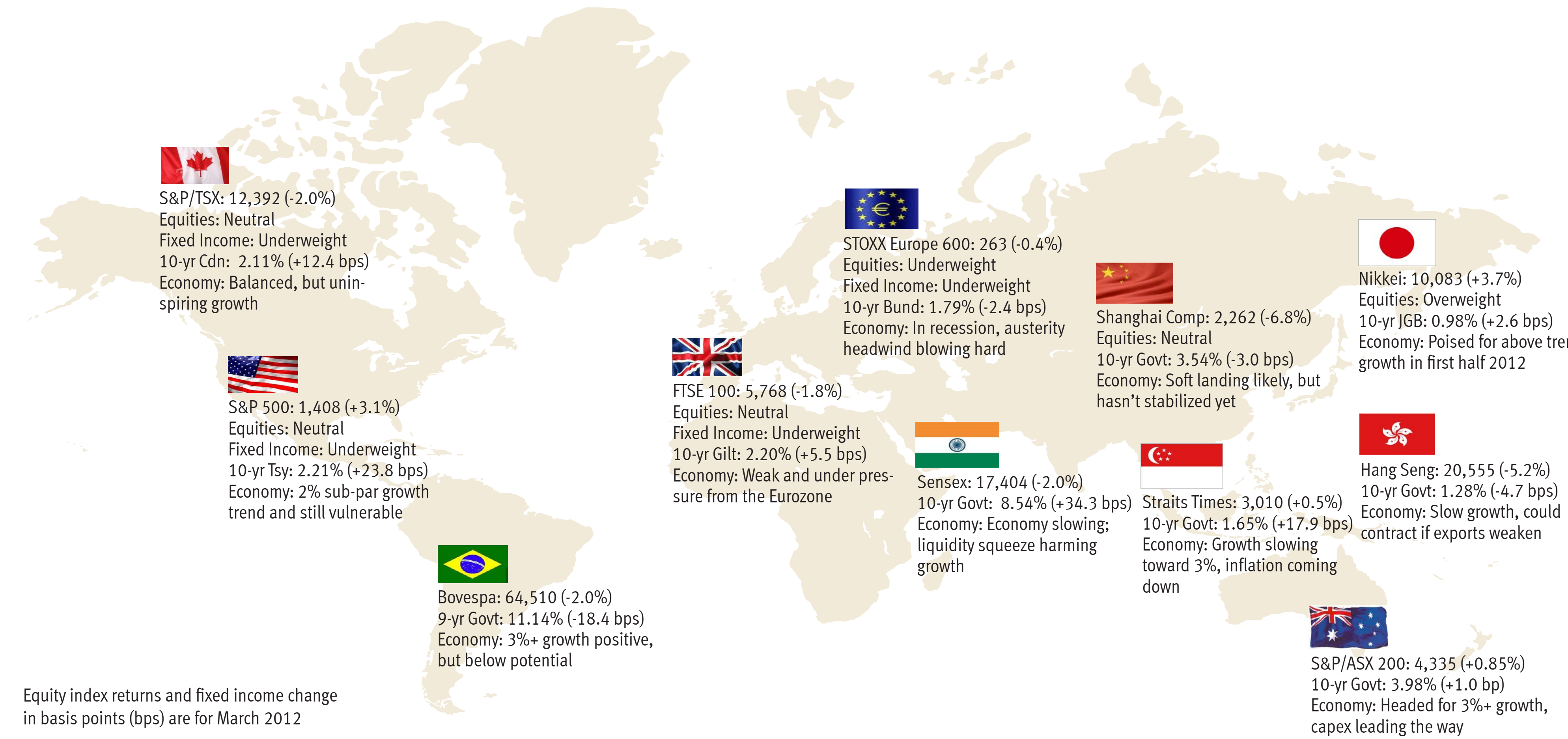
RBC's Investment Stance

We maintain our "Neutral" stance on global equities—that is, we recommend portfolios hold up to but no more than their benchmark, long-term allocation to stocks. The fragile nature of the global economic recovery and lingering Eurozone risks keep us from shifting to an "Overweight" stance. Also, stock prices have yet to fully reflect the very substantial U.S. fiscal/political risks we see coming to a head later this year.

In fixed income, we remain "Underweight," but recognize there are attractive opportunities in investment-grade corporate bonds and select regional subsectors. Despite our aversion toward safe-haven government bonds—they fail to adequately compensate the holder for inflation—we doubt the recent rise in yields reflects a sea change in the interest rate environment.

Global Asset Class View

Asset Class	View	Comment
Equities	=	Invested, but vigilant
Fixed Income	–	Unchanged
Cash	+	Maintain, but ready to allocate



Equity index returns and fixed income change in basis points (bps) are for March 2012

Financial Markets Commentary

- Successful U.S. bank stress tests and Eurozone stabilization helped boost equity markets. Safe-haven government bonds sold off, acknowledging conditions have changed.
- Markets have yet to peer over the "massive fiscal cliff" in front of the United States. After the November elections, Congress may have its hands full dealing with tax and spending policies. If key provisions expire as planned, the U.S. and global economies could suffer.

Three years ago markets were staring into the abyss due to the near collapse of the global financial system. Two large U.S. banks were on the verge of collapse and had to be rescued via forced merger and a massive injection of public money. Many others were in peril. Fast forward to today: equity markets are up significantly, and U.S. banks have improved their balance sheets to such a degree they are now overcapitalized.

Recently the Federal Reserve put major U.S. banks through extremely demanding stress tests to evaluate how they would fare during a severe domestic downturn assumed to feature an 8% plunge in GDP growth, a surge in unemployment to 13%, a roughly 50% decline in the stock market, and a further 21% decline in home prices. Among the 19 large banks examined, most passed with room to spare and received the Fed's blessing to raise dividends substantially and initiate stock buy-backs.

This all fueled a 7.3% rally in U.S. bank stocks in March and led many developed and emerging equity markets higher for the month. Canada was an exception as a pullback in precious metals and the continued correction in natural gas weighed on its resource-heavy stock market.

At the same time, safe-haven government bonds succumbed to a steep sell-off, and yields jumped to their highest levels in more than four months. Markets appeared to be acknowledging that conditions have stabilized compared to the crisis-ridden episodes of last fall when European banks appeared in danger of failing, the currency union unraveling, and the global economy slumping back into recession.

Back to Basics

This relative calm in Europe enabled markets to take a break from the sovereign debt crisis and refocus on the economic recovery.

U.S. growth is proceeding along at a sub-par rate, a trend that could persist for some time (see page 11). China's economy is transitioning to a slower, more sustainable pace. It seems headed for a soft landing but could be more drawn out and turbulent than commodity markets had hoped for (see pages 6 and 8).

Japan's economy, by contrast, is growing at an above-trend pace. This, combined with its relatively cheap valuation and loose monetary policies, are why we rate Japan's equity market "Overweight" (see page 21).

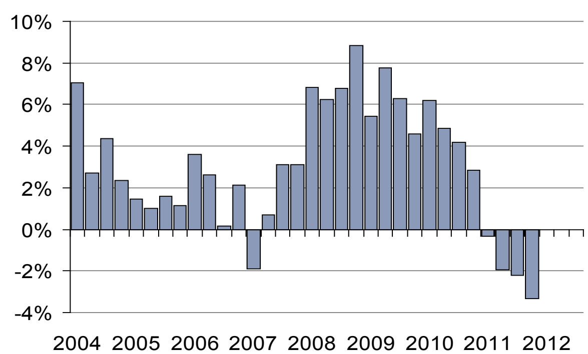
Europe is contending with a mild (so far) recession but could be vulnerable to a deeper downturn because the sovereign debt crisis, while off the front burner, is still simmering. Portugal is largely shut out of the private debt market and Spain's fiscal pressures are mounting. If Portugal and Spain were to deteriorate, the European interbank lending market could be right back in

Potential U.S. GDP Impact of Expiring Fiscal Provisions ($ bln)

Provisions	2013
Bush income tax rates expire; marginal rates rise	-$102
Social Security tax rate jumps back to 6.2%	-$120
Alternative Minimum Tax provisions	-$125
2011 spending cut legislation (debt ceiling deal)	-$70
Business tax provisions expire	-$55
Extended unemployment benefits expire	-$45
Fuel tax credit expires	-$6
Estate and gift tax rates jump back up	-$5
Total	-$528
Impact as a share of real GDP	**-3.80%**

Source: RBC Capital Markets, Haver Analytics

Real U.S. Federal Spending by Quarter (year-over-year % change)



Source: Federal Reserve Economic Data, St. Louis Fed; data through Q4 2011

the soup. Globally oriented U.S. banks may have passed their stress tests but aren't necessarily immune to derivatives risks related to Spain.

What's more, Europe will soon be facing elections in France and Greece, the Irish referendum, and parliamentary votes on the fiscal compact. Only 12 of the 17 euro area countries need to approve the fiscal compact; however, in Northern Europe it is already facing fiercer opposition than anticipated.

The U.S. Fiscal Cliff

In our assessment, the most underappreciated risk for the global economy and stock market is the "massive fiscal cliff" in front of the United States. Federal Reserve Chairman Ben Bernanke—not one to engage in hyperbole—coined the "massive fiscal cliff" phrase during his recent congressional testimony to describe the collection of automatic tax increases and spending cuts previously enacted by lawmakers that are scheduled to come into force January 1, 2013.

RBC Capital Markets' economists estimate these provisions would chop 3.8 percentage points out of GDP growth in 2013 (see upper table). If implemented, they could conceivably take the fragile economy right over the edge and into a recession and have serious knock-on effects for America's key trading partners, including Canada, China, Japan, Korea, and Latin America.

This stark recession risk may well prompt Congress to change at least some of these provisions before year end. But it could be a contentious, last-minute exercise. Campaign season dynamics could push some of these issues into a "lame duck" session after the November elections. If policy negotiations produce intense gridlock similar to the 2011 debt ceiling debate or if the outgoing Congress' solution lacks credibility, financial markets would likely express dissatisfaction at the very least.

Even if Congress manages to address the bulk of these issues and only one-third of the provisions are implemented, the private sector would need to grow well above trend in 2013 to maintain overall GDP growth of 2.0%—a formidable task.

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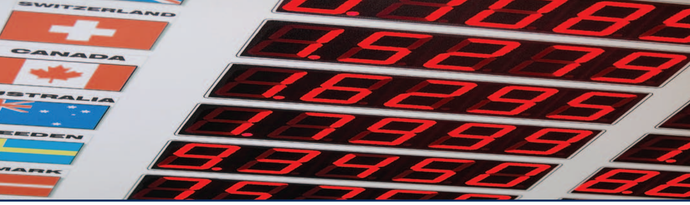


Market Scorecard

Index (local currency)	Level	1 Month	YTD	12 Month
S&P 500	1,408.47	3.1%	12.0%	6.2%
S&P/TSX Comp	12,392.18	-2.0%	3.7%	-12.2%
FTSE 100	5,768.45	-1.8%	3.5%	-2.4%
Hang Seng	20,555.58	-5.2%	11.5%	-12.6%
Dow (DJIA)	13,212.04	2.0%	8.1%	7.2%
NASDAQ	3,091.57	4.2%	18.7%	11.2%
Russell 2000	830.30	2.4%	12.1%	-1.6%
STOXX Europe 600	263.32	-0.4%	7.7%	-4.6%
German DAX	6,946.83	1.3%	17.8%	-1.3%
Nikkei 225	10,083.56	3.7%	19.3%	3.4%
Straits Times	3,010.46	0.5%	13.8%	-3.1%
Shanghai Comp	2,262.79	-6.8%	2.9%	-22.7%
Sensex	17,404.20	-2.0%	12.6%	-10.5%
Brazil Bovespa	64,510.97	-2.0%	13.7%	-5.9%

Bond Yields	3/30/12	2/29/12	3/31/11	12 Mo Chg
US 2-Yr Tsy	0.329%	0.293%	0.821%	-0.49%
US 10-Yr Tsy	2.209%	1.971%	3.470%	-1.26%
Canada 2-Yr	1.197%	1.097%	1.831%	-0.63%
Canada 10-Yr	2.111%	1.987%	3.350%	-1.24%
UK 2-Yr	0.419%	0.413%	1.356%	-0.94%
UK 10-Yr	2.204%	2.149%	3.689%	-1.49%
Germany 2-Yr	0.206%	0.191%	1.790%	-1.58%
Germany 10-Yr	1.794%	1.818%	3.354%	-1.56%

Commodities (USD)	Price	1 Month	YTD	12 Month
Gold (spot $/oz)	1,668.35	-1.7%	6.7%	16.5%
Silver (spot $/oz)	32.27	-6.9%	15.9%	-14.3%
Copper ($/ton)	8,474.50	-0.2%	11.7%	-10.0%
Uranium ($/lb)	51.00	-1.9%	-1.4%	-18.4%
Oil (WTI spot/bbl)	103.02	-3.8%	4.2%	-3.5%
Oil (Brent spot/bbl)	124.86	-0.3%	14.9%	5.5%
Natural Gas ($/mlnBtu)	1.98	-18.9%	-33.6%	-54.1%
Agriculture Index	444.17	-0.4%	2.3%	-16.6%

Currencies	Rate	1 Month	YTD	12 Month
US Dollar Index	79.00	0.3%	-1.5%	4.1%
CAD/USD	1.00	-0.9%	2.3%	-2.8%
USD/CAD	1.00	0.9%	-2.2%	2.9%
EUR/USD	1.33	0.1%	3.0%	-5.7%
GBP/USD	1.60	0.6%	3.0%	-0.1%
AUD/USD	1.03	-3.6%	1.3%	0.2%
USD/CHF	0.90	-0.2%	-3.8%	-1.8%
USD/JPY	82.87	2.1%	7.7%	-0.3%
EUR/JPY	110.56	2.2%	10.9%	-6.1%
EUR/GBP	0.83	-0.5%	-0.1%	-5.7%
EUR/CHF	1.20	-0.1%	-1.0%	-7.5%
USD/SGD	1.26	0.5%	-3.0%	-0.2%
USD/CNY	6.30	0.1%	0.1%	-3.8%
USD/BRL	1.83	6.4%	-2.1%	12.0%

Source: Bloomberg, RBC Wealth Management; data through 3/30/12. 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 1.00 means 1 Canadian dollar will buy 1 U.S. dollar. CAD/USD -2.8% return means the Canadian dollar has fallen 2.8% vs. the U.S. dollar during the past 12 months. USD/JPY 82.87 means 1 U.S. dollar will buy 82.87 yen. USD/JPY -0.3% return means the U.S. dollar has fallen 0.3% vs. the yen during the past 12 months.

