August 2016

RBC WEALTH MANAGEMENT

Global Insight

Perspectives from the Global Portfolio Advisory Committee

REITs: A home of their own

Real estate is finally getting a home of its own as an index sector. This will change the way investors approach portfolio construction.

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RBC Wealth Management

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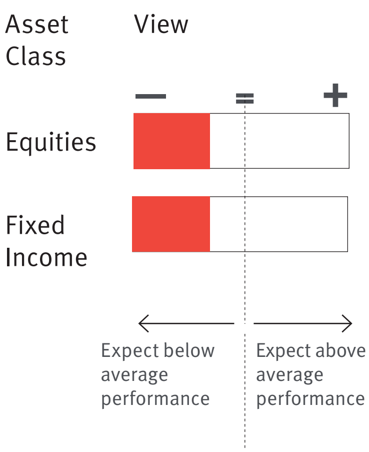

See "Views explanation" below for details

Source - RBC Wealth Management

Equities

- Global equities should deliver moderate gains in the coming year as major economies, excluding the U.K., are likely to keep growing at least slowly and corporate earnings should improve as the Energy sector recovers. Valuations are below average in Asia, and above average in North America and Europe. While they are not so high as to choke off the rally, additional "easy" multiple expansion seems unlikely in the near term.

- The current environment calls for greater selectivity within equity portfolios—not just in terms of which markets or sectors to own, but also in terms of which stocks to own. We favor secular and stable growers that are less dependent on the economic cycle. Our modest Underweight recommendation for global equities overall stems mostly from concerns around economic and earnings growth in the U.K. and Europe.

Fixed Income

- Volatility in fixed income markets should quiet down in August following the gyrations that surrounded the Brexit vote during the first half of the summer. The Bank of England is the only central bank scheduled to meet in August and it is expected to cut the benchmark rate 25 basis points to 0.25%. Given weak Q2 GDP growth in the U.S. and a continued focus on global developments, we still believe the Federal Reserve will refrain from hiking interest rates in 2016.
- We remain constructive on corporate credit overall, but continue to recommend being selective about adding exposure as spreads for many sectors are at the tightest levels so far this year. Rather than chase performance, we would exercise patience in putting new money to work at current levels in some segments of the credit market—for example, U.S. high yield—preferring to wait for better entry points.

Views explanation

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

+ Overweight implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

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

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

Focus article

REITs: A home of their own

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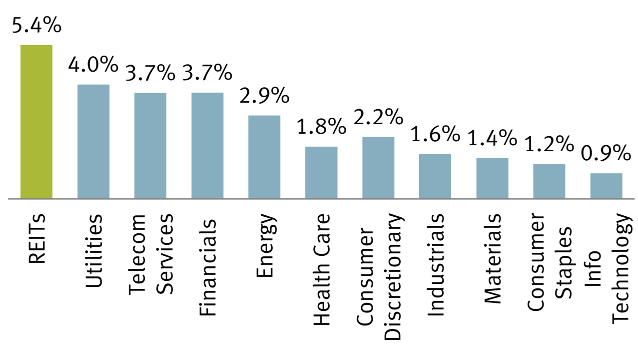
Real Estate Investment Trusts and Real Estate Operating Companies (REITs and REOCs) will come out of the Financials sector to comprise their own, stand-alone industry sector in September 2016. We expect this will raise the profile of these companies, provoke wider analyst coverage, and result in higher trading volumes.

Real Estate now a standalone GICS sector

Following an annual review of the GICS in 2014, S&P Dow Jones Indices and MSCI announced the creation of a new sector. Real Estate will become the 11th GICS sector in the U.S. and Canada effective September 1, 2016, having already been promoted to a headline sector in the U.K. and Australia. Real Estate Investment Trusts (REITs), Real Estate Operating Companies (REOCs), and real estate management and development companies will shift to the Real Estate sector. Mortgage REITs, which are involved in financing, will remain in Financials.

The Canadian Real Estate sector would be the eighth-largest within the S&P/TSX Composite based on current market capitalization, while leading all sectors in terms of dividend yield, followed by the Utilities and Telecom sectors. In comparison, the U.S. Real Estate sector would be the ninth-largest sector within the S&P 500 and would sport the second-highest dividend yield, surpassed only by the Telecom sector.

TSX sectors' dividend yields



Source - RBC Dominion Securities, Bloomberg; data through 7/25/16

Canadian REITs lead all TSX sectors in dividend yields.

This pending change recognizes that REITs and REOCs have characteristics which are distinct and unique from most of the companies classified within the rest of the Financials sector. We believe a standalone sector classification may result in a broader investor base (including more institutional investors), greater research coverage from the analyst community, and improved liquidity thanks to higher trading volumes.

Structural aspects make REITs distinct

REITs are structured as mutual fund trusts, making them, in a legal entity sense, distinctly different from a corporation. This trust structure is subject to no entity level taxation as long as it meets certain criteria within the Income Tax Act (the

All values in this article in Canadian dollars.

"REIT rules"). One component of these REIT rules dictates that a REIT must pay out substantially all of its taxable income. This results in distribution payout ratios which are typically 70%–100% of adjusted funds from operations (AFFO)[1] and cash yields which are typically high versus many other sectors. Relative to the shareholder in a public corporation, the structure also places the entire taxation burden directly onto the trust unitholder.

In terms of valuation, investors typically use a different set of analysis and valuation metrics to evaluate REITs.

[In the U.S., REITs are typically structured as corporations. Special provisions within the Internal Revenue Code provide that a U.S. REIT is also not subject to entity-level taxation as long as it distributes at least 90% of annual taxable income to shareholders in the form of dividends, and meets other criteria.]

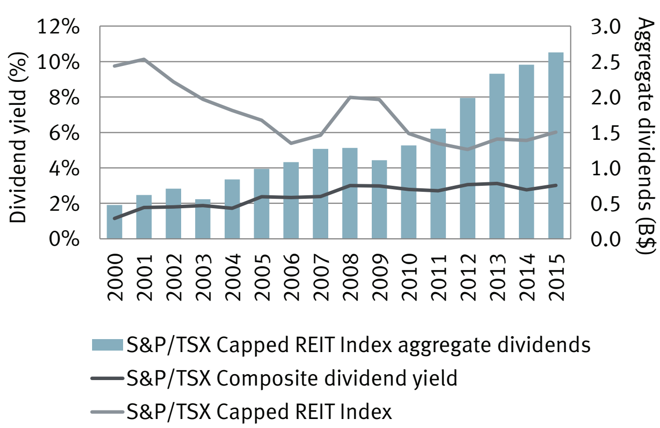
In terms of valuation, investors typically use a different set of analysis and valuation metrics to evaluate REITs. Historical valuation multiples for REITs are generally based on *net asset value (NAV)*[2] and *AFFO* rather than the *earnings per share* figure more commonly used for a corporation.

