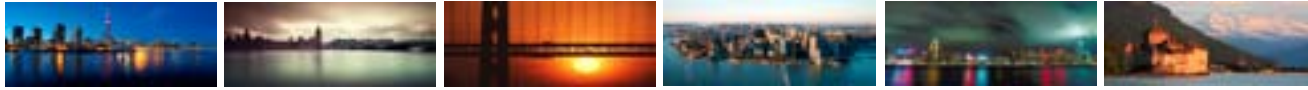


RBC Wealth Management | Global Insight Weekly



- » The Federal Reserve was in the spotlight during the week. A commitment to maintain its low interest rate policy despite potential tapering of asset purchases led to strong gains across global equity markets.
- » Global economic data continues to suggest growth in the emerging markets has slowed.
- » Earnings forecasts assume that elevated profit margins will move higher. The potential for higher interest rates, capital spending, and wages poses risks to profitability.
- » Global Roundup: Updates from the U.S., Canada, Europe, and Asia Pacific. (pages 3-4)

GLOBAL INSIGHT MONTHLY NOW AVAILABLE

The July edition discusses RBC's latest thoughts about the economy, equities, fixed income, currencies, and asset allocation. It also includes ...

Blue Skies Called Off Again: We have shifted our global equity rating down to Neutral and adjusted our regional ratings. Stock and bond markets should remain volatile as global interest rates continue to normalize.

Risk Management: Time for some house cleaning in equity portfolios. Reduce exposure to riskier holdings while looking for opportunities to add to high-quality stocks and re-evaluating regional positions.

Equity Scorecard – July 12, 2013

Index (local currency)	Level	1 week	MTD	YTD
S&P 500	1,680.19	3.0%	4.6%	17.8%
S&P/TSX Comp	12,462.17	2.7%	2.7%	0.2%
FTSE All Share	3,468.85	2.7%	5.4%	12.1%
Hang Seng	21,277.28	2.0%	2.3%	-6.1%
Dow (DJIA)	15,464.30	2.2%	3.7%	18.0%
NASDAQ	3,600.08	3.5%	5.8%	19.2%
Russell 2000	1,036.52	3.1%	6.0%	22.0%
STOXX Europe 600	296.20	2.7%	3.9%	5.9%
German DAX	8,212.77	5.2%	3.2%	7.9%
Nikkei 225	14,506.25	1.4%	6.1%	39.5%
Straits Times	3,236.06	2.1%	2.7%	2.2%
Shanghai Comp	2,039.49	1.6%	3.0%	-10.1%
Brazil Bovespa	45,533.24	0.7%	-4.1%	-25.3%

Note: Equity returns do not include dividends.

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Markets & the Economy

Market Scorecard – July 12, 2013

Govt Bonds (bps chg)	Yield	1 week	MTD	YTD
US 2-Yr Tsy	0.339%	-5.6	-1.6	9.2
US 10-Yr Tsy	2.582%	-15.7	9.6	82.5
Canada 2-Yr	1.138%	-8.7	-8.3	-0.3
Canada 10-Yr	2.432%	-11.8	-0.7	63.4
UK 2-Yr	0.359%	-4.2	-3.9	3.6
UK 10-Yr	2.328%	-15.7	-11.5	50.0
Germany 2-Yr	0.103%	-0.9	-8.5	11.8
Germany 10-Yr	1.560%	-15.9	-16.8	24.4
Commodities (USD)	Price	1 week	MTD	YTD
Gold (spot \$/oz)	1,284.90	5.0%	4.1%	-23.3%
Silver (spot \$/oz)	19.92	5.3%	1.3%	-34.4%
Copper (\$/ton)	6,992.00	3.1%	3.9%	-11.6%
Oil (WTI spot/bbl)	105.95	2.6%	9.7%	15.4%
Oil (Brent spot/bbl)	109.19	1.0%	6.8%	-3.2%
Natural Gas (\$/mBtu)	3.61	2.4%	1.0%	4.9%
Agriculture Index	392.57	3.8%	2.0%	-13.0%
Currencies	Rate	1 week	MTD	YTD
US Dollar Index	82.97	-1.8%	-0.2%	4.0%
CAD/USD	0.96	1.8%	1.2%	-4.6%
USD/CAD	1.04	-1.8%	-1.2%	4.8%
EUR/USD	1.31	1.9%	0.4%	-1.0%
GBP/USD	1.51	1.5%	-0.7%	-7.0%
AUD/USD	0.91	-0.1%	-0.8%	-12.8%
USD/CHF	0.95	-1.8%	0.1%	3.4%
USD/JPY	99.30	-1.9%	0.2%	14.5%
EUR/JPY	129.75	-0.1%	0.6%	13.4%
EUR/GBP	0.86	0.3%	1.1%	6.5%
EUR/CHF	1.24	0.0%	0.6%	2.4%
USD/SGD	1.26	-1.5%	-0.5%	3.3%
USD/CNY	6.14	0.1%	0.0%	-1.5%
USD/BRL	2.27	0.6%	1.6%	10.5%