China in 2012: Pay Attention to Policy

- Those hoping for a rapid reacceleration of Chinese growth are likely to be disappointed.
- Statements made at the National People's Congress suggest policy easing will be deliberate and "prudent."
- Shifting priorities place an emphasis on "higher quality," more sustainable growth.

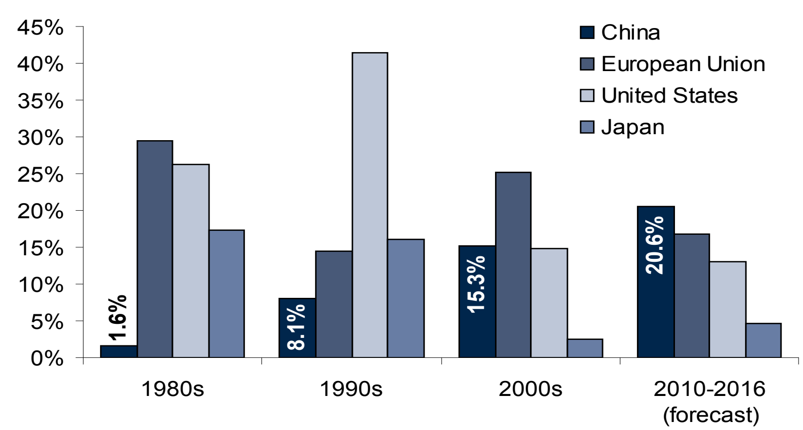
Unsurprisingly, the phrase "to have one's cake and eat it" does not translate literally into Chinese. Instead, a common Chinese phrase is "鱼与熊掌不可兼得," which means "you cannot have a fish and a bear paw at the same time." When it comes to the Chinese economy in recent years, it appears some investors have wanted both bear paws and fish, first fretting the Chinese economy was overheating and then worrying it is slowing down too much.

China garners so much attention from investors globally because it has become a major contributor to global GDP growth (see chart). Investors now ask how long the slowdown will last, to what level GDP growth will fall, and what a China slowdown means for global commodity demand.

While there are a range of possible outcomes to these questions, the data thus far continue to point to a gradual slowdown in the economy. Indeed, this has been the clearly stated aim of government policy for some time now. GDP growth moderated from 10.4% in 2010 to 9.2% in 2011, and RBC Capital Markets forecasts a decline to 8.4% in 2012. Consumer price inflation peaked in July 2011 at 6.5%, primarily due to high food prices, and has since fallen to 3.2% in February. Housing prices appear to have peaked in August 2011 and have since been gradually moderating (although generalizations are hard to make due to the hundreds of cities in China and the different levels of development across regions). Growth in the Chinese export machine has also moderated as external demand, particularly from Europe, has weakened.

Recently, the Chinese government provided a number of targets for 2012, via the Government Work Report, which reviews progress in the previous year and the outlook for the next year and was issued to the National People's Congress in March, and via comments from Premier Wen Jiabao. Given the outsized influence of the government in China, investors looking for

Share of Nominal Global GDP Growth



Source: International Monetary Fund

Jay Roberts – Hong Kong, China
jay.roberts@rbc.com
Yang Yufei – Hong Kong, China
yufei.yang@rbc.com

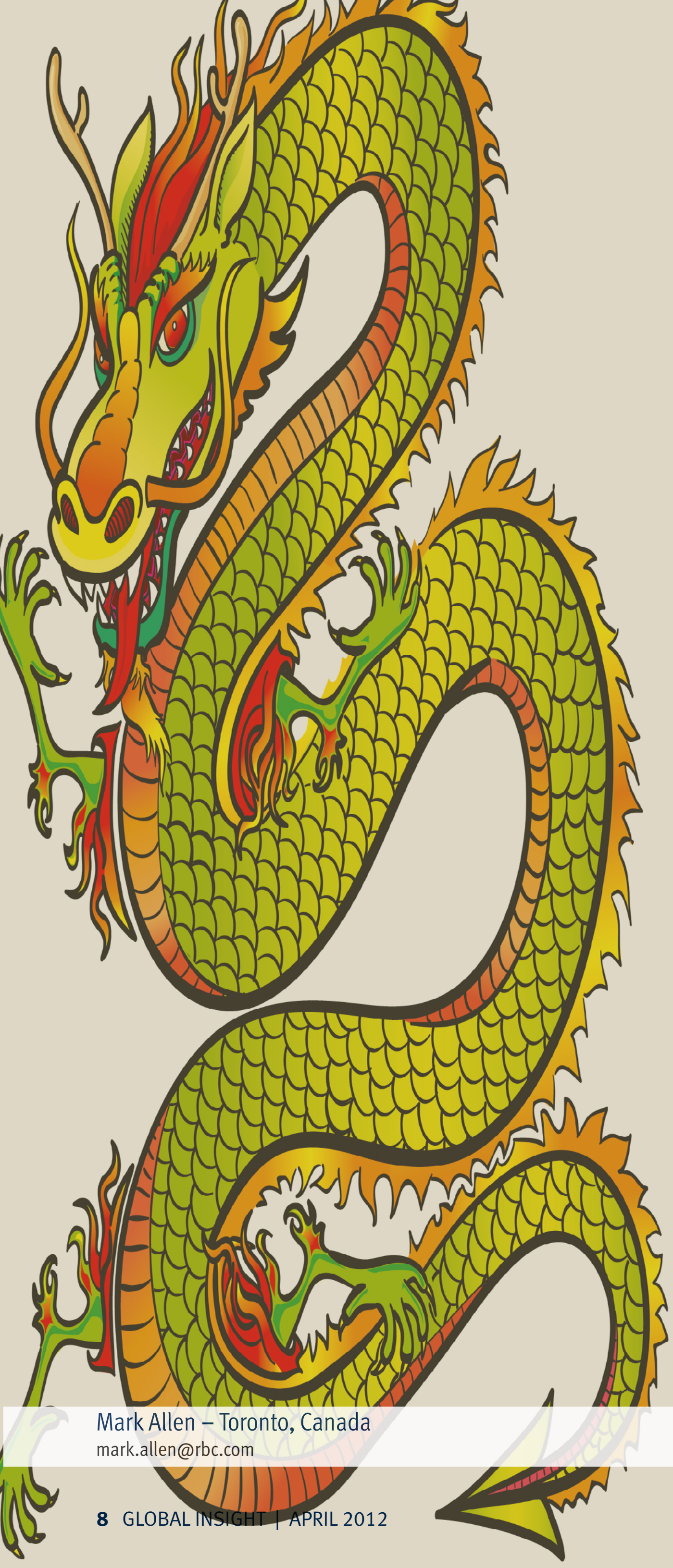
answers as to what might unfold in the Chinese economy in 2012 should pay close attention.

- **GDP:** The target for growth in 2012 is 7.5%. This is in line with the target average of 7% over the next five years that was laid down in China's 12th five-year plan in 2011. However, the Chinese economy has typically exceeded target growth rates. Arguably, these targets may be seen as minimum acceptable growth targets for the country to achieve. At the same time, government rhetoric is increasingly focused on the "quality" of growth. This may refer to sustainable growth in real investment rather than putting capital into projects of questionable value just to boost growth numbers and often leading to industry overcapacity.
- **Inflation:** The target for 2012 is 4%. This is higher than the long-term target of 3%. Chinese inflation, however, will likely be a recurring issue in the future. Inflation is imported via rising commodity prices, such as oil or imported food. Domestically, factor costs are rising, driven in particular by rapid income growth. The government has been raising minimum wages across the country.
- **Monetary Policy:** The watchword is "prudent." Money supply growth (M2) is targeted at 14%. The target for 2011 was 16%, but the actual number came in at 13.6%. While robust, 14% is the lowest target since 2002. Investors should also look for "directional loosening" of monetary policy, which refers to targeted measures to support key projects, the build-out of affordable housing, and small-to medium-sized enterprises.
- **Fiscal Policy:** The central government has targeted a deficit of 800 billion renminbi (RMB), about 1.5% of GDP. However, investors have been much more concerned with local government debt burdens, given they represent the majority of government expenditures. In 2010, China audited local government debt across the country for the first time—a total of RMB 10.7 trillion. In 2011, as the central government tightened policy, net new debt rose by only RMB 300 million. (This consisted of RMB 2.1536 trillion of new debt and RMB 2.1533 trillion of repaid debt.) Premier Wen Jiabao recently stated that much local government debt was backed by projects with cash flows, while "public projects" would be repaid by both central and local governments. He summarized that, "in short, we will take local government debt seriously and will not let it interfere with China's construction."
- **Property Market:** Investors should expect China's restrictive housing market policies to remain in place for some time. The government has consistently used strongly worded statements to reiterate its restrictive stance on the property market. There are many policies currently in place aimed at reducing investment demand and speculation. There have been instances of a few local governments attempting to ease policy restrictions, only to have the central government immediately order any such measures to be reversed. Premier Wen Jiabao recently said property prices are still "far from reasonable." While the downturn in the private property market is clearly a negative for base metals and bulk commodities such as iron ore, these commodities should receive support from China's ambitious plans to build more affordable public housing. Ten million units were started in 2011, and 4.3 million were finished. In 2012, the target is to begin more than seven million and finish a further five million. The overall target is to build 36 million units by the end of the current five-year plan period.
- **RMB Exchange Rate:** Since exchange rate reform began in 2005, the renminbi has appreciated by around 30%. Since last September, the RMB non-deliverable forward rate against the U.S. dollar has moved to either side of the spot rate. This implies the market has switched back and forth between expecting appreciation and depreciation of the currency. The spot rate has been relatively stable. RBC Capital Markets forecasts more renminbi appreciation, but not until the second half of 2012. Government rhetoric on this politically sensitive subject remains nebulous, with promises to "keep improving the reform of the exchange rate."

While the rate of the slowdown is currently under control, a harder question to answer is how long it will go on. Vice Premier Li Keqiang, who is widely expected to take over as China's Premier when the leadership changes hands later this year, notes the focus of the government's economic policy should be on balancing three factors:

1. the speed of growth;
2. the structure of the economy (referring to becoming less export dependent and more focused on growing domestic consumption, primarily by means of more urbanization and encouraging the services industry); and
3. inflation.

Investors looking for clues as to the end of China's slowdown should pay close attention to government rhetoric on these subjects.



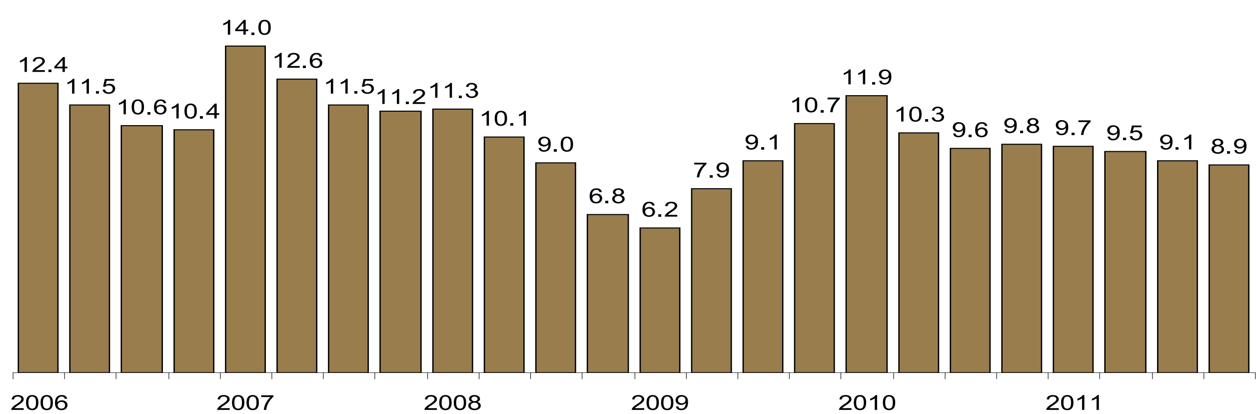
China & Commodities: Waiting on the Dragon

- The Chinese economy has been gearing down to a lower, more sustainable growth trajectory for more than a year.
- Prices of many commodities have been correcting and consolidating as producers and investors await signs China's slowdown phase is over …
- … They may have longer to wait.

Investors have been watching China slow down since last summer. The main cause has been deliberate moves by policy-makers—high interest rates, restrictive bank reserve requirements, and tough second-home purchase regulations—designed to curb a difficult inflation problem and rein in excessive increases in house prices. The slower GDP growth these policies have produced over the past five quarters has been exacerbated by a pronounced slowdown in the growth of exports stemming mostly from very weak demand from Europe, China's biggest customer.