Overall, we believe the rationale for shifting REITs and REOCs to a standalone GICS sector have merit and that the change will prove neutral-to-beneficial for the sector.

Portfolio benefits

Depending upon the measurement period, listed REITs and REOCs may (or may not) have been strongly correlated to the broader equity market. Since 2000, the monthly correlation between the S&P/TSX Capped REIT Index and the equity benchmark, the S&P/TSX Composite, has averaged 0.55. The correlation between the REIT benchmark and a bond index proxy, the FTSE TMX Canada Universe Bond Index is even lower at 0.12. These low levels of correlation suggest to us that investors may be able to enhance the risk-return profile of a traditional equity/bond portfolio by adding REIT exposure.

TSX REIT Index dividend yield versus TSX Composite dividend yield & TSX REIT Index aggregate dividends



Canadian REITs have demonstrated consistent distribution growth over the long term.

Source - RBC Dominion Securities, Bloomberg

[1] Adjusted Funds From Operations: A measure for the cash flow from a REIT's underlying assets, less an amount required to maintain the assets in operating condition. As such, it is both a key gauge of distribution capacity and a useful valuation metric.

[2] Net Asset Value: NAVs provide investors with an indication of the underlying value of a REIT's assets less its liabilities, based on private-market valuations.

Real Estate GICs sector

Over long time periods, REITs and REOCs should also protect their investors from the effects of inflation.

The steady and generally growing cash distributions provided by many REITs and REOCs have been a key factor propelling the rising allocation within portfolios. Since 2000, more than 80% of the total returns of the S&P/TSX Capped REIT Index have come from the cash distribution of income. In aggregate, these distributions have grown from $500M in 2000 to $2.6B, representing a compounded annual growth rate of approximately 12%. We would note that the annual dividend yield for the S&P/TSX Capped REIT Index has averaged 6.9% over the past 15 years, well above the 2.4% level of the S&P/TSX Composite.

Over long time periods, REITs and REOCs should also protect their investors from the effects of inflation. Over the long term, rents typically readjust as the price levels in the broader economy change. In the shorter term, many REITs may also be shielded from the volatility of rising (or falling) operating costs (e.g., utilities, property taxes, etc.) as the lease terms for some real estate assets (e.g., retail, industrial, and office properties) are such that the tenants pay these expenses on a pass-through basis.

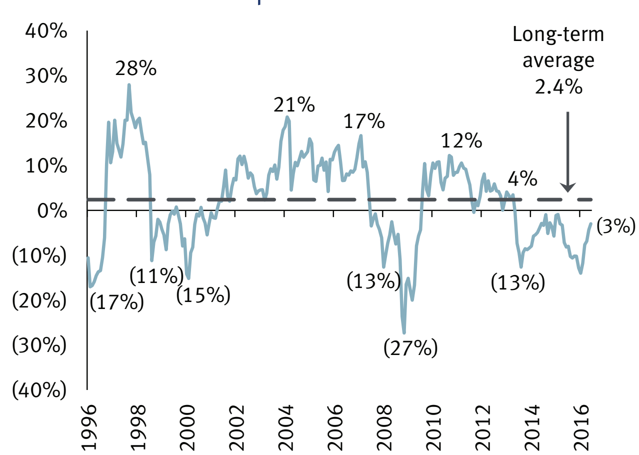
Potential rebalancing effects underappreciated

Early in the year, we were somewhat skeptical as to whether the classification of REITs and REOCs into their own distinct GICS sector would have any appreciable impact on valuation. As the year has progressed, we believe our original view may have been too conservative.

While it is often difficult to separate specific cause and effect within the context of the overall stock markets, we do note that the Canadian listed real estate companies (as measured by the S&P/TSX Capped REIT Index) have generated strong returns (+17.8% on a price basis and +21.3% on a total-return basis through June) this year. Moreover, this performance is one of the strongest across global REIT markets (e.g., total returns have been 12.6% in the U.S., 16.4% in Australia, -7.3% in Japan; and -13.4% in the U.K., measured in local currencies).

We attribute this year's strong returns to date to the fact Canadian REITs entered 2016 at very attractive valuation levels—the industry was trading at a 13% discount to NAV and a 13.6x multiple of forward AFFO. However, given that the S&P/TSX Composite is roughly 38% weighted towards Financials, of which only three percentage points are real estate, we believe many institutional portfolio managers

Canadian REIT sector price to net asset value



Canadian REITs are trading at a modest discount relative to their estimated net asset value.

Source - RBC Capital Markets, RBC Dominion Securities; data through 6/17/16

Investors should be selective about adding exposure to REITs.

have been underweight the property sector, with a bias towards owning a fewer number of the larger-cap Financials over REITs and REOCs.

A separately constituted Real Estate sector may, therefore, create the need for portfolio managers to *"have a view"* on the sector and an explanation for their underweight, neutral weight, or overweight positioning. If our thesis that "underweights" predominate is correct, then perhaps a flow-of-funds phenomenon towards at least partially neutralizing that stance may have driven the strong total-return performance amongst the REITs this year.

Strong returns year to date have tapered the value opportunities in REITs and pushed valuations for the sector into "fair value" territory. Investors should be selective about adding exposure to REITs, with a focus on solid balance sheets, capacity for distribution growth, and a diversified asset base.

Focus article

Digital disruption

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The U.S. Information Technology sector is riding a wave of innovation that we believe can take it to higher levels and pull the S&P 500 up with it. Cloud computing, cyber security software, the "Internet of Things," together with other emerging technologies have created new investment categories within the sector. In our view, reasonable valuations combined with attractive growth prospects make this sector a timely candidate for overweighting in portfolios.

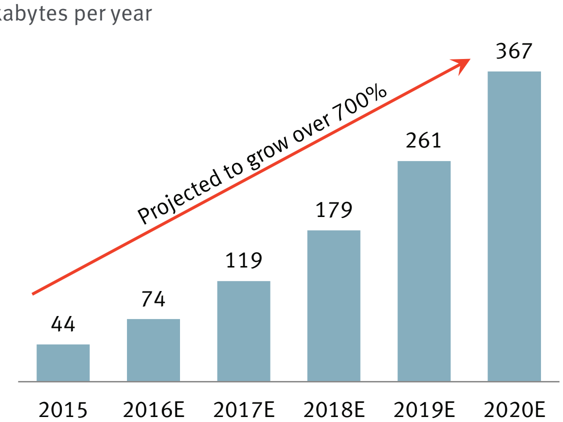
We are long past the days when the personal computer was considered the hub of the U.S. Tech sector. Nor is the smartphone, which burst on the scene in 2007, the center of the Tech investment universe anymore. Over the past few years, tech innovation has leaped well beyond those categories despite subpar U.S. and global economic growth.