Source: Bloomberg. Note: Bond yields in local currencies. Copper and Agriculture Index data as of Thursday's close. 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. Data as of 8:31 pm GMT 7/12/13.

Examples of how to interpret currency data: CAD/USD 0.96 means 1 Canadian dollar will buy 0.96 U.S. dollar. CAD/USD -4.6% return means the Canadian dollar fell 4.6% vs. the U.S. dollar year to date. USD/JPY 99.30 means 1 U.S. dollar will buy 99.30 yen. USD/JPY 14.5% return means the U.S. dollar rose 14.5% vs. the yen year to date.

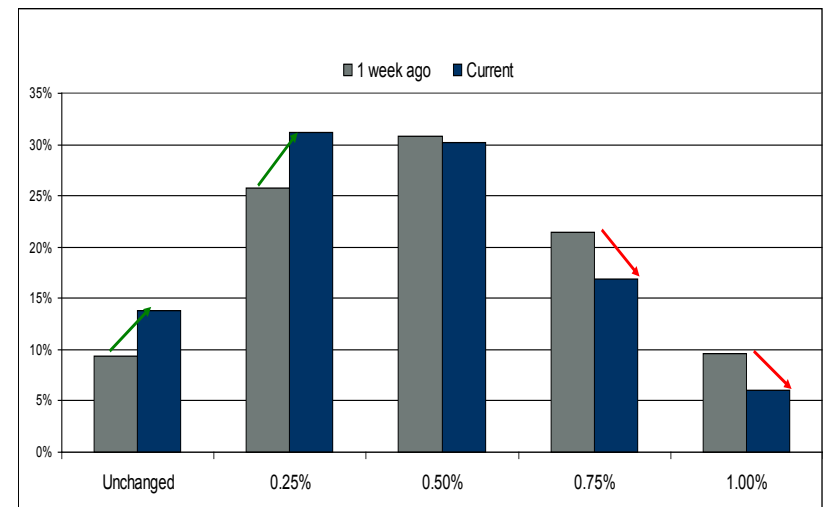
The week was marked by a strong recovery in global equity markets. The move was largely fuelled by comments made by Federal Reserve Chairman Ben Bernanke.

He was relatively clear in his remarks that a potential tapering of asset purchases, expected later this year, would not mark a change in the Fed's commitment to low interest rate policy. Bernanke went on to suggest that while there have been improvements in employment, the job outlook remains far from healthy, and disinflation remains a risk that bears monitoring. His comments were well received by global investors that had become concerned that a shift in interest

rate policy was on the horizon, perhaps much sooner than most expected. Expectations around a hike in the federal funds rate changed meaningfully over the past week (see chart).

The Federal Reserve's comments had a significant impact across global markets. One of the more-noticeable impacts was in emerging market equities, which have been under meaningful pressure in the last months, given weak economic data, volatility in the currency markets, and concerns over rising bond yields. Despite the strength seen in some of these regions in the latter half of the week, the recent economic data continues to paint a picture of a backdrop that is challenging. More specifically, China's trade numbers for the month of June fell short of expectations, with exports falling more than 3% year over year, while imports also fell over

Implied Probabilities of Federal Reserve Rate Hike by January 2015



Source Bloomberg

the month, by 0.7%. Furthermore, remarks from a government official suggested growth in the country could miss the official target of 7.5% for 2013. This news comes ahead of the release of the Chinese second-quarter GDP figure.

The focus of investors is likely to shift away from the macro economic backdrop and central bank policy over the coming weeks. The second-quarter earnings season is officially underway. According to Thomson Reuters, earnings expectations for companies in the S&P 500 sit at a modest 3% growth, which is lower than the 8.4% reported in the year-ago quarter. In particular, the banks will be in focus, given the strong performance in the sector of late that has been fuelled by the recovery in the housing market and employment.