While the government has begun to ease monetary policy, the moves so far have been far more deliberate and less forceful than market observers had been expecting. Tough housing regulations have not been eased, and bearish commentators continue to point to excesses in capital investment. Fear of a more extended slowdown in China has become more pronounced in recent weeks with China's premier forecasting 7.5% economic growth for 2012, the slowest pace since 2004. The government clearly regards a slower rate of GDP growth as appropriate, a fact that may not yet have been fully absorbed by commodity producers, distributors, and investors.

Ghina GDP Growth Rate (quarter-over-quarter % change)



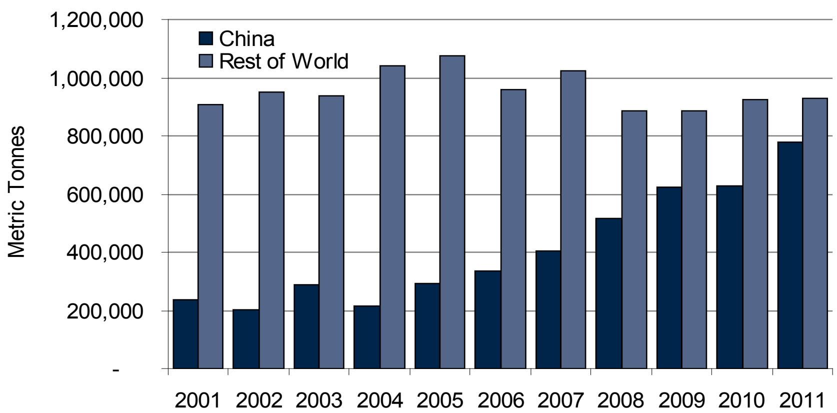
Source: National Bureau of Statistics, RBC Capital Markets

Mark Allen – Toronto, Canada
mark.allen@rbc.com

China & Commodities: Waiting on the Dragon

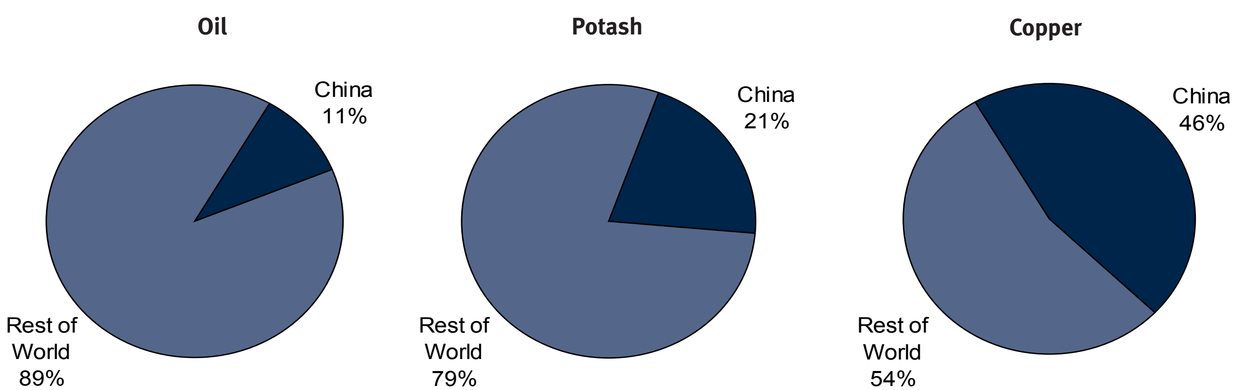
For commodities, the impact of a slowdown in China should not be underestimated. China has been the driving force behind the commodities super-cycle we have witnessed over the past decade. For most industrial materials, including base metals, China now represents the single largest consumer globally. For energy and fertilizers, the global distribution of demand is more diverse; however, China's influence on demand growth has been substantial. A further slowdown of the Chinese economy would likely usher in a more difficult period of correction for many commodities. A more measured, but enduring slowdown could also have serious implications for the longer-term commodity bull run.

Chinese Copper Demand vs. Rest of the World



Source: Bloomberg

China's Share of Global Demand in 2011



Source: RBC Capital Markets (Oil & Potash); Bloomberg (Copper)

Base Metals

China's urbanization and industrialization process has meant construction on a massive scale. Wiring all those buildings and stringing all those power lines require a great deal of copper, and in 2011 China represented approximately 46% of global copper consumption. In fact, Chinese copper consumption was even greater than that of the United States and Western Europe combined, which accounted for only 27%. A similar picture exists for other base metals. Nickel and zinc, for example, have been swept up by China for the making of corrosion-resistant steel. In 2011, China represented approximately 44% of global nickel consumption and 43% of global zinc consumption. Peering deeper into copper specifically, between 2001 and 2011 China accounted for a whopping 97% of the global increase in demand, offsetting declines in the United States and flat growth in Europe.

Fixed-asset investment has driven about half of China's GDP growth over the last 10 years. In China's 12th five-year plan, infrastructure investment has been given less of a focus. However, the commitment to continued construction remains large, with the government's target of building 36 million housing units between 2011 and 2015. Taking a step back to look at fundamental demand, another 80 million people in China are expected to move to cities by 2015 and 200 million by 2022, thus supporting longer-term construction trends.

All that said, at the recent National Peoples Congress, policy statements by the Premier made it clear the government places a high

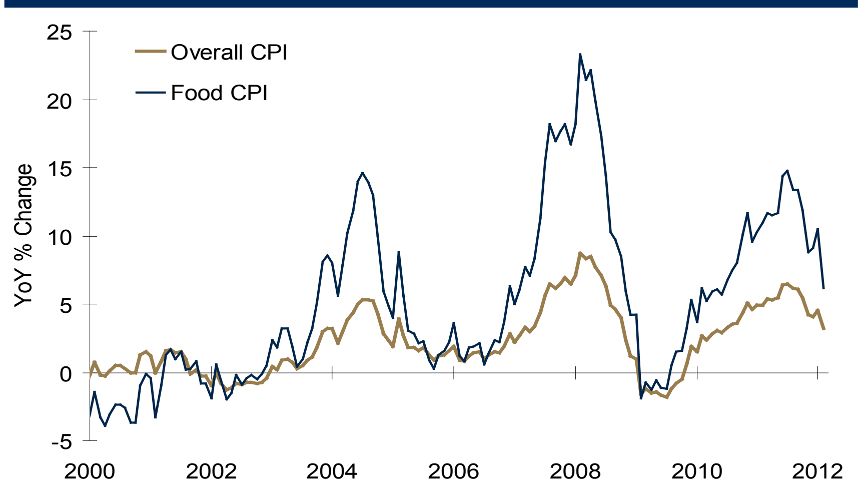
priority on improving the debt issues faced by local governments. Observers have concluded this means capital projects already underway will receive support, but new ones will be subject to a more onerous permitting process. This suggests to us the outlook for fixed-asset investment is likely to be somewhat clouded, at least for this year.

Oil

The tripling of China's economy over the last decade and the proliferation of auto sales have made China thirsty for oil. In 2004, China eclipsed Japan as the world's second-largest oil consumer and by 2011 had reached 10.7% of global demand, second only to the United States at 21%. Over the last decade, China's consumption has nearly doubled from 4.9 million barrels per day in 2001 to 9.5 million barrels per day in 2011. To put this in context, total worldwide demand growth over this same period was 10.8 million barrels per day; thus, China drove approximately 37% of the total consumption increase.

Meanwhile, domestic oil supply has seen comparatively modest growth, expanding from 3.3 million barrels per day in 2001 to 4.1 million barrels per day in 2010. As a result, Chinese imports surged, putting pressure on the global market and driving much higher clearing prices.

China's Consumer Price Index



Source: China National Bureau of Statistics

Potash

China has played a crucial role in the growth of demand for potash. In 2011, the country accounted for approximately 21% of global potash requirements. However, much as for oil, this number does not tell the whole story: China is the largest driving force behind global consumption growth. In the decade leading up to 2011, China contributed 34% to total global growth in potash use.

One of the principal goals of China's economic policies is "social stability." Sharply higher inflation in the first half of 2011 was viewed as a threat to that goal. When overall inflation peaked at 6.5% last summer, food price inflation was running at a very unsettling 15%. Pork, the protein of choice, was up by almost 60%. In addition to this short-term squeeze, China's per capita food consumption has been rising steadily for some time in step with household incomes and is forecast to go on doing so. These factors are stimulating Chinese agriculture to take every available step to increase crop yields and overall production.

Summary

China's growth is being purposely moderated by the government, and the emphasis is shifting from infrastructure spending to domestic consumption. While the last decade saw trend GDP growth of 10%-11%, the next decade could look closer to 7%-8% growth accompanied by diminishing capital intensity. Commodity markets and prices have been enduring an adjustment phase as the country's growth trajectory transitions to this new, somewhat more subdued profile. We expect commodities will be vulnerable to additional consolidation/correction until this period of "gearing down" is over.

Sizing Up a Downshifting Economy

Eric Lascelles – Toronto, Canada
Chief Economist
RBC Global Asset Management

- The United States and other developed economies are stuck in "slow gear" as they struggle to repair the damage done in the financial crisis and the Great Recession.
- Emerging new headwinds suggest slow growth may be the new normal.

Our material well-being is remarkably dependent on a perpetually growing economy. The economic machinery groans in protest against even the slightest bouts of stagnation or decline. Gears strip, chains break, fuses blow. Take the 2009 recession. Never mind economic output per American enjoyed its sixth-best year in history up until that point—the year was a disaster, plain and simple. Unemployment rates soared, financial markets plummeted, and gloom prevailed and still haven't fully recovered.

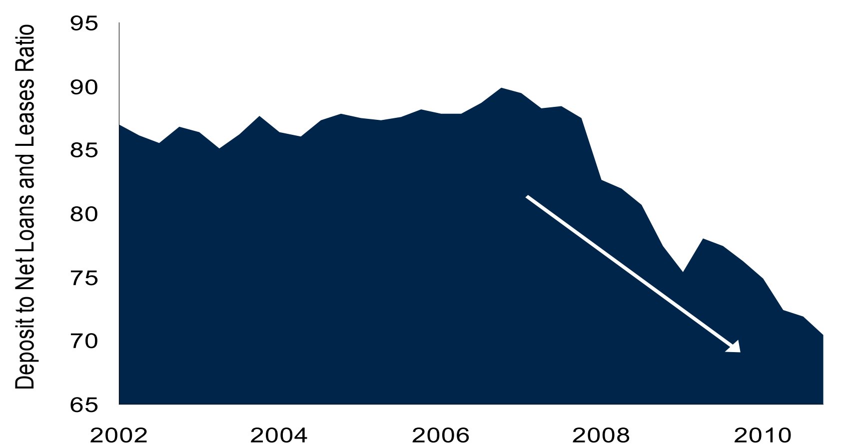
Right or wrong, economic growth has become of central importance and the more of it the better. It follows then that our belief future economic growth could remain somewhat slower than usual is disconcerting. Unpleasant consequences arise in an extended period of slower growth including a diminished buffer against recession, stagnant living standards, inadequate government finances, and possibly lower investment returns.

Post Crisis

In theory, economic growth should be slower after a financial crisis. Debt excesses need to be worked down until they are manageable given the underlying level of income and assets. Households should spend less and save more, and businesses should do the same. Banks deleverage. Governments are usually preoccupied with bailing out the rest of the economy first, but are ultimately cowed by markets into austerity of their own.

This process has already begun. The U.S. household debt-to-income ratio has started to fall. Banks continue to deleverage in the U.S., and now in Europe. The International Monetary Fund (IMF) estimates that adhering to tighter international bank capital requirements alone could chop something like half a percentage point off the level of developed world economic output.

U.S. Commercial Banks are Deleveraging, Reducing Loan Availability



Source: Federal Deposit Insurance Corporation

Sizing Up a Downshifting Economy

Another consequence is a retrenchment in risk appetite. Few households, businesses, banks, or governments are willing to take large risks or to invest boldly in the future. The popularity of ultra-low-yielding government bonds demonstrates this phenomenon. Without risk there is no reward, and economies tend to move more slowly when everyone plays it safe.

In the heat of this financial crisis, economic output dropped precipitously. Most of this has since been restored. However, a few percentage points of activity appear to have vanished into the ether, and the economy finds itself on a parallel, lower trajectory.

The Cost of Labour Market Dislocation

In the U.S., this loss has been due mainly to a troubled labour market. As the average spell of American unemployment yawns three times wider than normal, skills corrode. Multi-year bouts of joblessness reduce a worker's salary and productivity by an average of 14%.

Today's unemployed workers are disproportionately trained in construction and manufacturing, whereas job creation now tends to be elsewhere. They can switch sectors but will not be as employable, productive, or highly paid. Simultaneously, underwater mortgages prevent American households from escaping the most economically waterlogged regions.

Even as net job creation picks up, workers are not opportunistically hopping from job to job, as they would normally. Instead of securing better matches between their skills and roles, they are choosing to stick with the devil they know in a time of uncertainty.

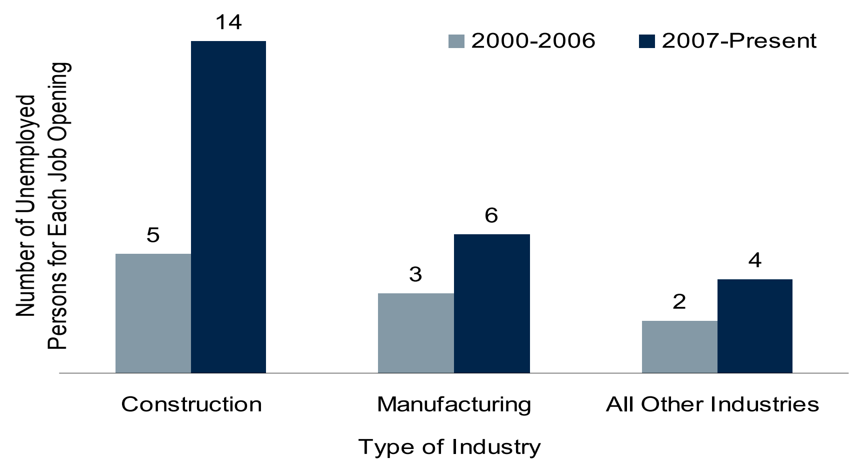
Slower for Longer

Regrettably, there is a good chance the sluggish economic growth of the past few years will endure for several more to come. The fact that growth in the decade after a financial crisis tends to be slower than beforehand is often cited as evidence. But this statistical phenomenon is not as informative as it first appears.