Now the sector revolves around an array of newer technologies such as cloud computing, big data analytics, cybersecurity software, "smart" advertising on mobile devices, video streaming over the internet, and semiconductors geared toward the "Internet of Things." A "fintech" category is also emerging, aimed at delivering financial services more efficiently through technology solutions.

For those and other innovative tech areas, growth opportunities are compelling. For example, RBC Capital Markets believes internet advertising will represent 44% of total global advertising by 2018, up from 28% in 2014. It estimates cybersecurity spending will surge 47% from 2013 to 2018, and regards the adoption of cloud computing as only in its adolescent phase. At the same time, it estimates mobile data traffic will likely continue to skyrocket (see chart).

Forecast global mobile data traffic

In exabytes per year



Mobile data could grow exponentially by 2020.

Source - RBC Capital Markets, Cisco VNI Report (2015); 2016 and onward are Cisco estimates; 1 exabyte = 1 billion gigabytes

What's an exabyte?

One exabyte, referenced in the prior chart, is equal to roughly one quintillion (1,000,000,000,000,000,000) bytes of digital data, or 1 billion gigabytes. But that definition just doesn't cut it for most of us. We can imagine that's big, but just how big? One exabyte is equivalent to ...

- The content of 5.68 million miles (9.14 million kilometers) of printed books lined up on a shelf, or
- Content that would fill almost 7,000 times the amount of bookshelf space at the U.S. Library of Congress, the world's largest library, or
- More than 333 million hours of streaming high definition movies or television shows over the internet.

In other words, one exabyte represents an extraordinarily large unit of digital data.

Source - RBC Wealth Management, Library of Congress, Netflix, techopedia.com, whatsabyte.com

Meanwhile, next-generation technologies are in the works including mass data intelligence, augmented reality, artificial intelligence, human-to-computer interfaces, advanced robotics, autonomous vehicles, and the convergence of health care and technology.

The digital hub

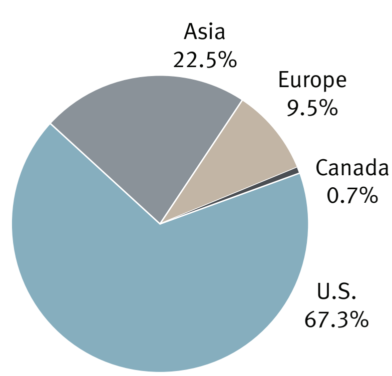
We believe investors should zero in on the U.S. Tech sector because it is the source of much of this innovation.

Most global tech companies are domiciled in the U.S. They represent a far greater share of the S&P 500 compared to Tech sectors in other country and global indexes. The U.S. is the home of eight of the 10 largest tech firms worldwide by market capitalization. Among the largest 100 tech companies globally, U.S.-based firms garnered 67% of the revenue in the past 12 months.

Top 10 largest publicly-listed tech companies globally, ranked by market capitalization (in USD billion)

Company	Headquarters	Market cap	Revenue in past 12 mos.
Apple	U.S.	561.5	220.3
Alphabet (Google)	U.S.	535.0	81.8
Microsoft	U.S.	441.7	85.3
Facebook	U.S.	355.9	22.2
Tencent	China	225.1	17.7
Oracle	U.S.	169.2	37.0
Intel	U.S.	164.6	56.6
Cisco Systems	U.S.	153.6	49.5
IBM	U.S.	153.5	80.3
TSMC	Taiwan	145.4	25.9

Geographic revenue breakdown of world's largest 100 publicly-listed tech firms by market cap



Source - RBC Wealth Management, Bloomberg; data as of 7/29/16; percentages do not total 100% due to rounding

Tech is cheaper than the S&P 500 and its historical average.

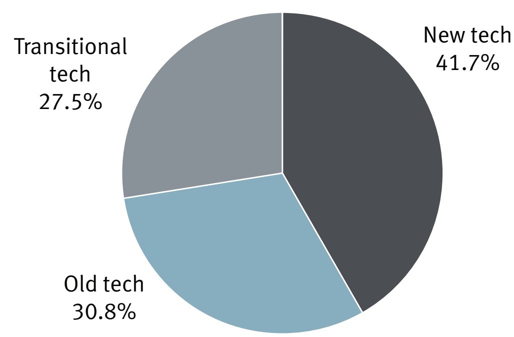
So much change has unfolded so rapidly, the composition of the sector has shifted dramatically.

"New tech"—companies geared toward the innovations cited previously—represents the largest part of the U.S. Tech sector by market capitalization at almost 42%, according to RBC Capital Markets. Examples of such companies include Facebook ("smart" mobile advertising, development of virtual reality), salesforce.com (cloud computing), and PayPal (fintech).

Companies mainly leveraged toward technologies that prevailed 5–10 or so years ago—"old tech"—make up the second-largest share of the sector at roughly 31%. Examples of these companies are Texas Instruments (chips for cellphones and other traditional applications), Juniper Networks (legacy routing, switching, and related networking solutions), and Micron Technology (DRAM, SRAM, and other memory chips).

"Transitional tech" firms, which have old tech foundations but are increasingly generating revenue from new tech innovations they have developed or acquired, represent the rest of the sector. These types of companies include Microsoft (cloud computing along with its traditional Windows software business), Visa (a "fintech" firm due to mobile payments initiative and classified as Tech by Standard & Poor's), and Cisco Systems (networking software and equipment for "Internet of Things" combined with traditional networking).

Market cap share of U.S. Tech sector by innovation category



New and transitional tech make up 69% of the sector.

Source - RBC Capital Markets, FactSet; data as of 6/20/16

Capture relative value

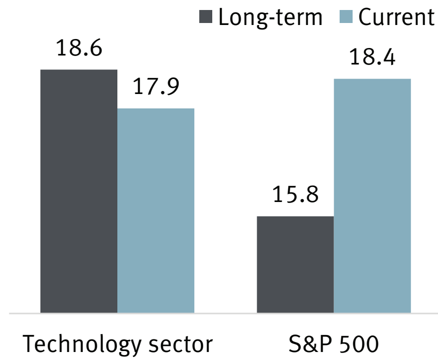
Despite the rapid take-up of significant innovations and emergence of new tech, the sector's valuation is reasonable based on a number of measures.

The Tech sector is trading below the market multiple and at nearly a 4% discount to its long-term average price-to-earnings ratio, while the S&P 500 is trading at a 16% premium to its norm (see left chart on following page).

Tech's free cash flow yield—one measure of expected return—exceeds the S&P 500 and all other sectors except for Financials and Telecommunications.

