MARCH 2016

RBC WEALTH MANAGEMENT

# GLOBAL INSIGHT

PERSPECTIVES FROM THE GLOBAL PORTFOLIO ADVISORY COMMITTEE

## Taking Canada's Pulse

We're checking the Canadian economy's vital signs and giving our prognosis for its outlook.

Matt Barasch | Page 4

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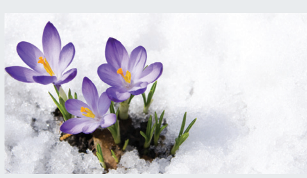

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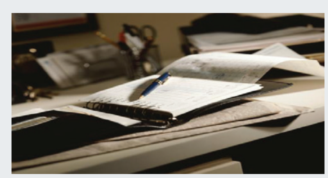

GLOBAL FIXED INCOME
IT'S ABOUT TO GET EASIER

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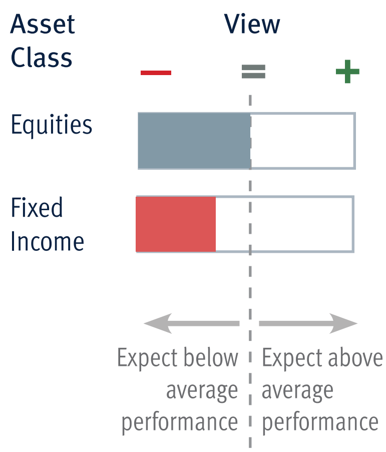
All values in U.S. dollars and priced as of February 29, 2016, market close, EST, unless otherwise noted.

*Global Asset*
Class View

# RBC's Investment Stance

### Global Asset Views




See "Views Explanation" below for details

Source - RBC Wealth Management

## Equities

- Following an onslaught of economic, commodity, and currency headwinds, the global equity market has managed to bounce off the correction low and seems likely to reward investors over the course of the year.
- The U.S. economy is defying the naysayers once again as growth is picking up on the back of stronger consumer spending and healthy employment gains. Add to that accommodative central bank policies and hints of stabilization in China's currency, and some stresses in the global economy should ease.
- Equity valuations are supportive in North America and Europe, and are relatively inexpensive in Asia. Outside of the Energy Sector, earnings for most developed markets should rise at least moderately this year. We continue to recommend accumulating high-quality stocks and maintaining a targeted, full allocation to equities.

## Fixed Income

- Even though major central banks have pursued highly unorthodox policies for more than seven years, they are not finished yet. At meetings this month, we expect the European Central Bank to ease policy again and the Federal Reserve to strike a dovish tone, pushing out the normalization of interest rates. The long arm of central banks is likely to extend throughout 2016, at least.
- There are opportunities in fixed income despite near- or below-zero percent benchmark interest rates in many developed countries. In our view, investors should take advantage of the recent widening of credit spreads in segments of the corporate bond market and extend duration of fixed income holdings. There are also other attractive strategies for investors in North America and Europe (see pages 16–17).

### Views Explanation

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

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

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

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

*Focus*
Article

# Taking Canada's Pulse
## An Interview With Matt Barasch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As the bear continues to stomp about and with markets whiplashed by volatility, we turn to the chief Canadian equity and structured note stategist at RBC Capital Markets, LLC for his diagnosis of the health of Canada's economy. The stress is significant and will take time to dissipate, but he points out some silver linings that may assuage investors' jitters.

### Q. There's been a lot of volatility in the markets which has produced elevated investor concerns about the economy and financial markets. Contrast the current environment with the financial crisis.

**A.** While it's understandable that folks are still scarred by what took place back in 2008 and 2009, what markets are currently experiencing does not have much in common with what we went through back then. There was a "three-sigma" bubble in U.S. housing that had been building up for years and a U.S. banking sector that had massive exposure to this bubble and inadequate capital to deal with it if it went wrong. Of course, it went wrong and that produced a devastating bank balance sheet contraction. It took all the tools in the toolbox to get the global economy going again.