In fact, growth tends to be horrific in the immediate aftermath of a crisis but then frequently reverts to an ordinary-looking profile within a few years. This renders the ten-year average unrepresentative of both early and later periods. As we enter year four of this recovery, might we then be on the cusp of accelerating activity?

This is a tempting notion, but we regard it as unlikely. Financial crises that come paired with housing busts—such as this one—tend to experience a rougher ride. The especially deep and global nature of this financial crisis also tilts the odds toward a less attractive outcome. Deleveraging and risk aversion have clearly not evaporated, which continues to suppress growth.

Supply is Greater Than Demand in the U.S. Job Market



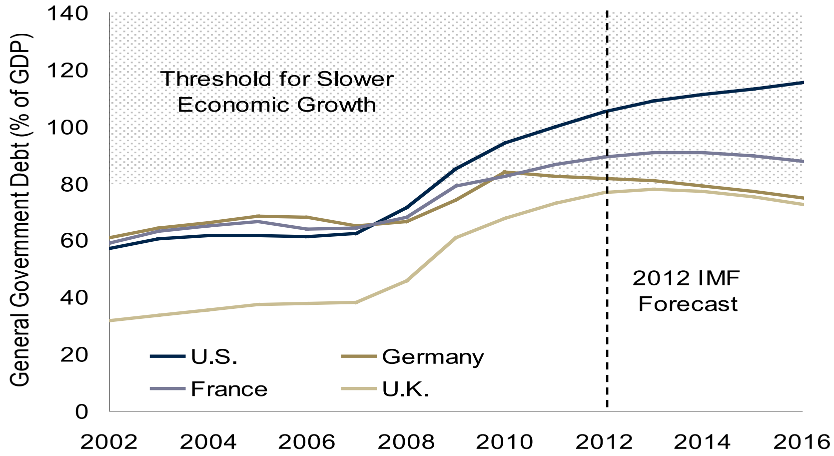
Source: Haver Analytics, RBC Global Asset Management

Fiscal Drags

Crumbling government finances also limit economic growth. Structural deficits equal to 6% of GDP in the U.S. and 5% across the developed world will need to be tackled over the coming years. Unfortunately, the optimistic notion that fiscal austerity might be economically neutral or even beneficial has been thoroughly debunked. Fiscal austerity mathematically slows the economy. Realistically, this will amount to a fiscal drag averaging 0.5%-0.75% on annualized GDP growth over the next several years.

Sizing Up a Downshifting Economy

Government Debt is Reaching Problematic Levels



Note: U.K. is net general government debt, other are gross general government debt.
Source: International Monetary Fund (IMF) and RBC Global Asset Management

Added to this is the burden associated with high debt levels. Rising debt levels ordinarily don't cause much pain to the economy, until they reach the level when they abruptly do—usually at about 90% of GDP. Developed economies are at this very moment whistling past that graveyard.

What's Normal?

Of course the reality is there is no such thing as truly "normal" growth. Conditions are always changing. But we need a frame of reference, and for many the 1980s and 1990s are still the epitome of "normal," when the U.S. economy grew at an annualized rate of 3.2% per year.

Unfortunately, there were several under-acknowledged tailwinds during that period. These included false financial innovation, excess leverage, entry of the Soviet Bloc and China into the global economy, low and steady commodity prices, as well as falling inflation, interest rates, and tax rates.

In short, the 1980-1999 period had an element of fairy tale to it. Future growth over the long run should be a little slower simply because the sleek carriage has reverted back to pumpkin form.

Headwinds Won't Help

Just as old tailwinds are ceasing to blow, new headwinds are mounting. Most importantly, demographics are becoming much less amenable to economic growth. The rate of educational attainment may also be starting to flatten out.

Perhaps the most contentious subject of all is technological change, which is a big part of productivity growth that in turn is a prerequisite for an expanding economy. Simply put, technological gains are obvious only in retrospect. There remain plenty of fields ripe for major breakthroughs, including communications, information, computing, robotics, artificial intelligence, nanotechnology, and pharmaceuticals. However, attempts to predict the form they will take or the speed of their arrival is clearly folly.

We believe the loss of prior tailwinds may subtract around 0.5 percentage point from economic growth, while new headwinds could subtract another 0.75 percentage point. Together leaving economic growth around 1.25 percentage points slower than the 3.25% 1980-1999 norm for the U.S. and Canada—about 2% growth per annum. It implies even slower growth in most other developed economies.

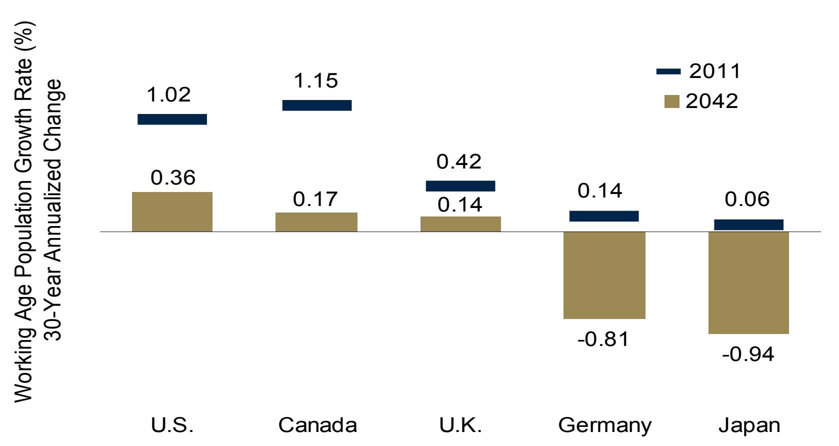
Although we do not anticipate a second recession for the U.S. or Canada, a second contraction is *unusually* common in the decade following a financial crisis, even if it is *usually* attributed to some other cause.

Of course, there is nothing exact about these estimates, and it is worth acknowledging that forecasting precision declines over time. It is also true there are examples of countries that bucked these trends—notably Sweden, Finland, and Canada in the 1990s. There is also some unorthodox historical evidence that periods of slower population growth are associated with faster productivity growth, perhaps providing a partial offset. Too, a growing cohort of seniors won't just stop spending money because it has exited the workforce.

We should avoid the temptation of disaster myopia—imagining we will forever be stuck in

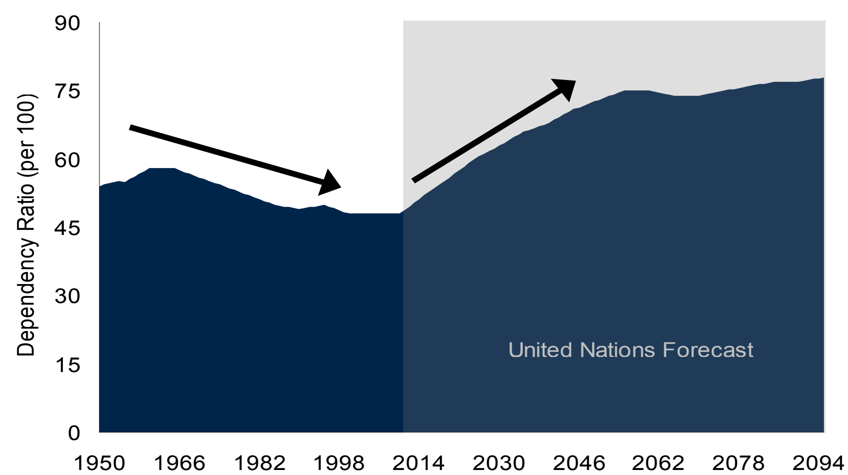
Sizing Up a Downshifting Economy

Working Age Population Growth Slows



Source: Haver Analytics and RBC Global Asset Managment

Dependency Ratio in Developed Nations Will Rise



Note: Dependency ratio represents ratio of population age 0-14 and 65+ per hundred population age 15-64.
Source: United Nations, Haver Analytics, RBC Global Asset Management

calamitous times—simply because that has been the recent experience. The world has endured many bouts of economic disaster as bad as or worse than this one—global wars, pandemics, and the Great Depression—and yet ultimately has always bounced back.

Bottom Line

All that said, our assessment leads us to expect a prolonged period of slower growth than the world was accustomed to prior to the financial crisis as deleveraging continues and fiscal austerity bites. Over the long run, growth may also downshift into a lower gear, due to the loss of prior economic tailwinds and the addition of new headwinds such as slower population growth. This is clearly not ideal, because it eats away at the natural buffer against recession, slows the advancement of living standards, represents an enormous burden for governments, and may diminish investment returns.

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

Global Equities

"Vigilance" Remains the Watchword

Major markets were mostly higher in March, buoyed by an encouraging U.S. employment report, further indications the Eurozone and its banks had moved back from the precipice, and positive results of the demanding U.S. bank stress tests. U.S. bank stocks rose strongly all month, helping to boost developed markets.

Canada's S&P/TSX was the exception. The index's almost 50% weighting in energy and materials stocks left it lagging most other global averages. Official statements out of China (see articles on pages 6 and 8) made it clear that easing of restrictive monetary and regulatory policies was going to be more deliberate and drawn out than commodity markets had been hoping for.

Looking forward, some elements of the economic/financial market picture have shifted, although the scene it portrays is much the same as it has been for some time. The U.S. is still working through an extended period of below-trend growth (see article on page 11). China, too, is transitioning to a slower, more sustainable growth trajectory, with all the discomfort and market challenges that entails. And Europe, now in recession, is gradually addressing its sovereign debt/banking crisis and remains a considerable way from fully resolving it.

Meanwhile, the steady stream of economic data, which on balance was ahead of expectations from September to January, has since tended to marginally disappoint.

Earnings appear to offer a constructive backdrop for equities—but not overwhelmingly so. Analysts expect earnings to grow in 2012, nevertheless they continue to revise estimates lower and have for many months running. For example, the 2012 forecast for S&P 500 earnings is now down to $105.70 per share versus roughly $113 last spring. Our below-consensus estimate stands at $101. That would represent a 3.2% advance on 2011—not a growth rate that would typically drive extraordinary returns from here, but together with dividends, enough to make it a satisfactory year for investors.

What would make it better would be a combination of faster-than-expected growth in the U.S. and China (even just a bit faster) and additional, convincing actions to resolve Europe's debt crisis. What would make it worse would be the opposite. We don't put a high probability on either coming to pass, but enough of a probability that we believe "vigilance" will continue to be the watchword for at least the next several months.

Our stance has not changed: we recommend a "Neutral" exposure to stocks—that is, portfolios should contain up to but not more than their long-term target allocation to equities.

Global Asset Class View

Asset Class	View	Comment
Equities	=	Invested, but vigilant
Fixed Income	–	Unchanged
Cash	+	Maintain, but ready to allocate

Region	Weighting	
U.S.	Neutral	=
Canada	Neutral	=
Continental Europe	Underweight	–
U.K.	Neutral	=
Asia (ex Japan)	Neutral	=
Japan	Overweight	+

Equities: United States

Neutral (=)

Sector View	
Financials	+
Industrials	+
Information Technology	+
Consumer Staples	=
Energy	=
Health Care	=
Consumer Discretionary	–
Materials	–
Telecommunication Services	–
Utilities	–

Kelly Bogdanov – San Francisco, California
kelly.bogdanov@rbc.com

Janet Engels – New York, New York
janet.engels@rbc.com

- Sub-par economic growth, year-end fiscal risks, and lingering European uncertainties keep us in the "Neutral" camp for U.S. equities, although attractive valuations should keep a bid underneath large-capitalization stocks.
- The historic multi-year leadership run for small-cap stocks may be coming to an end. Large-caps seem poised to pick up the baton.

Market Developments

Financials significantly outperformed the broader market in March, rising 7.3% due to successful bank stress tests and higher-than-expected dividend increases. Seven of 19 large banks examined by the Fed raised dividends 44%, on average. Most banks' balance sheets are strong enough to allow dividends to rise further in the years ahead.

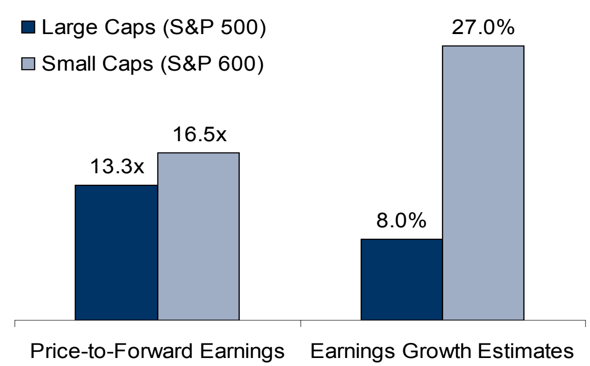
The S&P Retail Index climbed 7.2% in March and has rallied 21% so far this year on strong earnings results and despite elevated gasoline prices. Nevertheless, retail stocks are richly priced and could be approaching peak profitability. We rate the Consumer Discretionary sector "Underweight."