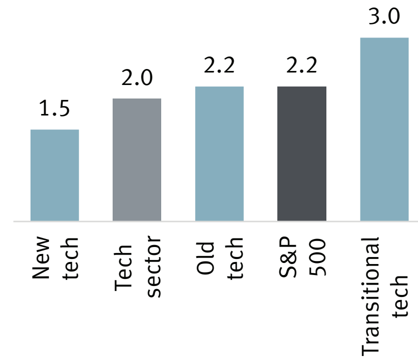
Admittedly, valuation metrics of some tech stocks seem quite stretched, including those of select new tech firms. But when earnings growth is taken into consideration, new tech is actually the cheapest category (see right chart on next page). New tech's revenue outlook also appears to be bright. The sector seems positioned to increase revenue 7.1% in the next 12 months, well ahead of old and transitional tech at 4.5% and 2.1%, respectively, and the S&P 500 at 4.0%, according to consensus forecasts.

Tech & S&P 500 P/E ratios based on 12-month forward earnings



Source - RBC Wealth Management, Bloomberg; "Current" data represents 8/1/16; long-term is quarterly data back to Q1 1990

Price-to-earnings growth ratios (PEG) based on next 12 months forecasts



RBC Capital Markets, Thomson Financial, FactSet; data based on consensus forecasts on 6/20/16

Most new tech companies are secular growers—meaning, they are caught up in long-term innovation trends that are separate from the economic cycle. We believe such companies deserve premium valuations because of their scarcity, especially since growth is more difficult to come by in this subpar economic environment.

Semi-tough

The sector is our technical analyst's favorite for new buying.

Technical indicators also point toward improved performance for the Tech sector. The bellwether semiconductor and internet industries recently broke out above previous resistance levels and seem likely to trade higher, in our view. The relative strength of semis is noteworthy because in the past such moves often led to or coincided with strength in the Tech sector as a whole and the broader U.S. equity market. RBC Wealth Management's technical analyst believes "… a new wave of buying interest is starting to show up in some of the larger technology names, many of which are starting to break out of long trading ranges, and could be starting some longer-term uptrends. This is our favorite market sector for new buying …"

Potential bugs in the system

Reasonable valuations and innovation trends don't fully shield the sector from outside threats. At this stage, we are monitoring two potential risks for the sector:

- **Global IP growth** – If global industrial production (IP) slows down, mature cyclically-oriented old tech companies and some transitional tech firms that are leveraged to the economic cycle may have more difficultly growing.
- **Dollar strength** – Sources of revenue for the U.S. Tech sector are among the most geographically diverse of all sectors, so another period of dollar strength would negatively impact U.S. Tech earnings, mostly due to adverse currency "translation effects."

Have a byte

In our view, despite the potential headwinds, innovation trends combined with reasonable valuations and attractive growth prospects amid this sluggish economic environment are compelling reasons to overweight the U.S. Tech sector in portfolios. We believe the innovation wave has the sector well positioned to help lead the S&P 500 in the next year or longer. We regard U.S. Tech as a timely overweight opportunity for inclusion in U.S. and global portfolios, and view new tech as the most attractive category for long-term investors.

Follow the leaders

So far, Brexit's impact on equity markets has been a two-day "flash in the pan"—especially when we look at markets in local currency terms. For example, in London the FTSE All-Share Index rallied strongly off its Brexit low and currently stands 5% ahead of where it was the day of the vote. But over that same interval, the pound collapsed to 30-year lows. That leaves the FTSE All-Share down 8% in dollar terms. Looked at the same way, European stocks are almost 4% lower, Canada's TSX is flat, and the S&P 500 is up 2.5%.

More importantly, the Brexit result has dimmed what was already a tepid outlook for global economic growth. Most of this comes from slower growth on the Continent and a likely (mild) recession in the U.K. But the disappointing first estimate of U.S. Q2 GDP growth has cast an additional pall over global economic prospects.

Earnings expectations, already down from more optimistic levels earlier in the year, may erode further. As a consequence, the advance in equity prices has now pushed the price-to-earnings (P/E) ratios of most developed markets up to more expensive levels.

P/E ratios could still go higher: in fact, we believe they are likely to if corporate bond yields drop further. But any stock market advance that builds from here is unlikely to be a tide that lifts all boats. Rather, we expect investors to focus increasingly on sectors and individual businesses that appear capable of delivering worthwhile sales and earnings growth—a tall order in a slower growth world. The *Digital disruption* article on page 8 focuses on one such secular growth sector—Technology—and specifically on one category, so-called "new tech."

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Equity views

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

Source - RBC Wealth Management

This is not a "sector rotation" story—i.e., head to the sectors that typically do well in this part of the cycle—but rather a "head to high conviction sales and earnings growth" environment. Only companies that deliver on growth will continue to command investor favour. Unless global economic growth meaningfully reaccelerates, we would look for a gradual narrowing of market leadership and a market P/E ratio that moves higher amid a combination of much more extravagant multiples accorded those companies investors anoint as proven growers, those with "the right stuff," and much less vibrant valuations for everyone else.

For a global equity portfolio, we believe a modest Underweight in equities is appropriate. This stems mostly from our concerns about the long period of policy uncertainty facing the EU and U.K. economies. This is not a call for investors to shift into a highly defensive stance. As long as no U.S. recession or renewed global economic contraction is in sight, and we don't think either is, then, in our opinion, equities can be given the benefit of the doubt and are likely to be the best-performing asset class. However, it is very much a call for selectivity where a focus on businesses that can thrive despite the shallow global growth trajectory is likely to be rewarded disproportionately.

Regional highlights

United States

- After trading in a sideways range for more than two years, the S&P 500 broke out to a new all-time high in July. This is encouraging because such a move has historically resulted in additional gains. Since 1954, on the 12 previous occasions that it took the S&P 500 one year or more to reach a new peak, the market rose 92% of the time 12 months later. The average gain was 12%, not including dividends.

- There are also fundamental reasons to believe the market could work its way higher over the next year. The worst of the "earnings recession" seems to be over as Energy sector losses have been the main culprit holding back S&P 500 earnings. Those losses should diminish substantially in Q3 and the sector could move into the black in Q4. This would likely push S&P 500 earnings growth to the mid-single-digit range or better for the first time since Q4 2014.

- If the bull market persists as we expect it will, strong secular and stable growth companies should reassert their leadership roles. The Information Technology sector seems particularly well positioned. We also favor the Consumer Discretionary and Consumer Staples sectors. Furthermore, small-cap stocks are attractive for investors with above-average risk tolerances.

Canada

- We maintain our Overweight recommendation in Canadian equities due to our constructive outlook for key sectors. We believe earnings expectations for banks have troughed; the Energy sector should benefit from further rebalancing in the crude oil market while heightened geopolitical uncertainty creates a favorable backdrop for the gold sector.