Today, banks are well capitalized, probably even overcapitalized in many cases, while there are no bubbles out there that are bursting around us. Yes, we have had a very large downward move in oil prices and there was a lot of debt issued by oil and gas producers before prices started to come down, but the size of this debt balloon (if we want to extend the analogy) is a drop in the bucket when compared to U.S. housing and the 2008–09 experience. We think today that we are dealing with a bunch of storm clouds coming together at the same time. These include: a Fed rate hiking cycle, which normally carries some wobbles; a Chinese economy that continues to shift from capital expenditure-based to operating expenditure-based, which makes China less predictable and slower growing overall; a U.S. presidential election, which increases uncertainty for markets and has some colorful characters, that probably enhances this uncertainty; and the aforementioned issues with oil. While it might be hard to imagine these storm clouds lifting, they will, and things such as the health of the U.S. consumer, the benefits of lower gasoline and heating oil costs, very stimulative global monetary policy, and compelling valuations on stocks make the outlook pretty interesting.

### Q. What has been behind the disappointing performance of Canadian equities over the last 12+ months?

**A.** You could easily extend 12 months to five years as the S&P/TSX is roughly 1,000 points lower than it was in February of 2011. We think there has been a combination of factors. Oil is obviously the most recent one as the approximate 70% drop from the summer of 2014 has taken a lot of the steam out of a big chunk of the market, while it has also had a knock-on impact on those sectors that are indirectly tied to oil. Going back further, the broader commodity complex collapsed as years of overdeveloping in anticipation of Chinese demand growth that would go on forever, but then slowed sharply, left most commodities with poor supply/demand balances. Add to this gold losing much of its luster as the fear that stemmed from 2008–09 began to abate and you have accounted for a big chunk of the Canadian market that has been under varying degrees of pressure.

One of the easiest trades of the past five years for global investors might have been to position portfolios to reflect poor Canadian growth versus other markets since: (1) the loonie was about 20% overvalued five years ago; (2) our banks were not particularly cheap when compared to global peers; (3) they probably remembered reading an article somewhere that suggested our housing market was a bubble; and (4) oil started to crack along the way. Even Canadians have been similarly positioned to some degree by moving assets to the U.S. market.

The good news is that we think most of these are pretty long in the tooth and global managers are probably not that far off from feeling the same way.

### Q. Can Canadian banks repeat their performance from the last five years over the next five years?

**A.** The Canadian banks did really well from 2011 to 2014, but the past two years have been a much tougher slog. We think the next five years are likely to be somewhere between these two periods in terms of performance. Look, it's going to be tough for the banks to grow earnings by more than say mid-single digits over the next little while as: (1) the yield curve is as flat as a pancake, which hurts net interest margins; (2) credit losses are going to get worse because of the collapse in oil prices and the likelihood of some loan-loss provisions there; and (3) loan growth is probably not going to be any great shakes as Canadian consumers are pretty leveraged and you can only leverage your population once.

This doesn't sound very encouraging, but the banks are starting from a very low valuation point relative to historical norms and some of the above will likely not turn out to be as bad as many fear. The Canadian banks have proven to be great stewards of capital over the past 15 years and we suspect that when we see provisions for credit losses over the next couple of quarters, they are not going to be nearly as bad as some suspect. This should help to boost valuations, so even if overall earnings growth is not great, the combination of a good dividend plus a bit of a valuation bump can still deliver an attractive return.

### Q. Why are depressed oil prices more of a story in 2016 than in 2015?

**A.** We're not sure they are more of a story, but it's much more likely we are going to see some things happen in 2016. 2015 was a weird year because most oil companies entered the year pretty well hedged, so even though prices were down sharply, many oil companies had sold forward a chunk of their production at much-higher prices, so there was not a big incentive to cut near-term production. In addition, many of the shale producers "high-graded" their development, which means they essentially drilled the prospects that would give them the most production for the least amount of spending. Add to this additional barrels from Libya, Iraq, and the lifting of sanctions on Iran and it was almost like 2015 was a "punt the football and wait for 2016" year.