First-quarter earnings season is around the corner. The consensus S&P 500 forecast calls for $24.02 per share, representing 2.2% year-over-year growth, the weakest pace since 2008. Analysts may end up cutting their 2012 estimates further. On a year-over-year basis, forecasts for Q2 and Q3 growth seem somewhat reasonable at 8.1% and 5.4%, respectively. However, the consensus growth estimate for Q4 seems far off base at 16.3%. Many management teams have yet to provide second-half guidance and could temper expectations in the weeks ahead. Our full-year estimate stands at $101 per share versus the $105.70 consensus forecast.

Portfolio Recommendations

- We would continue to tilt portfolios toward three economically sensitive sectors: Technology, Industrials, and Financials. However, bank stocks probably need time to consolidate their recent gains.
- For investors with outsized positions in small-cap stocks, we would begin to pare back exposure and shift into large caps. Small caps have outperformed persistently since 1999 but may be passing the leadership baton. During the past year, the Russell 2000 Index underperformed its large-cap S&P 500 cousin by almost 8%. Analysts' small-cap earnings estimates seem far too aggressive—up 27% in 2012 on a year-over-year basis versus only 8% for the S&P 500. That gap seems too wide. Further, small caps currently trade at a 24% valuation premium compared to large caps. The premium could shrink if earnings fall short of what we think are unrealistic expectations.

2012 Small-Cap Earnings Estimates Seem Too High



Source: RBC Capital Markets, Bloomberg

Equities: Canada

Neutral (=)

Sector View	
Financials	+
Industrials	+
Telecommunication Services	+
Consumer Discretionary	=
Consumer Staples	=
Health Care	=
Information Technology	=
Materials	=
Energy	–
Utilities	–

- We maintain a "Neutral" recommendation (benchmark allocation) for Canadian equities. Attractive valuations and accommodative central bank policies could be catalysts for worthwhile returns in 2012.
- The uneasy slowdown in China continues to weigh on the relative performance of the Canadian market because nearly half of the S&P/TSX is exposed to commodities.
- While our base case remains a "soft landing," commodity stocks are unlikely to outperform until more conviction emerges that China's slowdown phase is ending.

Market Developments

The S&P/TSX is up 3.7% year to date, one of the worst performances among major global indices. The S&P/TSX has now underperformed the S&P 500 by 17% since the early October lows.

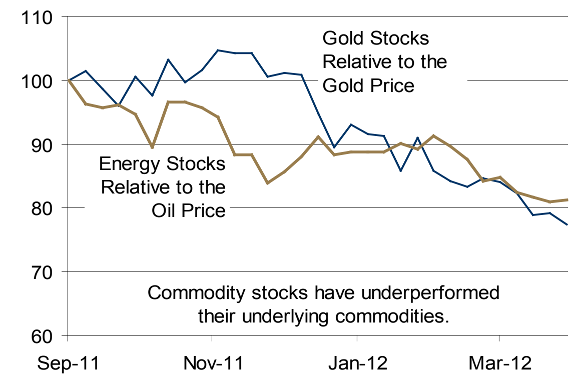
Both energy and commodity stocks continue to underperform relative to their underlying commodities. While WTI crude is up ~4% year to date, the S&P/TSX Energy sub-index is actually down 1.2% for this period.

Solid Q1 results confirm Canadian banks are recovering from a poor 2011. While the domestic Canadian economy has slowed, the Canadian banks continue to generate ROEs far in excess of their global peers, helping to justify the premium valuations most of the Canadian banks enjoy.

Portfolio Recommendations

- We expect the Canadian market to deliver worthwhile gains; however, we recommend domestic Canadian investors consider taking advantage of a richly valued Canadian dollar to diversify exposures to other markets that may currently offer more compelling valuations and prospects.
- Commodity stocks offer attractive long-term value, although, we would be cautious about adding exposure until the technical backdrop and Chinese prospects improve.
- We continue to advocate a focus on dividend payers and growers, but we note yield-hungry investors have bid up many high-quality issues to levels that are no longer attractive.

TSX Gold & Energy Stocks Relative to Gold & Oil Prices



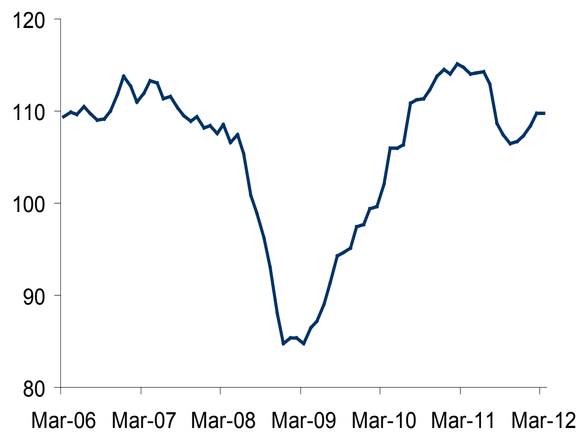
Source: RBC Capital Markets

Matt Barasch – Toronto , Canada
matt.barasch@rbc.com
Jean-François Dion – Toronto , Canada
jean-francois.dion@rbc.com
Maha Arshad – Toronto , Canada
maha.arshad@rbc.com

Equities: Continental Europe

Underweight (-)

Ifo Germany Business Climate Index



Source: Bloomberg, quaterly series; data through March 2012

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

- European markets struggled in March. This was not due to a particularly poor Eurozone news flow but rather to deteriorating economic momentum in China and few economic upgrades in the U.S.
- The road should remain bumpy, but there is reason to be hopeful with Germany functioning as a beacon of stability and Italian Prime Minister Monti pushing through austerity and reforms.
- European equity markets are trading at 11.3x 2012 and 10.0x 2013 earnings and offer an attractive yield of 4.1%.
- We continue to be discriminating when selecting investments and hence remain "Underweight."

Market Developments

European equity markets struggled in March largely due to a more cautious macroeconomic environment in the U.S. and in China. Defensive sectors (Food and Beverages, Health Care) and insurance led the market.

Macroeconomic news during the month was mixed. The Eurozone Purchasing Manager Indices were weaker than expected, reinforcing the belief the euro area economy is likely to have fallen into technical recession in Q1 2012. German consumer confidence was disappointing as well, dented by higher energy prices.

Nevertheless, German business confidence remains strong, as the March Ifo index increased again, illustrating sound economic fundamentals. Italian and French consumer confidence also improved during the month, though are still at low levels. Whether this optimism is sustainable remains to be seen as high oil prices, austerity measures in almost all other Eurozone countries, and the slowdown of the Chinese economy could erode both domestic and external demand.

On the political front, news was mixed as well. Italian Prime Minister Monti still enjoys a 62% approval rating in recent polls and is pressing ahead with labour reforms and austerity. Meanwhile, the Spanish Prime Minister Rajoy's support is eroding, as shown in the opposition's victory in a recent provincial election. Mr. Rajoy has to focus on bringing the fiscal deficit down from 8.5% of GDP last year to 5.3% this year—a tall order after years of economic contraction. It is no wonder Spanish ten-year bond yields have surpassed Italy's in recent weeks.

However, a lot has changed in Europe. Two LTROs have added much-needed liquidity, lessening the risk of a financial system collapse. The Greek bail-out package has been agreed on, and Greece is no longer perceived as an imminent threat. And importantly, Germany has become less dogmatic, realising that austerity is only part of the solution. To illustrate, German Chancellor Merkel used to be starkly opposed to having a European bail-out fund bigger than €500bn. The tone has been markedly softened recently, with a plan to run the EFSF (€192bn committed) and the permanent €500bn ESM concurrently. We see this softening stance as a step closer to the long-term plan of fiscal union.

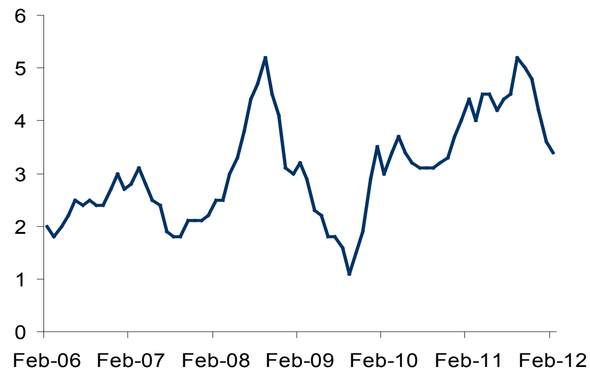
Portfolio Recommendations

- While recent policy action has greatly reduced the possibility of a crisis escalation, risks remain. Spain in particular is a worry. We would focus on resilient and cash flow generating companies in the stronger countries of Europe, such as Germany, Switzerland, and Sweden.

Equities: United Kingdom

Neutral (=)

U.K. Consumer Price Index (year over year % change)



Source: Bloomberg; data through February 2012, the most recent report

- March macro data point to the U.K. economy struggling but not deteriorating markedly.
- The budget was the first in years not to reduce growth expectations.
- We maintain a "Neutral" (benchmark) position in U.K. equities. The market is inexpensive, and the 4.1% yield is supportive.

Market Developments

U.K. equity markets lost momentum in March, led by sharp falls in Basic Materials and Energy, two sectors hit by the prospect of weaker Chinese growth.

Economic news centered on inflation and unemployment releases. U.K. CPI inflation slowed from 3.6% year over year in January to 3.4% year over year in February but was a little stronger than the consensus forecast (3.3%). CPI inflation has fallen for five months running, but RBC Capital Markets expects this trend will shift from March onwards as the impact of past increases in VAT and energy prices fall out of the index, and as rising energy prices put upward pressure on inflation. Given the emergence of further inflation risks and barring any negative growth surprise, the Monetary Policy Committee is unlikely to vote for more Quantitative Easing in May.

Recently released data indicates the level of U.K. unemployment continued to creep higher in January, with the number of people unemployed increasing by 28k over the period to reach 2.67 million. The ILO unemployment rate was unchanged at 8.4% during the three months to January. The latest labour market data confirm the pace of deterioration has slowed markedly in recent months, a trend that is expected to continue as the labour market inches towards reaching a point of inflection.

Chancellor of the Exchequer Osborne delivered a budget that was largely fiscally neutral. For the first time in years, there was no deterioration in the country's expected outlook. The independent Office for Budget Responsibility's growth forecasts were little changed: growth should be 0.8% this year and 2% next year. If these forecasts materialize and cost-cutting is implemented, the Treasury sees the net national debt figure peaking at 76.3% in 2014/15 rather than 78.0% as it did in the autumn budget statement.

This may provide some comfort to credit rating agencies that have recently put the U.K.'s AAA rating on negative watch. Fiscal stabilisation, however, is clearly dependent on no further deterioration in either the Eurozone crisis or in oil prices.

The U.K. equities market is inexpensive, trading on 10.4x 2012 and 9.4x 2013 consensus earnings estimates, though this reflects the high weightings in the lowly valued Energy, Materials, and Financials sectors. Even so, a dividend yield of 4.1% and possible stock buybacks are further supportive of the market.

Portfolio Recommendations

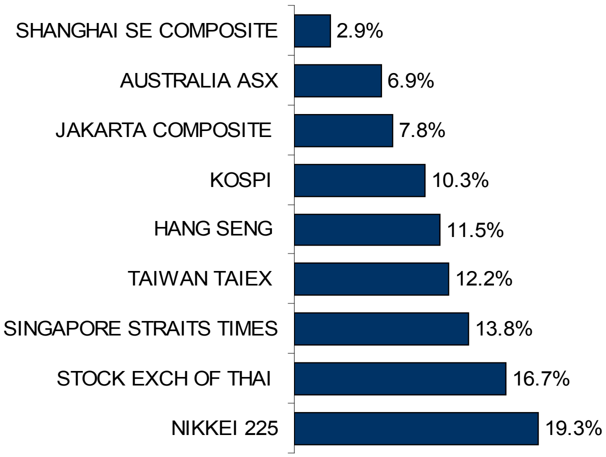
- We continue to favour companies with relatively high exposure to international sales. We would focus on companies with solid market positions, high barriers to entry, exposure to growing regions or industries, a strong balance sheet, and robust cash flow generation. These attributes tend to enable companies to implement an attractive, sustainable, and often progressive dividend policy.

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

Equities: Asia

Asia (ex Japan): Neutral (=)
Japan: Overweight (+)

Indices Year-to-Date Performance



Source: Bloomberg

- Asian equities declined in March. Sentiment weakened at the end of the month on softer economic leading indicators from China. Surging energy prices are now a headwind for Asian growth because the largest Asian economies all rely on oil imports. We maintain our "Neutral" stance on equities in Asia ex-Japan and our "Overweight" stance on Japan. Japan's Nikkei has been the best-performing index in Asia thus far in 2012.
- The annual National People's Conference (NPC) was held in Beijing. A range of economic targets were issued, and Premier Wen Jiabao commented on hot issues including Chinese property and local government debt levels. Our base case still calls for a soft landing as the Chinese leadership transitions later this year. RBC Capital Markets forecasts 2012 Chinese GDP growth of 8.4%.
- Policy remains tight in China, although we are beginning to see some selective easing in certain areas, such as limited support for small- to medium-sized enterprises. However, a multitude of measures to control property prices remain firmly in place. It appears Chinese property prices peaked in August 2011. We expect the moderation to continue for an extended period since the government's rhetoric on property prices has remained steadfast.

Market Developments

Weaker Chinese data towards the end of the month changed the tone of the MSCI Asia ex-Japan Index which declined by 3.2% in March. Additionally, remarks from commodity giants BHP Billiton and Rio Tinto that commodity demand from China was slowing received wide-spread attention.

China

The HSBC Flash PMI for China, a leading economic indicator, weakened to 48.1 in March, lower than February's 49.6. The new orders index was particularly weak, declining to 46.2. The PMI is consistent with other Chinese data that indicate a steady slowdown. For example, recent export data has been weaker, primarily due to a sizeable decline in demand from Europe.