- The Canadian banks are trading at a price-to-earnings valuation roughly in line with the long-term average. While industry headwinds suggest limited prospects for valuation expansion, we believe subdued earnings expectations and historically attractive dividend yields offer reasonable value.

- The rail industry has been mired in a protracted period of weak demand since 2014's record volumes. In response, management teams have taken action to rationalize costs. As a result, any eventual return of volume growth could translate into substantial earnings growth.

- RBC Capital Markets' latest WTI crude oil forecast calls for an average price of $59 per barrel in 2017, a 31% increase over the 2016 forecast of $45. Historically, the S&P/TSX has outperformed the S&P 500 in years when crude oil prices have increased 10% or more.

- Global geopolitical and economic uncertainties coupled with ongoing monetary stimulus provide a strong case for gold exposure. We expect precious metal producer share prices to remain highly sensitive to the price of the underlying commodity and would be selective with our entry point for investors looking to add exposure.

Continental Europe & U.K.

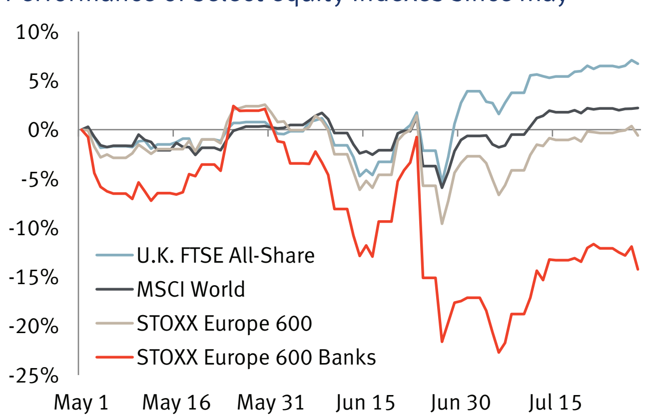
- The FTSE All-Share Index is now above its pre-EU referendum level in local currency (GBP) terms. This resilient performance can be explained by three factors. First, markets have reacted to the faster-than-expected transition to a new prime minister, which removed one layer of political uncertainty. Second, the anticipation of supportive action from the Bank of England has helped to stabilize sentiment. Third, many large companies, most of which are exporters, have benefitted from the steep decline of the local currency (-12%).

- Yet, the ambiguity regarding the U.K.'s future position in the EU, its largest export partner, remains acute and is affecting hiring and investment decisions, as illustrated by the recent flash Composite PMI, which fell into contractionary territory (47.7).
- Our bias remains towards large-cap, non-cyclical companies with diversified international exposure. Opportunities in the embattled domestic cyclical sector may appear, though it is still too early, in our view. We continue to be cautious of the banking sector, which will likely suffer in the lower-for-longer interest rate environment.
- By contrast, European economic indicators are holding up well for now. The weakening euro may give a much needed tailwind to meagre earnings expectations, currently below 2%. With a very heavy political agenda over the next 15 months, and a banking sector challenged by negative interest rates and crippling nonperforming loans (Italy), we find other regions more attractive.

Asia

- Asian markets continued to rebound after the initial selloff following the Brexit result. The MSCI AC Asia Pacific Index pared all losses in 2016.
- Japanese stocks led the rally in July thanks to the yen weakening to 106 per dollar. Expectations that Prime Minister Shinzo Abe would come up with major fiscal stimulus grew after the ruling Liberal Democratic Party scored a convincing victory in Japan's Upper House election. In June, Abe delayed the planned sales tax hike and pledged to take "bold" measures to support the economy. Japan's TOPIX Index is trading at a price-to-book multiple of 1.14x.
- China's economy continued to steady. GDP grew 6.7% in Q2, in line with the Q1 reading and slightly better than the 6.6% consensus forecast. Both industrial output and retail sales came in better than expected. Consumer spending remained resilient. Fixed asset investment slowed to 9% as property investment eased from the April peak.
- The yuan came under pressure after the Brexit vote. Both onshore and offshore RMB weakened to around 6.7 per dollar. However, the depreciation didn't lead to significant capital outflow like that seen at the end of 2015 and the beginning of 2016. China's foreign exchange reserves rose by $13.5B in June.

Performance of select equity indexes since May

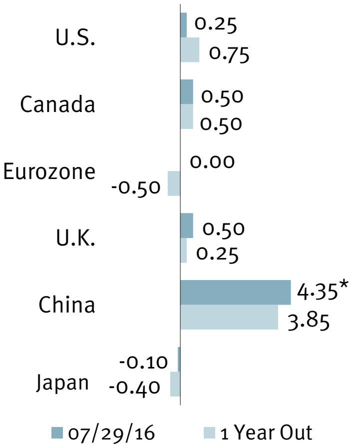


European banks have been hit hard by Brexit while the U.K. has recovered.

Source - RBC Wealth Management, Bloomberg; data through 7/28/16

The eye of the storm

Central bank rate (%)



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

Fixed income markets should remain relatively calm through August after a tumultuous period of volatility in the first six weeks of summer. With the exception of the Bank of England, which will convene on August 4, most central banks will not hold regular policy meetings again until September. That barren central bank calendar combined with direction provided at July meetings leaves few catalysts for government bond markets on the near-term horizon. The welcome respite will likely prove brief as we expect September to be a fairly volatile month.

The Bank of England signaled at its July policy meeting, the first after the Brexit referendum, that stimulus was likely coming in August. In addition to a prospective cut to its benchmark interest rate, the BoE plans to share its near-term outlook for growth and inflation at its August meeting. Over the medium term, investors will be keenly attuned to inflation data given the steep decline of the British pound will likely prove inflationary, perhaps limiting the scope of growth-inducing monetary stimulus.

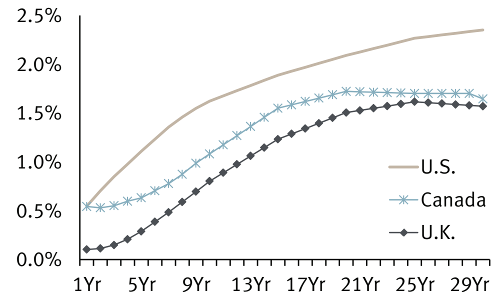
We remain constructive but increasingly selective on corporate credit. The summer doldrums are likely to take hold this month in credit markets after a very healthy month of new supply in July. Expectations for prolonged accommodation from major central banks continued to feed a thirst for yield in July, pushing spreads to the tightest levels of 2016 in many sectors.

Regional highlights

United States

- The Fed held policy steady at the July FOMC meeting but noted that near-term risks to its economic outlook

Sovereign yield curves



Source - Bloomberg

have diminished. We continue to believe a rate hike will not come before 2017. The Fed is likely to exhibit caution given the full impact of Brexit remains uncertain. Inflation has yet to move convincingly toward the Fed's 2% target, which is also likely to support the Fed's inclination to stand pat.