2016 is likely to play out much differently. There are no new barrels coming to market aside from what Iran can put together, while high-grading can only work for so long. Add to this about $400B in capital expenditure cuts and there is the potential that supply takes a bigger hit as we get into the later part of the year. Lastly, we'd note that there's a lot of debt that starts to come due this year (although more in 2017 and 2018) and this may force some more production off the market. Thus, it wouldn't surprise us if we were talking about higher prices as we get to later in the year, especially with demand continuing to rise in response to lower prices.

### Q. How should Canadians view investing in U.S. equities at this juncture?

**A.** With the loonie now roughly 20% below fair value, Canadians probably want to throttle back a bit on U.S. exposure. But this does not mean they should take a hatchet to their U.S. exposure as the loonie is likely to trade below fair value (estimated to be in the low-to-mid-US$0.80s) for the next number of years. The Canadian market has not been this cheap relative to the U.S. market for a long time, so there is an opportunity to sell high and buy low for Canadians who went heavily into the U.S. market over the past half-decade. However, because of the diversification opportunities offered by the U.S. market and the likelihood the currency doesn't hurt you too much (won't be a tailwind, but doesn't mean it becomes a big headwind), we would still keep a healthy dollop of U.S. exposure.

Focus Article

# Europe: Handle With Care

The European Central Bank's lukewarm "action" back in December underwhelmed markets and did little to jump start the region's economy. With mounting credit stress and euro appreciation threatening to stifle growth, the central bank may not be able to tolerate much more before it intervenes with more intense action.


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Recent credit market stress, particularly in the Financials Sector, may have upped the ante for the European Central Bank (ECB) as it considers expanding its unconventional monetary policy measures.

Until recently, eurozone economic data had held up relatively well thanks to a lessening of austerity, some structural reforms, and the early benefits of quantitative easing (QE). More recent indicators have showed declining inflation expectations and softening growth, with the strengthening euro presenting an additional headwind.

We believe the combination of these factors and credit market stress could potentially exacerbate downside risk to the eurozone's still-fragile recovery and compel the ECB to take further action.

## European Fixed Income: How Low Can You Go?

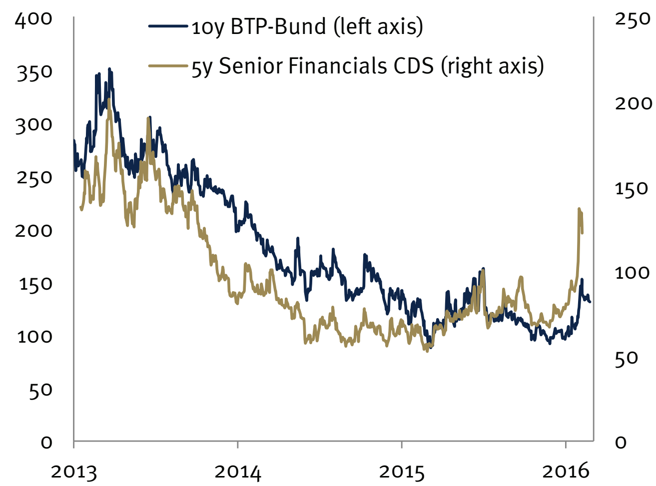
The question for many European fixed income investors is "how low can rates go?" Investors are not only questioning how far into negative territory the ECB can push its deposit rate, but also how low the German Government bond yield curve can move to in 2016. German Bund (10-year) yields are currently not too far off the historical low of 7 basis points, or 0.07%, reached in April 2015.

We believe a re-test of these levels may be inevitable given the ECB's likely policy initiatives to keep overall financial conditions accommodative. ECB President Mario Draghi is likely to act, in our opinion, even though an argument can be made that the pricing of risks at present is exaggerated.

The ECB will utilize various metrics to measure how tight financial conditions have become. For European sovereign markets outside of Germany, the ECB will keep an eye closely trained on the excess amount of interest paid by a sovereign above that of Germany. Although absolute yields of debt issued by Italian or Spanish governments are still low, the chart on the following page shows how spreads to German rates have widened. In our opinion, further spread widening from current levels will likely dent recovery efforts.