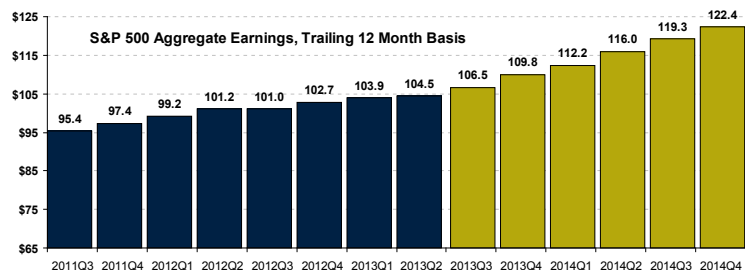
U.S. CORPORATE PROFIT MARGINS—HOW MUCH HIGHER?

One of the key drivers of the advance in the U.S. stock market since 2009 has been the steady increase in corporate profit margins, defined as the ratio of earnings to sales.

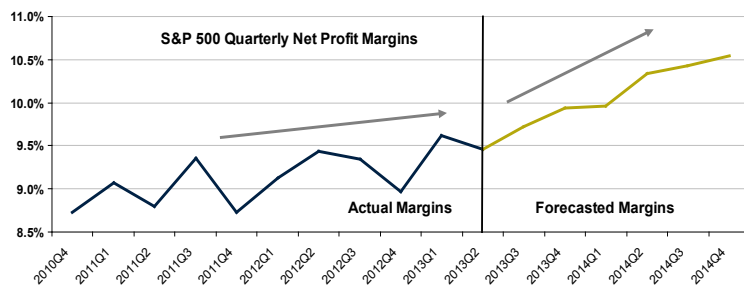
CEOs have proven adept at trimming expenses, and this has allowed profits to increase at a faster clip than the lukewarm sales growth typical of a below-par economic recovery. This has supported stocks by boosting cash earnings and valuation multiples.

As attention turns to the prospect of a sustainable recovery, we consider what effect increasing economic momentum may have on the ability of executives to continue to improve profitability and whether stock analysts may be too optimistic on this count.

Consensus Profit Forecasts.....



....Are Based on the Assumption Margin Growth will Accelerate



Charts Source - FactSet Research Systems, RBC Wealth Management

The recession was good for margins. Really.

Profit margins for U.S. companies are higher than they've been in decades. Several factors have contributed to this upswing, most of which were actually amplified by the economic downturn.

For example, total interest expenses for companies have fallen dramatically since the recession. This is a function of lower interest rates and a lower appetite to borrow. As the economy normalizes, we expect both of these trends to reverse, leading to higher spending to service debt.

Additionally, effective corporate tax rates have been abnormally low as fiscal discipline took a back seat to sustaining a fragile economy. Many temporary tax breaks and loopholes are likely to expire or close over the next few years.

Depreciation costs have also fallen as executives have held off on investing in new capital goods. As business confidence returns, old equipment will need to be replaced, and the cost will hit the bottom line over the next several years.

Corporate America has also benefited from a weak dollar. Overseas operations account for about 45% of the total earnings of S&P 500 companies, up from about 25% at the end of the last century. If the U.S. dollar continues to appreciate as interest rates rise, the profitability in dollar terms of international businesses will face headwinds.

What about wages?

For most companies, employee compensation is still the most important cost of doing business. After adjusting for inflation, wage costs in the U.S. are at the same level as in 2008.

The high unemployment and low labor mobility rates since the recession have combined to freeze wages, allowing the lion's share of corporate productivity gains to drop to the bottom line.

However, we are seeing signs U.S. corporations are having to compete for labor again. The surprisingly strong June jobs report released recently showed aggregate wages increased 0.6% during the month. While the rate of change is still low, the data suggests wage growth bottomed at the start of the year and is now turning up.

Is the market complacent about costs?

Earnings forecasts for the next few quarters imply a steady increase in profits (see top chart). However a deeper dig into analysts' calculations shows this growth assumes a sharp *upturn* in profit margins, even as the cost-containment trends of the past appear to be reversing (see bottom chart). This may not be enough to derail a strong stock market, but investor caution is warranted all the same.

Global Roundup

United States

- **The S&P 500 ended the week meaningfully higher.** Federal Reserve Chairman Ben Bernanke made comments that suggested the central bank is **unlikely to change its low interest rate policy** despite the potential for it to scale back on large-scale asset purchases later this year. The commentary helped to relieve some concern that was rising with respect to a marked shift in policy that could have led to an earlier-than-expected rise in its short-term federal funds rate.
- The Q2 earnings season officially kicked off. Positively, companies like **Alcoa, Yum Brands, JP Morgan Chase, and Wells Fargo** reported results that were higher than consensus forecasts.