- Credit spreads tightened sharply in July to the lowest levels in over a year. The high-yield market led the way with particular strength in the energy sector despite a sharp decline in oil prices to $42 from the $50 level achieved in June. While we continue to believe that the U.S. credit markets will perform well over a medium-term horizon, we would exercise caution at this point when putting new money to work given the magnitude of the rally to date.
- The global hunt for yield has driven valuations in the $25 par preferred share market to extreme levels, in our view. The $1,000 par fixed-to-float market has not participated to the same extent, and we see opportunities for investors to swap out of $25 par holdings and into $1,000 par securities of the same issuer and with similar structures, but with more attractive yield-to-calls.

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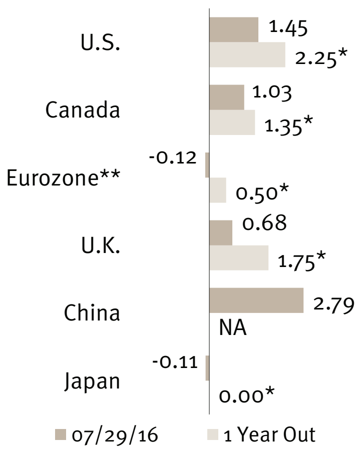
Global fixed income

10-year rate (%)



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

Canada

- The Canadian preferred share market rallied 2.6% during July. We believe that preferred shares continue to offer the best relative yield of the CAD investment-grade options. The yield that investors currently earn on preferred shares presents a better risk-return profile than we believe exists in the corporate bond market.

- Canadian government bonds in the 1- to 10-year range held up better than comparable U.S. issues in July as the latter sold off in response to stronger domestic economic data. With the Brexit result now in the rear view mirror, we anticipate the theme of monetary policy divergence between Canada and the U.S. to be the primary driver of government bond yields. That said, market activity is likely to be to be muted given expectations for future rate hikes have been pushed out until 2017.

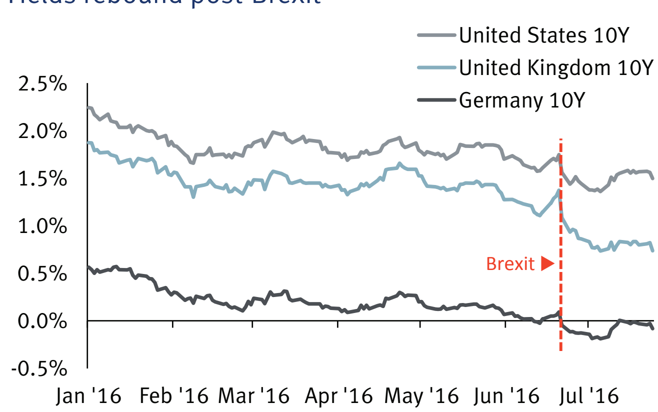
Continental Europe & U.K.

- The U.K.'s decision to leave the EU continued to affect European fixed income markets through July. Uncertainty has kept Gilt yields at depressed levels, a situation that we expect to linger for some time. Despite a recent move higher, the 10-year Gilt yield is 50 basis points lower than it was pre-Brexit, sitting at 0.88%. We struggle to find a catalyst to take yields higher in the U.K., particularly over the short term where additional loosening of monetary policy is expected.

- Investors in European government bonds have largely written off any effect of Brexit. Peripheral country spreads have fully recovered and German bund yields are back to pre-Brexit levels around 0%. While these yield levels seem perplexing, the European Central Bank's (ECB) bond purchase programs should keep European yields anchored. Providing inflation expectations remain low and growth tepid, the ECB would not surprise were it to introduce further easing measures over the summer months. As such, we remain comfortable taking duration risk.

- European credit has seen a strong recovery rally since the initial shock of Brexit. U.K. corporates retain a Brexit premium and we expect this to remain, particularly in financials and retail names. Valuations are catching our attention, but we fail to find them appropriate for conservative fixed income investors.

Yields rebound post-Brexit



Global yields have stabilized as near-term Brexit concerns have eased, but long-term questions should keep yields contained.

Source - RBC Wealth Management, Bloomberg; data through 7/29/16

The golden bull

Commodity forecasts

	2016E	2017E
Oil (WTI $/bbl)	45.00	59.00
Natural Gas ($/mmBtu)	2.40	3.00
Gold ($/oz)	1,250	1,500
Copper ($/lb)	2.10	2.25
Corn ($/bu)	3.86	3.92
Wheat ($/bu)	4.65	5.00

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

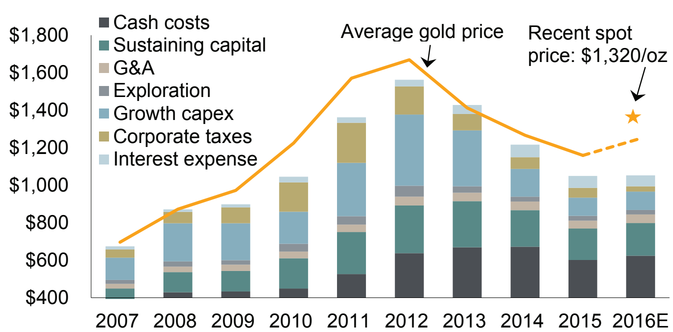
There are many reasons to look favorably on gold. Low and negative bond yields offer investors limited opportunity in fixed income. After a long, multi-year run in U.S. equities, valuations are now somewhat above historical averages. Growth data from the world's two-largest economies—the U.S. and China—have been choppy over the past year. Aggressive monetary policy and high sovereign debt burdens around the world have reduced the dry powder available for the next period economic slowdown. Finally, the recent vote by the British to exit the E.U. has weighed on the outlook for Europe.

With this macroeconomic backdrop and amid equity market volatility, investors have turned to gold as a safe haven this year. This trend has been reflected in a resurgence of gold ETF holdings and a spiking of speculative long positions in gold on the COMEX.

While the price of gold has moved up significantly, from about $1,100/oz. at the beginning of the year to over $1,300/oz. recently, gold equities have risen much further than bullion with the VanEck Vectors Gold Miners ETF roughly doubling year to date. The pronounced difference in performance can be explained by the operating leverage in the industry. Looking at the top nine gold miners, production costs, including corporate overhead and select capital expenditures, are estimated at about $1,150/oz. this year (see chart). With a cost base this high, the cash margin for the industry has expanded dramatically as gold prices have risen, hence delivering a substantial run in gold equities. In a recent publication, RBC Capital Markets estimated that Tier I (large cap) and Tier II (mid cap) producers were discounting gold prices on average that were largely in line with spot gold at levels just over $1,300/oz.