Consumer price inflation rose 3.2% for the month of February. This was less than expected and a big drop from January's 4.5% advance, although the timing of Chinese New Year does affect economic data. Investors should welcome this decline because it ultimately provides Chinese authorities with more scope to ease policy.

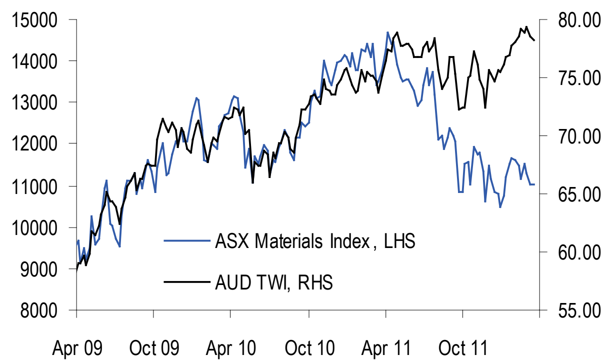
During the National People's Congress, Premier Wen Jiabao noted property prices are "still far from returning to reasonable levels," and consequently it is not possible to relax regulation. He also noted the central government will take the matter of local government debt "very seriously" and not allow it to affect China's development negatively.

Economic targets for 2012 from the NPC include: real GDP growth of 7.5% (previous target for 2005 – 2011 was 8%); inflation target of 4%; steady export

Jay Roberts – Hong Kong, China
jay.roberts@rbc.com
Yang Yufei – Hong Kong, China
yufei.yang@rbc.com

Asia (ex Japan): Neutral (=)
Japan: Overweight (+)

Australian Dollar and Australian Materials Equities: Relative Performance



Source: RBC Capital Markets, ASX, RBA, Bloomberg

and import growth of about 10%; ensure urban and rural income will match broad GDP growth; central government budget deficit of 1.5% of GDP; money supply (M2) growth target of 14%; and begin construction on 7 million units of affordable housing.

In Hong Kong, Mr. C.Y. Leung won the election for the position of Chief Executive against his main rival Henry Tang. Mr. Leung has been perceived by some as being more socialist, more aligned to Beijing, and less pro-business.

ASEAN Region & Australia

South-east Asian currencies continued to appreciate against the U.S. dollar in March. The Thai baht rallied 1.2%, the Malaysian ringgit rose 2.4%, the Singapore dollar rose 0.5%, and the Indonesian rupiah rose 1.4% after a negative February.

Australia's quarter-over-quarter Q1 GDP of 0.4% was only half the forecast number, partly due to weaker housing construction. The Reserve Bank of Australia left the benchmark rate at 4.25%, as forecast. A combination of weaker GDP and confirmation China will continue to attempt a soft landing in its economy, which is the dominant source of demand for Australian iron ore, helped push the AUD lower.

While the Bank of Thailand kept its benchmark rate on hold at 3.0%, it also noted global economic risk had eased. After a terrible year in 2011 due to the floods, the central bank increased its 2012 growth forecast for Thailand to 5.7% from 4.9% as the economy recovers.

Japan

Retail sales in Japan jumped in February by 3.5% year on year, almost three times more than forecast and the biggest rise since mid-2010. Sales were boosted by very strong auto sales growth of over 21% year on year, but also by higher fuel costs. The Bank of Japan forecasts 2% GDP growth for fiscal-year 2012, which begins in April. Key risks to the economy include any prolonged decline in Europe, high oil prices, and China's slowdown.

Portfolio Recommendations

- **General:** We have an "Overweight" benchmark weighting on Japan and a "Neutral" benchmark weighting on Asia (excluding Japan). However, we are cognizant that regional economic leading indicators may be bottoming. There could be an opportunity to consider an "Overweight" position later in the first half of the year if stabilization in the regional economy is confirmed.
- **Countries:** We prefer Japan—lowest valuation in Asia, trading at 1.0x book value; Indonesia—strong domestic consumption theme and oil exporter; Australia—high dividend yield. Chinese equities may be inexpensive at these levels, but we await confirmation the country's economic momentum is bottoming. While the pace of "soft landing" appears to be under control, the length of it is less clear.
- **Sectors:** We prefer defensive, non-cyclical sectors but are now actively looking to add cyclical stocks into portfolios as the economic data stabilizes.
- **Style:** We prefer large-capitalization names, supportive dividends.

Global Fixed Income

Safe Haven Sell-Off Unlikely a Major Shift for Interest Rates

The most notable move in financial markets in March occurred in safe-haven government bonds where yields broke out of their multi-month trading range, sparking a debate about whether the historic bull market could be nearing an end.

Initially, safe-haven bonds drifted higher as the market embraced the notion that conditions have changed materially since last fall when Europe was on the brink of calamity and the U.S. faced recession risks. The Eurozone sovereign debt crisis, while not solved, has stabilized. The U.S. economy, while growing at a below-trend pace, has improved.

Then mid-month, prices sold off sharply and yields spiked above their recent trading ranges after the Federal Reserve issued its monetary policy statement. The 10-year Treasury yield rose to its highest level since late October, and yields of Canadas, U.K. Gilts, and German bunds jumped up as well.

The Fed's statement was perceived as less dovish than prior communications. But the reality is the Fed tweaked its economic assessment only slightly. Further, Chairman Ben Bernanke later emphasized the U.S. economy and labor market remain vulnerable, and he did not deviate from his target to keep rates low for a very long time. As the month progressed, safe-haven government bonds retraced some of their losses.

Despite our long-standing aversion toward government bonds—they fail to adequately compensate the holder for inflation—we doubt the recent rise in yields reflects a sea change in the interest rate environment. We expect to see continued volatility in rates within the new, slightly higher trading range. However, any significant move upward is not likely until there are clear signs of an imminent change in central bank policies.

Chairman Bernanke is not explicitly laying the groundwork for a third round of quantitative easing (QE3), but it remains a possibility if economic trends sour in coming months.

While we don't anticipate any new easing measures from the European Central Bank—the onus is now on fiscal policy—it could act if Portugal or Spain were to deteriorate. Lingering sovereign debt risks and tightening private-sector credit conditions should keep the ECB accommodative for some time, in our view.

The near-term pathway for safe-haven government bonds likely depends on economic trends, Eurozone developments, and U.S. fiscal decisions.

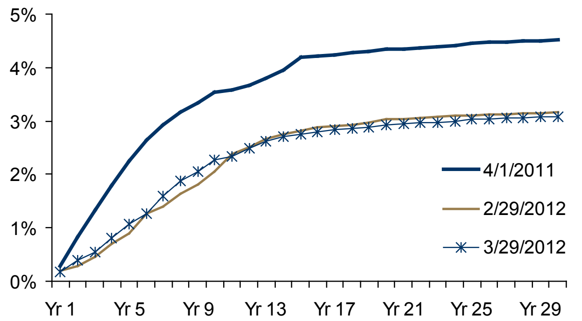
Overall, we remain "Underweight" global fixed income. However, we still see attractive opportunities in credit sectors, even though spreads have continued to tighten. Because there is a perception interest rates could drift higher, bond issuance may pick up across regions over the near term. The supply should be well received given the strong investor appetite for yield.

Global Asset Class View

Asset Class	View	Comment
Equities	=	Invested, but vigilant
Fixed Income	–	Unchanged
Cash	+	Maintain, but ready to allocate

Fixed Income: United States

U.S. Treasury Yield Curve Comparison



Asset Class Yield Curve Comparison

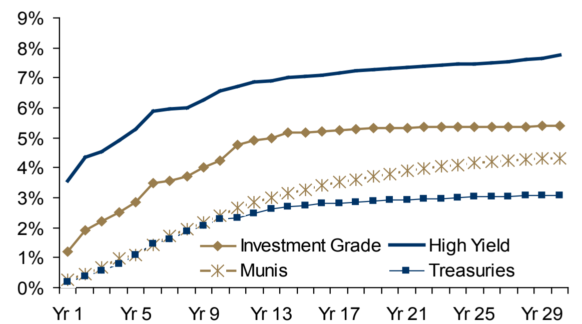


Chart Sources: Bloomberg; data through 3/30/12

U.S. Treasuries

- Strength in February U.S. employment data and some progress in the Eurozone sent yields to their highest levels in more than four months.
- The Federal Reserve's commitment to its monetary policy stance and ongoing purchases of long-dated securities is supportive of a "lower-for-longer" rate environment and a flatter yield curve.
- Even with the uptick in Treasury yields, current rates of inflation, and low interest rate environment, we still see better opportunities in credit-sensitive sectors.

Agencies

- Agency (GSE) yields moved higher, but spreads remain tight to Treasuries.
- Nonetheless, with investors continuing to search for any opportunities with additional yield, agency debt and some of its structures, such as step-ups, provide those opportunities.
- It appears the Federal Reserve may be holding off on announcing another QE program, but it is still considering the possibility of outright purchases of agency mortgage-backed securities.

Corporates

- Investment-grade spreads moved noticeably tighter in March, but monthly total returns were negative due to the move higher in government yields. The best-performing issues were riskier credits given their greater sensitivity to credit spreads than to rates.
- An improving economic outlook is bullish for corporates. We expect to see robust new issuance as companies try to lock in low borrowing costs while investors' demand for yield remains strong.
- Even though credit spreads have tightened in 2012, we still believe there is value in a number of names across various sectors as global policy efforts remain supportive of riskier assets.
- Default risk remains low, which is positive for the high-yield sector. High-yield spreads continue to tighten but remain above historical averages. We believe the asset class continues to provide selective opportunities for risk-oriented investors.
- Floating-rate notes (FRNs) have recently become more attractive. Higher quality issues allow investors to gain exposure to the theme of tightening credit spreads without assuming duration risk.

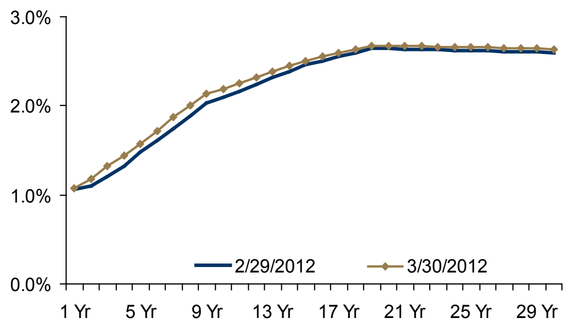
Municipals

- Volatile market conditions made it difficult to complete some new deals. As a result, muni yields rose steadily in March. Even with this correction, 10-year yields on high-grade paper are still well below last year's average.
- Municipals remain somewhat rich, and additional weakness would be a welcome event, providing a better entry point for investors. That said, with the current supply/demand dynamics, a single best entry point may prove elusive.
- Municipals continue to be subject to headline risk as a result of ongoing financial stress at the state and local levels. Default rates are creeping slightly higher, but are still well below other fixed income sectors, and we remain comfortable with their overall credit quality.
- Until high-grade yields back off more, investors will likely look for ways to increase yield. In the muni market they will find it by selectively moving down the credit scale. Extension swaps and "kicker bonds" with 5-10-year calls also offer value.

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

Fixed Income: Canada

Government of Canada Yield Comparison



Asset Class Yield Curve Comparison

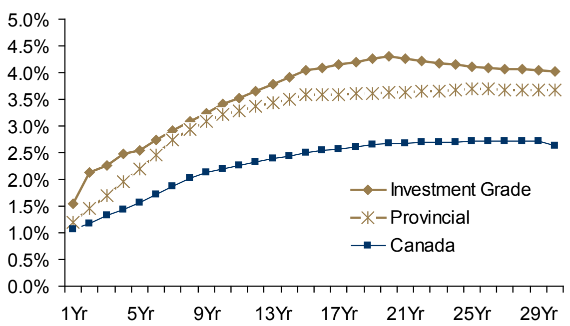


Chart Sources: Bloomberg; data through 3/30/12

Rajan Bansi – Toronto, Canada
rajan.bansi@rbc.com

Canadas

- Yields pushed higher in March in response to better global economic data, but off the highest levels recorded in the month.
- Foreign investors reduced their holdings of Canadian securities by $4.2 billion in the month of January, only the second month of net outflows since 2007. Investors will be keenly tracking this data in coming months to gauge whether international demand for Canadian bonds is waning.

U.S. Treasuries

- Strength in February U.S. employment data and some progress in the Eurozone sent yields to their highest levels in more than four months.
- The Federal Reserve's commitment to its monetary policy stance and ongoing purchases of long-dated securities is supportive of a "lower-for-longer" rate environment and a flatter yield curve.
- Even with the uptick in Treasury yields, current rates of inflation, and low interest rate environment, we still see better opportunities in credit-sensitive sectors.

Provincials & Agencies

- Provincial and agency yield spreads (over Canadas) widened moderately in March.
- Brisk new issuance was due to seasonality and looming provincial and federal budgets at the end of March.
- For conservative investors looking to maximize return, we continue to favour provincials versus Canada bonds due to their relatively higher yields that adequately reflect credit differentials.