Global Roundup

- **Coming up:** Q2 earnings all week, Retail Sales (July 15); Consumer Price Index and Industrial Production (July 16); Housing Starts (July 17).

Canada

- Corporate earnings were the main focus in Canada during the week. **Corus Entertainment, Couche-Tard, and Jean Coutu** reported results **below consensus** expectations, while **Cogeco Cable** posted **stronger-than-expected** earnings and provided upbeat guidance.
- **Government of Canada bond yields moved lower across the yield curve.** The largest decline in yields came on short and intermediate maturities as comments by Fed Chairman Ben Bernanke on July 10, drew a clear distinction between reigning in QE asset purchases and moving short-term rates higher. Short- and intermediate-term Canadian and U.S. government bond yields had jumped considerably in recent weeks on fears of higher short-term rates, so these comments precipitated a considerable relief rally.
- **It was a mixed bag of economic data in Canada,** as the Business Outlook Survey showed softening sales expectations, while housing starts were better than expected, and the Bank of Canada's (BoC) Senior Loan Officer Survey reflected an easing in credit conditions.
- **Coming up:** BoC Rate Decision (July 17).

Europe

- **Equity Markets in Europe continued their positive trend.** The **Bank of England (BoE) and European Central Bank (ECB) kept interest rate levels unchanged** and took unprecedented steps in providing forward guidance to investors.

- The **ECB expects the key interest rates to remain at present or lower levels for an extended period of time** and justified this guidance referring to the subdued outlook for inflation and the broad-based weakness in the economy.
- The BoE's Monetary Policy Committee (MPC) statement noted the recent rise in market rates would undermine the outlook for the economy and the implied trajectory for policy rates was not warranted by the recent economic developments.
- **Other macro economic data in Europe were mixed** with Spanish and Italian Manufacturing Purchasing Managers' Indexes for June showing another month of improvement, ending the third quarter on a positive note. Though the pace of activity is likely to remain subdued for some time, the headline readings increased the perception the recession in both countries could bottom out in the second half of the year. **In Germany, industrial production fell 1% in May, after three robust monthly gains.**
- **In the U.K., lending statistics data suggested credit continued to flow more easily to households than in the corporate sector,** with mortgage approvals increasing rapidly to 104,000 from 98,500.
- **Coming up:** U.K. Consumer Price Index (July 16); BoE MPC Minutes (July 17); U.K. Public Finances (July 19).

Asia Pacific

- **Bank Indonesia raised its benchmark rate by 50 basis points to 6.5%,** more than expected. The bank is trying to tackle inflation, which may top 8% towards the end of the year. **Inflationary pressures increased recently**

when the government reduced subsidies on fuel, thereby sending prices up. **The Bank reduced its 2013 GDP growth forecast to 5.8%-6.2%,** 0.4% lower than the previous forecast.

- **The Bank of Japan raised its assessment of the economy** and still intends to implement its expansion of the country's monetary base as it seeks to lift the country out of deflation. **The Bank of Korea kept its benchmark rate at 2.5%** even as it raised its 2014 growth forecast to 4% from 3.8%.
- **Rates were also kept on hold in Malaysia and Thailand. The Bank of Thailand confirmed it is about to downgrade its GDP forecast,** but also noted the recent slowdown in domestic demand was partly due to a normalization in the growth rate from previously high levels brought on by government stimulus.
- **Chinese trade data was weaker than expected. Exports fell 3.1% in June, over a year ago, while imports declined by 0.7%. Consumer price inflation rose to 2.7% in June,** in line with forecasts and within the government's target range. **Producer price inflation, however, declined by 2.7%** and has been declining for 16 months. The Shanghai Interbank Offered Rates (SHBIOR) continued to moderate after the spike in June.
- **Lou Jiwei, China's finance minister, noted in Washington he expects growth to be over 7% this year.** The government's official target is 7.5%. Notably, Lou said 6.5% growth would not be a "big problem." Separately, **Prime Minister Li Keqiang implied the government would stabilize growth in China if it fell below the government's lower limit.** Chinese equities rallied on the speech.

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			Count	%
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Hold (SP)	644	43.28	162	25.16
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