Strong demand for gold reinforced by recent fund flows in the investment realm, and more constrained mine supply growth provide fundamental supports. The Brexit result has introduced more geopolitical and economic uncertainty for a major trading block. We think Brexit is also likely to lead the Federal Reserve to a lower-for-longer tilt on interest rates, which may attenuate future appreciation of the U.S. dollar. Low and negative bond yields, significant appreciation of U.S. equities in recent years, and economic and geopolitical uncertainty all provide solid arguments for gold as portfolio ballast, in our opinion. We would expect this environment to provide continued support to the price of gold going forward.

Global gold equity cost structure



High industry costs have led to a substantial jump higher in cash margins as the price of gold has increased from $1,100/oz. to over $1,300/oz.

Source - RBC Capital Markets, RBC Wealth Management; data as of 7/26/16

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Currencies

Currency forecasts

Currency pair	Current rate	Forecast Sep 2017	Change*
Major currencies			
USD Index	95.53	100.59	5%
CAD/USD	0.77	0.77	0%
USD/CAD	1.30	1.30	0%
EUR/USD	1.12	1.03	-8%
GBP/USD	1.32	1.20	-9%
USD/CHF	0.97	1.06	9%
USD/JPY	102.06	95.00	-7%
AUD/USD	0.76	0.67	-12%
NZD/USD	0.72	0.59	-18%
EUR/JPY	114.06	98.00	-14%
EUR/GBP	0.84	0.86	2%
EUR/CHF	1.08	1.09	1%
Emerging currencies			
USD/CNY	6.64	7.40	11%
USD/INR	67.00	72.00	7%
USD/SGD	1.34	1.58	18%
USD/PLN	3.90	4.08	5%

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

U.S. dollar

The dollar continued to strengthen throughout early July, maintaining its post-Brexit gains when measured on a holistic basis. After recent weakness in U.S. data, signs of a rebound in Q2, including a healthy payroll report and retail sales, had helped to underpin the move. Despite this, a weaker GDP report at the end of the month resulted in a decline for the greenback, with the dollar surrendering some of its gains. While the jury may be out on the chances of Fed rate hikes this year, several Fed speakers have been quick to remind markets of the potential for a rate hike, and we maintain our bullish outlook for the dollar.

Euro

The single currency has been gradually moving lower the past month due to a confluence of factors. Much hinges on whether the European Central Bank delivers changes to its quantitative easing programme should post-Brexit data suggest the euro area economy needs greater stimulus. With low inflation, political uncertainty, and lower global growth, we remain strategically bearish on the EUR.

British pound

Sterling has remained at depressed levels after the U.K. referendum result led to a sudden, sharp decline. As highlighted last month, we moved to a negative outlook for the pound, but the key to the velocity of any further decline will depend on the immediate economic impacts of the Brexit vote, as well as the process and speed of trade negotiations. On the former, we will need to wait until August/September for first indications, while on the latter the wait may be much longer.

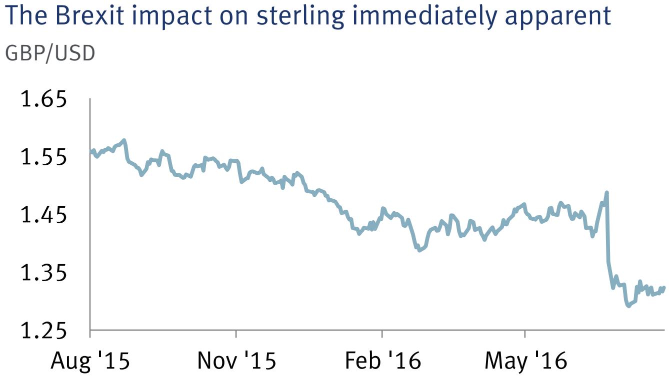
Canadian dollar

A more positive-than-expected statement from the Bank of Canada has caused markets to pare back expectations of a future rate cut and kept the currency well supported. However, this move has been somewhat muted against the backdrop of a stronger USD. Partner this central bank optimism with RBC Capital Markets' forecast for a further rally in oil prices and we remain comfortable with our modestly bullish view.

Japanese yen

The yen rallied very strongly as investors sought safe havens following the U.K.'s shock referendum result. USD/JPY dipped below 100 for the first time since 2013. Since then, speculation about potential coordinated fiscal and monetary easing has seen the yen aggressively trade in a broad 100–107 range. Despite a considerable amount of volatility between last month and now, we still struggle to find real direction amongst all the noise, and would remain vigilant in managing yen exposure during this difficult period.

The Brexit impact on sterling immediately apparent



Velocity of downturn dependent on severity of decline in economic activity.

Source - Bloomberg, RBC Wealth Management; data through 7/29/16

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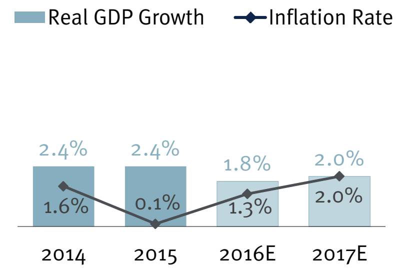
Key forecasts

Forecasts are under review.

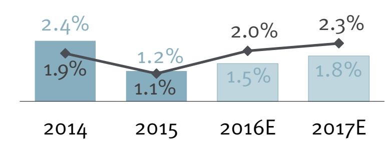
United States — sustained growth

- Q2 GDP growth a disappointing 1.2% largely due to continued inventory liquidation. Mfg. new orders and production expanding faster. Consumer balance sheets, income growth, employment, confidence all strong. Spending up 4.2% in Q2, saving solid. Housing steady, permits higher. Capex soft, exports weak. Leading indicators, confidence point to sustained, albeit slow, domestic growth.



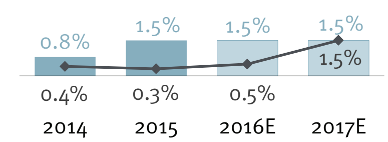
Canada — in transition

- Q1 growth improved to 2.5%. Q2 likely much weaker. Fort McMurray fires a big drag, should reverse in Q3. House construction firm, PMI off its high, but steady. Energy capex weak. Consumer attitude restrained by resource sector weakness. Mfg. sales ex-petroleum products growing consistently, as are exports including services and tourism all helped by weak loonie.



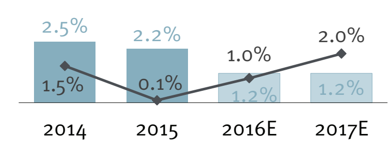
Eurozone — plateauing

- Q2 growth slowed to 1.7% in Q2. Germany and Spain solid. France and Italy fading after a better Q1. Bank loans to private sector up year over year. PMIs still in expansion zone. New orders weaker. Fractious politics, Brexit weighing on consumer and business sentiment. Tourism bookings down sharply. Italian banks keeping ECB ultra loose. GDP growth to hold steady in 2016 and 2017.