Corporates

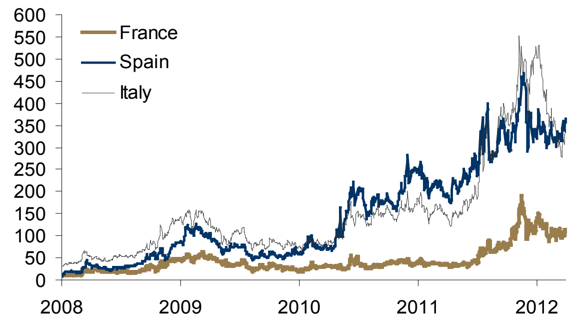
- Investment-grade credit spreads narrowed in March, but monthly total returns were negative due to the move higher in government yields. The best-performing issues were riskier corporate bonds with more sensitivity to credit spreads than rates.
- An improving economic outlook is bullish for corporate debt. We expect new issuance to remain robust as companies try to lock in lower borrowing costs while investors' demand for yield remains strong.
- Even though credit spreads have tightened in 2012, we continue to believe there is value in a number of names across various sectors as global policy efforts remain supportive of riskier assets.
- Floating-rate notes (FRNs) have recently become more attractive. Higher quality issues allow investors to gain exposure to the theme of tightening credit spreads without assuming duration risk.

Preferreds

- Preferred share prices were modestly lower in March due to rising rates and an uptick in issuance from lower quality issuers.
- Despite weakness in a few recent new issues, appetite for yield remains robust. Coupled with an improving economy, this will likely keep new issue activity elevated as companies look to minimize financing costs.
- We believe investors aren't adequately compensated for possible extension risk on rate-reset preferreds. We recommend looking for opportunities to move higher in the corporate capital structure into longer-dated subordinate bonds where yields are similar and upside is greater.

Fixed Income: London

France, Spain, & Italy 10-year Yield Spread to Germany (basis points)



Historical U.K. Government 10-year Yield

Chart Sources: Bloomberg; data through 3/30/12

Hakan Enoksson – London, United Kingdom
hakan.enoksson@rbc.com

Gilts

- The U.K. Gilts market suffered another month of upward yield pressure across the curve due to the economy showing some encouraging signs of recovery, a risk-on market theme, and a short but sharp sell-off in U.S. Treasuries.
- The U.K. government floated the idea of a 100-year issue moments before the curve moved about 30 basis points higher over a span of two days as it explores ways to take advantage of current low rates to reduce its fiscal deficit.
- Medium term, rates on Gilts will likely remain volatile with an upward bias as Eurozone pressures ease and if sentiment about the domestic economy continues to improve. However, a short-term reversal of U.K. economic fortunes and resumption of Eurozone safe-haven flows could pressure rates lower.

Eurozone Sovereigns

- The Sovereign space had a positive overall performance in March as the Greek drama concluded with an orderly restructuring.
- Core government issuers were particularly hard hit mid-month, and German benchmark yields moved about 30 basis points higher. German macroeconomic data suggested some sectors are now surprisingly resilient to the wider Eurozone uncertainties.
- Yields on Italian government benchmarks came down significantly with a return of investor confidence due to the global risk-on theme and Italian Prime Minister Monti's hardline approach to labour reforms.
- Spain's higher-than-expected budget deficit turned the market against Spanish paper, pushing the yield on the 10-year note wider than its Italian comparable for the first time since August 2011.
- The ECB continued to support recent LTROs, which should have a positive impetus on the financials sector and take some strain off sovereign issuers with particularly vulnerable banking industries.
- Market sentiment is likely to continue to be volatile, with swings on the success of EU summits in the near term as firewalls are formalized for the region's two bailout funds (EFSF, ESM).
- We continue to stay away from the crowded safe-haven AAA space, and peripherals are still likely to see extraordinary volatility and potential risk of haircuts. For a balance between volatility and virtually zero yields, there is some value in second-tier issuers despite the recent correction in levels.

Corporates

- In the U.K., spreads continued to tighten on the back of the risk-on theme in the market.
- GBP denominated corporate primary issuance saw flows from a variety of issuers but virtually none from financials as the recent LTRO funding kept them away from the market. Continued low interest rates pushed many issuers to the longer-dated segment of the market.
- In the U.K., corporates generated positive returns in March through impressive spread compression. Lower-rated issuers outperformed.
- Eurozone corporate spreads also tightened on the back of improved investor sentiment about the Eurozone crisis.
- European corporates dominated primary issuance in an active market, and highly rated financials also managed to tap the market. Corporates continue to outperform sovereigns and are up 5.6% since the start of the year.
- For risk-oriented investors, we continue to see value in the corporate sector, especially shorter maturities. Despite recent spread compression, we believe corporate issuers continue to provide good cushion against any sell-off in underlying Gilts and German government bonds.

Commodities

- Recent improvements in global manufacturing Purchasing Managers' Indices have been encouraging for economically sensitive commodities.
- Over the longer term, sustained growth in commodity-intensive economies—like China and India—together with constrained supplies, would suggest constructive market conditions.
- However, in the near term, an extension of the current slowdown in China could weigh further on base metals, oil and fertilizers (see article on page 8).

Commodity Forecasts	2012E	2013E
Oil (WTI $/Bbl)	100	106
Natural Gas ($/mmbtu)	3.00	4.75
Gold ($/oz)	1,700	1,700
Copper (US$/lb)	3.75	4.00
Potash (US$/tonne, Midwest)	558	551
Ammonia (US$/tonne, Tampa)	485	365
Corn (US$/bu)	6.20	6.20
Wheat (US$/bu)	6.50	7.18

Source: RBC Capital Markets forecasts (oil, natural gas, gold, copper, potash & ammonia), Bloomberg consensus forecasts (corn, wheat)

Mark Allen – Toronto, Canada
mark.d.allen@rbc.com

Gold

- The gold price has recently been pressured by a number of factors:
  - Rising interest rates combined with falling inflation rates
  - Rising U.S. dollar
  - Lower risk of a disorderly default of Greece
- While the above has led to short-term volatility, key supports remain in place for gold including:
  - Exceptionally low real interest rates
  - Macro uncertainty in Europe
  - ETF and central bank buying
- Most notable remains the central banks' buying that rose to net purchases of 440 tonnes in 2011, up from 77 tonnes in 2010. This compares to total gold demand from all sources of 4,067 tonnes in 2011.

Energy

- High oil prices are raising concerns about the potential negative affect on global growth. The International Energy Agency has reported that at current oil prices, we are at an "oil burden" nearing 5% of GDP, which is similar to 2008. In the past, these levels have coincided with global economic slowdowns.
- Oil prices are up on tensions between western nations and Iran regarding nuclear development activities. Iran has responded to western sanctions by threatening to prevent shipping through the Straight of Hormuz.
- Iran exports 2.5 million barrels per day and expects to see a drop of 300 thousand barrels per day in March, the first significant change following tighter sanctions.
- Saudi Arabia has tried to calm the oil market by reporting it can increase its production from the current 10 million barrels per day to its capacity of 12.5 million barrels per day. Longer term, projected increases in Iraqi production and the return of Libyan production could ease the tight spare capacity situation at the margin.
- For natural gas, continued growth in industry-wide U.S. domestic production combined with an abnormally warm winter, have led to U.S. storage levels dramatically higher than the 5-year average.

Copper and Industrial Metals

- China, the world's single, largest consumer of copper (estimated at 46% of global consumption in 2011) drives the demand picture.
- China has been gradually slowing for several quarters (see article on page 8). From 9.8% GDP growth in Q4-2010, year-over-year growth fell to 9.7% in Q1-2011, 9.5% in Q2, 9.1% in Q3, and 8.9% in Q4.
- Fear of a longer, deeper slowdown in China has become more pronounced in recent weeks, with China's premier forecasting 7.5% economic growth for 2012 (the slowest pace since 2004). Also, recent comments from BHP Billiton have warned of "flattening" iron ore demand from China, which would suggest moderating construction activity.
- The global supply/demand balance for copper has been in deficit for two years; however, this is expected to shift to a mild surplus for 2012 when several large mine expansions come on-stream.

Corn and Agricultural Commodities

- A slow start to the pre-buying season for Northern Hemisphere farmers has been observed, particularly in Europe.
- For potash, inventories have continued to rise and ended February at 34% over the five-year average. Despite demand weakness, Canpotex recently signed a potash contract with China's Sinofert at $470/tonne, keeping the price flat from H2/2011.

Currencies

Currency Forecast	Current as of Mar 30, 2012	Forecast to Mar 29, 2013
CAD/USD	1.00	1.01
USD/CAD	1.00	0.99
EUR/USD	1.33	1.26
GBP/USD	1.60	1.59
AUD/USD	1.03	1.03
USD/CHF	0.90	1.00
USD/JPY	82.87	70.00
EUR/JPY	110.56	88.20
EUR/GBP	0.83	0.79
EUR/CHF	1.20	1.26
USD/CNY	6.30	6.05

Source: RBC Capital Markets
Examples of how to interpret currency data: CAD/USD 1.00 means 1 Canadian dollar will buy 1 U.S. dollars. USD/JPY 82.87 means 1 U.S. dollar will buy 82.72 yen.

Alan Robinson – Seattle, United States
alan.robinson@rbc.com

Key Viewpoints: Major Currencies

We are less bearish on the **euro** than most of our peers; we expect just a slow depreciation of the currency over our forecast horizon. This view is partly due to valuation—we think the euro is already 20% cheaper against the dollar than it would have been had the sovereign debt crisis not occurred.

The negative sentiment towards the euro due to fears of quantitative easing is overblown, in our view. Rather, we believe the extra liquidity provided to European banks by the ECB through the expansion of its balance sheet can be supportive of the currency by reducing risks of a run on the banking system.

Our forecast for an appreciating **yen** has been dead wrong since the Bank of Japan increased its asset purchase program in February. However, we stick to our view because we think short-term interest-rate expectations are now out of line.

We believe the yen sell-off was due mainly to expectations of rising interest rates in other developed nations, particularly in the U.S., rather than due to changes in Japanese interest rates that are already pegged near zero.

However, the recent rise in U.S. interest rates now implies the Fed could hike rates in early 2013 and not in late 2014 as it has recently pledged. We think the pickup in U.S. economic activity so far this year is partly weather related and may give back some gains into spring. This would reset rate expectations and provide a catalyst for a yen rally.

In contrast to the yen, we think the **Swiss franc** is significantly overvalued, particularly against the euro, and due for a correction over the next twelve months. The Swiss National Bank has expressly committed to maintaining a floor in EUR/CHF at 1.20 and would lose credibility if it were to abandon that target.

Asian and Emerging Currencies

Slower growth in China's export markets has prompted officials to keep the **yuan** exchange rate near 6.30. However, we expect the currency to resume its uptrend against the dollar during the second half of the year as the global economy improves and to avoid an escalation in trade tensions with the U.S.

The **Brazilian real** has declined roughly 6% against the dollar since the end of February due to a combination of increased government efforts to cool the currency's strength and a broader sell-off in emerging market assets. We expect weakness to continue through the second quarter before foreign capital flows resume and push the real higher by year-end.

Commodity-Based Currencies

We still expect the **Canadian dollar** to outperform its **Australian** and **New Zealand** counterparts over the next twelve months, but only slightly.

Over the short-term we expect the Aussie dollar will reverse some of the weakness it suffered in March. This weakness was due to the market anticipating interest rate cuts in Australia, which we now think are fully priced in. However, as we look beyond the summer we expect the Canadian dollar will benefit from the "NAFTA trade" and its association with the comparatively strong U.S. economy.

Currencies

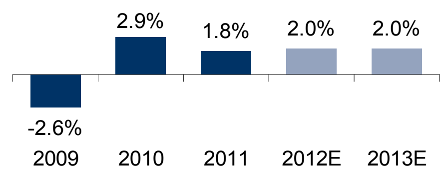
Country (Currency)	Comment	Monthly Change in Major Cross Rates	Country (Currency)	Comment	Monthly Change in Major Cross Rates
U.S. (USD)	▪ U.S. economic data is improving, but high unemployment and fiscal concerns remain. ▪ We forecast the dollar index (DXY) to rise 1% to 80.2 by Mar 29, 2013.	USD/EUR -0.1% USD/JPY 2.1% USD/GBP -0.6% USD/CAD 0.9%	**Eurozone (EUR)**	▪ Shorts have been squeezed out on Greek "progress." Expect slow decline, no collapse. ▪ We forecast the EUR to fall 5% vs USD to 1.26 by Mar 29, 2013.	EUR/USD 0.1% EUR/JPY 2.3% EUR/GBP -0.4% EUR/CHF -0.1%
Japan (JPY)	▪ Poor trade data and QE has hurt the yen, but we maintain the sell-off is temporary. ▪ We forecast the JPY to rise 18% vs USD to 70.0 by Mar 29, 2013.	JPY/USD -2.1% JPY/EUR -2.2% JPY/GBP -2.6% JPY/CAD -1.2%	**U.K. (GBP)**	▪ Likely to keep semi-haven status due to fiscal progress but may lag in risk-on rally. ▪ We forecast the GBP to fall 1% vs USD to 1.59 by Mar 29, 2013.	GBP/USD 0.6% GBP/EUR 0.4% GBP/JPY 2.7% GBP/CHF 0.4%
Switzerland (CHF)	▪ The SNB has both the will and firepower to intervene to defend the EUR/CHF floor. ▪ We forecast the CHF to fall 10% vs USD to 1.00 by Mar 29, 2013.	CHF/USD 0.2% CHF/EUR 0.1% CHF/JPY 2.3% CHF/GBP -0.4%	**Canada (CAD)**	▪ In a holding pattern but should still benefit from the global (and NAFTA) risk-on trade. ▪ We forecast the CAD to rise 1% vs USD to 0.99 by Mar 29, 2013.	CAD/USD -0.9% CAD/EUR -1.0% CAD/JPY 1.2% CAD/AUD 2.8%
Australia (AUD)	▪ The RBA may not be done easing, especially if growth slows at resource customers. ▪ We forecast the AUD to fall 1% vs USD to 1.03 by Mar 29, 2013.	AUD/USD -3.6% AUD/EUR -3.7% AUD/CAD -2.7% AUD/NZD -0.8%	**New Zealand (NZD)**	▪ Interest rates unlikely to fall further; light positioning argues for gains versus AUD. ▪ We forecast the NZD to fall 1% vs USD to 0.81 by Mar 29, 2013.	NZD/USD -2.8% NZD/EUR -3.0% NZD/CAD -2.0% NZD/AUD 0.8%
China (CNY)	▪ Soft domestic data and EZ export markets suggest flat near-term before gains continue. ▪ We forecast the CNY to rise 4% vs USD to 6.05 by Mar 29, 2013.	CNY/USD -0.1% CNY/EUR -0.2% CNY/JPY 2.0% CNY/AUD 3.7%	**South Korea (KRW)**	▪ Vulnerable to negative EZ headlines, but 2012 GDP growth near 3.5% should attract buyers. ▪ We forecast the KRW to rise 9% vs USD to 1020 by Mar 29, 2013.	KRW/USD -1.3% KRW/EUR -1.4% KRW/JPY 0.8% KRW/CNY -1.2%
Brazil (BRL)	▪ High interest rates should still attract fund flows, but government floor at 1.70 likely to remain. We forecast the BRL to rise 6% vs USD to 1.72 by Mar 29, 2013.	BRL/USD -6.0% BRL/EUR -6.1% BRL/GBP -6.5% BRL/CAD -5.2%	**Mexico (MXN)**	▪ Easing of risk aversion should allow MXN to make up lost ground. Valuation cheap. ▪ We forecast the MXN to rise 5% vs USD to 12.25 by Mar 29, 2013.	MXN/USD -0.2% MXN/EUR -0.3% MXN/CAD 0.7% MXN/BRL 6.2%

Source: RBC Capital Markets and RBC Wealth Management

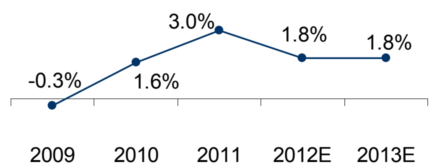
Key Forecasts

U.S.