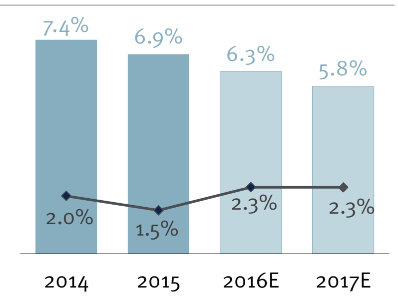
United Kingdom — weakening

- Q2 GDP improved ahead of Brexit vote. However, PMIs, new orders slumped into contraction territory in July. Construction weak as is business confidence. Important services sector also affected. Employment firmer prior to vote as were household earnings.
- Mild recession expected in 2nd half. Economy likely to underperform as EU uncertainty takes a toll.



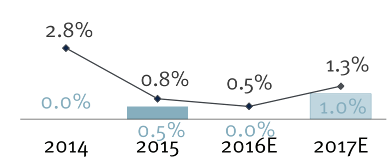
China — slowing

- Q2 firm, GDP now at +6.7% y/y. Domestic loan growth distorted lately by paydown of U.S. dollar debt, but loans still growing faster than GDP. PMIs and new orders improved in July. Services sector PMI also strengthening. Employment, wages, retail sales all growing, but somewhat more slowly. Exports, industrial production, mfg. output all steady in June.
- Fixed asset investment slowing. Currency weaker. House prices higher year over year in major centers.



Japan — conflicted, still weak

- GDP growth regained positive territory in Q1, but barely positive over 12 mos. Leading indicators and mfg. PMI have ticked higher, services somewhat weaker. Corporate earnings solid, but business confidence weak.
- Wages growing, but household spending weak. Low oil prices, strong currency putting inflation targets in jeopardy. Planned sales tax increase has been put off until 2018, new fiscal package announced.



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

Market scorecard

Index (local currency)	Level	1 Month	YTD	12 Month
S&P 500	2,173.60	3.6%	6.3%	3.3%
Dow Industrials (DJIA)	18,432.24	2.8%	5.8%	4.2%
NASDAQ	5,162.13	6.6%	3.1%	0.7%
Russell 2000	1,219.94	5.9%	7.4%	-1.5%
S&P/TSX Comp	14,582.74	3.7%	12.1%	0.8%
FTSE All-Share	3,653.83	3.9%	6.1%	0.0%
STOXX Europe 600	341.89	3.6%	-6.5%	-13.7%
German DAX	10,337.50	6.8%	-3.8%	-8.6%
Hang Seng	21,891.37	5.3%	-0.1%	-11.1%
Shanghai Comp	2,979.34	1.7%	-15.8%	-18.7%
Nikkei 225	16,569.27	6.4%	-12.9%	-19.5%
India Sensex	28,051.86	3.9%	7.4%	-0.2%
Singapore Straits Times	2,868.69	1.0%	-0.5%	-10.4%
Brazil Ibovespa	57,308.21	11.2%	32.2%	12.7%
Mexican Bolsa IPC	46,660.67	1.5%	8.6%	4.3%
Bond Yields	**7/29/16**	**6/30/16**	**7/31/15**	**12 mo chg**
US 2-Yr Tsy	0.655%	0.582%	0.661%	-0.01%
US 10-Yr Tsy	1.453%	1.470%	2.180%	-0.73%
Canada 2-Yr	0.540%	0.518%	0.409%	0.13%
Canada 10-Yr	1.027%	1.061%	1.441%	-0.41%
UK 2-Yr	0.110%	0.099%	0.568%	-0.46%
UK 10-Yr	0.685%	0.867%	1.882%	-1.20%
Germany 2-Yr	-0.625%	-0.661%	-0.232%	-0.39%
Germany 10-Yr	-0.119%	-0.130%	0.644%	-0.76%
Commodities (USD)	**Price**	**1 Month**	**YTD**	**12 Month**
Gold (spot $/oz)	1,351.00	2.2%	27.3%	23.3%
Silver (spot $/oz)	20.34	8.7%	46.8%	37.6%
Copper ($/metric ton)	4,915.25	1.6%	4.5%	-5.9%
Uranium ($/lb)	25.00	-7.4%	-27.3%	-30.6%
Oil (WTI spot/bbl)	41.60	-13.9%	12.3%	-11.7%
Oil (Brent spot/bbl)	42.46	-14.5%	13.9%	-18.7%
Natural Gas ($/mmBtu)	2.88	-1.6%	23.1%	5.9%
Agriculture Index	290.17	-6.5%	2.3%	1.5%
Currencies	**Rate**	**1 Month**	**YTD**	**12 Month**
US Dollar Index	95.53	-0.6%	-3.1%	-1.9%
CAD/USD	0.77	-0.9%	6.1%	0.3%
USD/CAD	1.30	0.8%	-5.8%	-0.5%
EUR/USD	1.12	0.6%	2.9%	1.7%
GBP/USD	1.32	-0.6%	-10.2%	-15.3%
AUD/USD	0.76	1.9%	4.3%	3.9%
USD/CHF	0.97	-0.7%	-3.3%	0.3%
USD/JPY	102.06	-1.1%	-15.1%	-17.6%
EUR/JPY	114.06	-0.5%	-12.7%	-16.2%
EUR/GBP	0.84	1.2%	14.6%	20.1%
EUR/CHF	1.08	-0.1%	-0.5%	2.0%
USD/SGD	1.34	-0.6%	-5.6%	-2.4%
USD/CNY	6.64	-0.2%	2.2%	6.8%
USD/BRL	3.25	1.1%	-18.0%	-5.0%

Equities bounced sharply following the Brexit lows. Canadian market far exceeding peers year to date.

Though the BoE chose not to cut rates in July, expectations it will in August dragged yields to new lows.

Oil corrected as U.S. supply discipline came into question.

Despite initial Brexit gains, the Dollar Index ended July lower due to the weak U.S. Q2 GDP report

Equity returns do not include dividends, except for the German DAX. Equity performance and bond yields in local currencies. U.S. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing. Examples of how to interpret currency data: CAD/USD 0.77 means 1 Canadian dollar will buy 0.77 U.S. dollar. CAD/USD -0.3% return means the Canadian dollar has fallen 0.3% vs. the U.S. dollar during the past 12 months. USD/JPY 102.06 means 1 U.S. dollar will buy 102.06 yen. USD/JPY -17.6% return means the U.S. dollar has fallen 17.6% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 7/29/16.

Research resources

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

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

Distribution of Ratings - RBC Capital Markets, LLC Equity Research
As of June 30, 2016

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	878	50.51	246	28.02
Hold [Sector Perform]	741	42.64	129	17.41
Sell [Underperform]	119	6.85	10	8.40

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

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