GDP

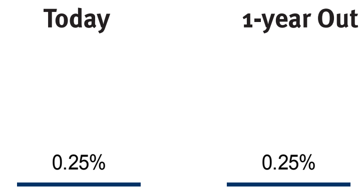


Inflation

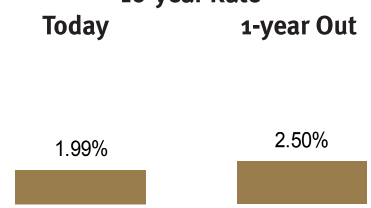


- Real disposable income under pressure from inflation and slower wage gains. Consumer spending flat for four months running (to Jan). Gasoline taking bigger share. Confidence boosted recently by jobs and housing data.
- Fiscal drag becoming more pronounced, but extension of the payroll tax cut and unemployment benefits lightens burden for 2012.
- Business capital investment a bright spot all last year, but leading indicators are mixed, new orders weak. Tax incentives for 2012 have been cut in half.
- Muddle through at 2% GDP growth, but slow growth makes economy vulnerable to external shocks from Europe, oil, geopolitics, etc. Recession not in our forecast but can't be entirely ruled out.

Central Bank Rate



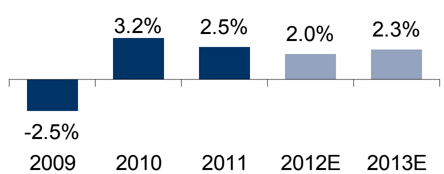
10-year Rate



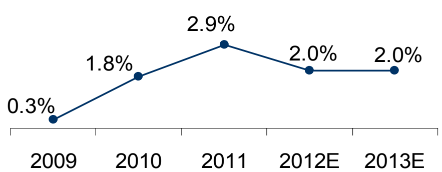
- FOMC committed (sort of) to no rate hike before mid-2014. Fed has readied new asset purchase program (QE3) targeted at mortgage-backed securities but likely won't be introduced unless economy softens again.
- European concerns have repeatedly driven Treasury yields below 2%. A Eurozone solution would quickly push them back up toward 3%, but fast-falling inflation and the prospect of QE3 would limit the upside.

Canada

GDP

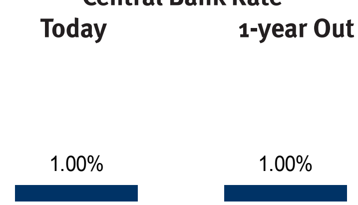


Inflation

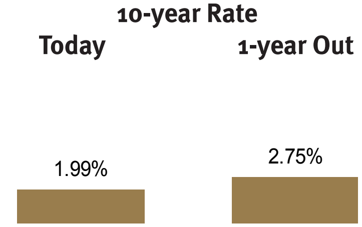


- Employment growth becoming less certain. Canada lost jobs in 3 of the last 6 months; may start to weigh on confidence. Inflation ebbing; wage growth ahead of prices. Longer term, substantial build-up of household debt has left consumer too exposed to future rate increases.
- Weak U.S. growth and a more drawn-out slowdown in China will make for more challenging export performance.
- Government stimulus finished; spending cuts coming this year and next.
- Capex heavily skewed toward energy. Cross-border pipeline politics and weak natural gas prices could be a drag.

Central Bank Rate



10-year Rate



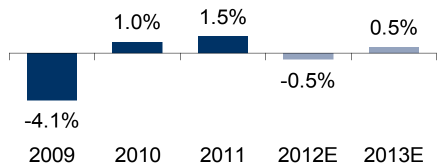
- The Bank of Canada (BoC) lowered its growth forecasts out to and including 2013, citing substantial global headwinds including a longer, deeper European downturn. Expectations for a rate hike mid-2012 are off the table for now.
- An end to the flight-to-safety bid would send Canada bond yields higher with no contemplated BoC QE program to provide an offset. However, government spending cuts and huge investor appetite for yield would limit rate upside.

Source: RBC Investment Strategy Committee and RBC Capital Markets

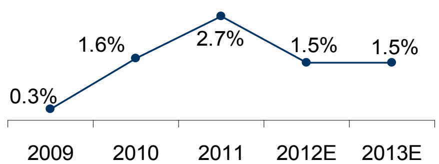
Key Forecasts

Eurozone

GDP



Inflation



- GDP contracted in Q4, including in Germany. Look for more of the same in Q1. Region in recession. Despite deep austerity cuts to come, confidence has improved somewhat in France and Germany, less elsewhere. Consumer spending remains weak; capex intentions uncertain.
- Rate cuts won't have traction before second half, and not then if banks, under pressure to raise capital, choose to do so by shrinking loan books.
- Undervalued currency should help core countries; peripheral outlook grim.

Central Bank Rate

Today **1-year Out**

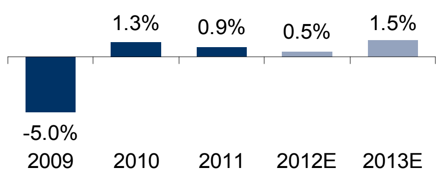
10-year Rate

Today **1-year Out**

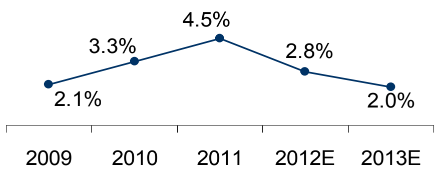
- The ECB now on hold. Inflation below 3% and likely headed toward 2% over the year. More rate cuts feasible if economy weakens further.
- December decision to give banks 3-year access to ECB funding has removed risk of area banks slipping inadvertently into a funding crisis. It has bought time and substantially lowered Spanish, Italian, and French 10-year yields.
- Big loser from "closer fiscal union" or "Eurobond" solution would be German bunds.

U.K.

GDP



Inflation



- U.K. economy continues to slowly weaken. GDP contracted in Q4. Consumer squeezed by inflation, spending weak in January/ February. Capital spending intentions weak.
- Trade was a bright spot in Q4, but half of exports go into the Eurozone—at risk as Europe slips into recession. Heavily exposed to Ireland in both trade and finance. Recession hard to avoid if Europe downturn worsens.
- Inflation fell to 3.4% in February (from 5.2% in September and 3.7% in January). Last year's VAT increase has started to fall out of the calculation, and utility rate increases will do the same this summer. Bank of England forecasts a reading below 2% by year end.

Central Bank Rate

Today **1-year Out**

10-year Rate

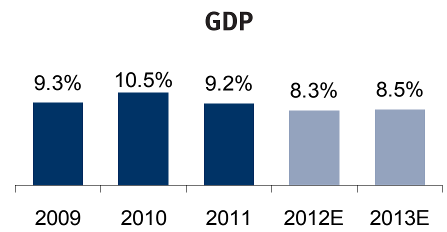
Today **1-year Out**

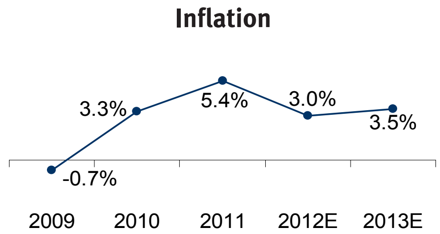
- Inflation ebbing takes the Bank of England (BoE) off the hot seat. Will continue balancing ultra-tight, austerity-driven fiscal policy with very accommodative monetary policy. No rate change before 2013. New round of QE approved in October has since been increased.
- Gilts have benefitted from flight-to-safety bid and the BoE's extended and enlarged QE program. An end to both would herald a more pronounced back-up in yields.

Source: RBC Investment Strategy Committee and RBC Capital Markets

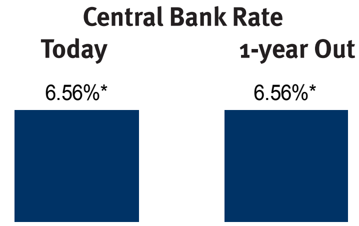
Key Forecasts

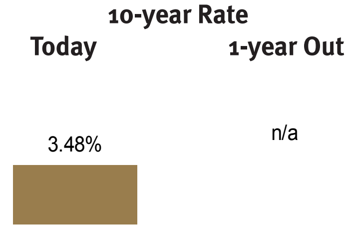
China





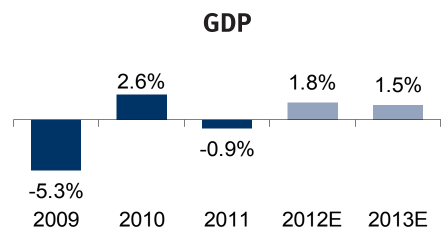
- Economy slowing, exports weaker, especially to Europe. Exports now down year over year, but Jan/Feb affected by New Year holiday.
- Credit crunch hurting small-to-medium manufacturers and property developers. Real estate markets cooling off.
- Gov't fiscal policy supportive, especially via affordable housing construction. Consumer spending growing at double-digit rates.
- Inflation fell sharply to 3.2% in February (from 4.5%) under influence of moderating food prices. Likely to be stickier from here.
- More easing to arrive over 2012. However, policymakers appear willing to allow GDP growth to moderate further rather than risk rekindling price pressures by reversing course too quickly.
- "Soft landing" is our forecast, but meaningful reacceleration is some ways off.

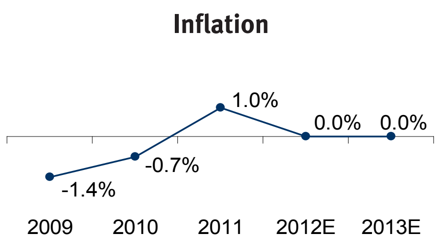




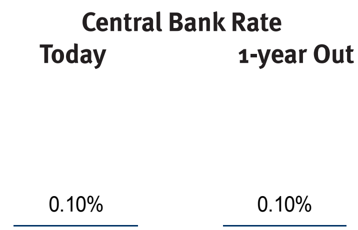
- Reserve requirements at 21.5% and base lending rate at 6.56% produced a credit crunch and brought money supply growth down to just 13%. Bank lending growth continues to slow. Inflation has fallen in half.
- Reserve requirements (RR) were lowered by 50 bps in December and again in February. We expect another 200-300 basis points of RR easing over 2012 but at a measured pace. Interest rate cuts unlikely until inflation rate seen to be sustainably below one-year deposit rate (3.50%).

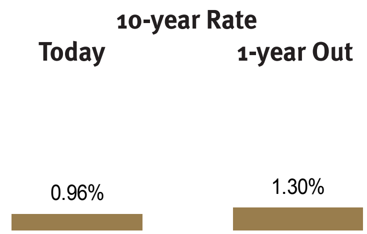
Japan





- Reconstruction and restart of the auto sector produced the promised V-shaped recovery from the earthquake-induced downturn, but industrial production faded following the summer spurt. GDP shrank by 0.6% in Q4. Currency strength has become a drag on trade.
- Growth in first half likely to be respectable against easy comps; supply disruptions from Thai flooding no longer a factor. Second half will need stronger demand from China and America.
- Retail trade and machinery orders both ticked higher in Q4. However, lacklustre domestic demand together with a more challenging export environment in 2012 suggest growth will quickly subside into the sub-2% zone. Inflation not a factor.





- Bank of Japan provided plenty of liquidity during the Tsunami crisis and has now embarked on an expanded (again) QE program (¥ 65 trillion) buying Japanese Government Bonds, citing European concerns and the strength of the yen. It also lowered its growth and inflation forecasts for 2012 and 2013 and is under increasing pressure to do more.

Source: RBC Investment Strategy Committee and RBC Capital Markets
*1-yr base lending rate for working capital, People's Bank of China; Source: Consensus Economics

Research Resources and Important Information

Research Resources

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Craig Bishop – Head of U.S. Fixed Income Strategies, RBC WM Portfolio Advisory Group
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