In the corporate market, we expect the ECB to focus on spreads in the financials sector given the importance of banks to an economic recovery. The chart shows how credit spreads in the iTraxx Europe Senior Financials Index have now returned to levels last seen in 2013, which suggests a significant tightening of conditions.

Credit Spreads Jump




Source - RBC Wealth Management, Bloomberg; data through 2/29/16

**Stress in the credit markets increases.**

We see a number of attractive opportunities in the European corporate bond market. For more conservative investors, the Utilities Sector provides an interesting alternative to government bonds. While for more balanced investors, we continue to like consumer goods and services companies, particularly those that have recently been through corporate actions, management teams' incentives are to reduce leverage and maintain investment-grade status.

## European Equities: Appreciate Euro Depreciation

We reiterate our neutral stance on European equities. With the recovery taking hold, supported by a tepid, but real improvement in bank lending, lower oil prices, and a weak euro, we expect consensus earnings growth forecasts for the region of 5% y/y in 2016 to be achieved. European earnings are still depressed, with corporate margins still much-below precrisis levels. Valuations, after the recent correction, are becoming compelling, in our view.

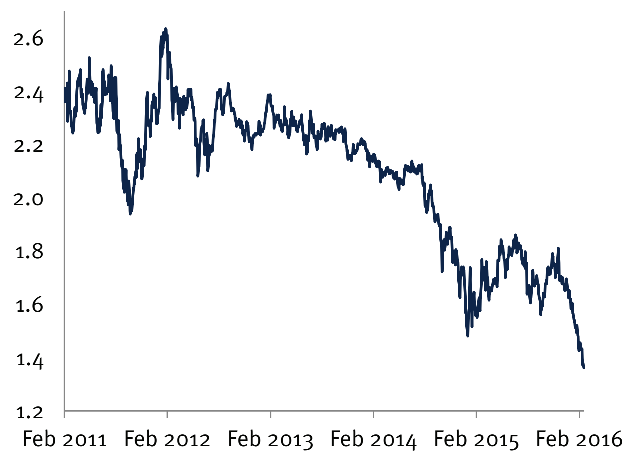
Our preferences are for domestic cyclicals and U.S. dollar earners. We note, however, that if profit-taking continues in U.S. equity markets, and if tensions in credit markets linger, European equities are unlikely to decouple and turn in a sustainable positive performance.

Should the euro weaken during the year, as a result of additional monetary loosening by the ECB, earnings could expand further, as more than half of European sales derive from outside the euro area. In this vein, the euro's recent appreciation is unhelpful.

With STOXX Europe 600 ex UK Index retreating as much as 25% since the summer, we see value starting to emerge. On a price-to-earnings (P/E) ratio of around 13x 2017E earnings, Europe trades roughly in line with its long-term average. Moreover, the region trades at a steep discount to the U.S. on several metrics, for example, trading on a price-to-book value (P/BV) of 1.6x versus the U.S.'s 2.4x. A 33% discount is extreme, even taking into account the European corporate sector's lower profitability.

**Inflation Expectations Tumble**

5-year, 5-year EUR inflation swap rate




Source - RBC Wealth Management, Bloomberg; data through 2/29/16

**Deflation fears are growing, putting pressure on the ECB to act.**

Within the region, however, important discrepancies are appearing. “Quality” companies—those with a resilient business model and robust cash flow generation—are trading at a premium of up to 50% to their lower-quality counterparts. While we continue to suggest quality stocks as core holdings, investors should also start introducing some value names as part of a well-diversified portfolio.

Our sector preferences are for domestic cyclical plays, such as Telecoms. This sector can also be defensive during bouts of volatility. We would expect U.S. dollar earners, such as Consumer Discretionary and Health Care, to benefit from a weak euro.

After a decade of struggles, the outlook for the Telecoms Sector is improving. Lessening macroeconomic and regulatory headwinds, as well as consolidation, have contributed to improving pricing power. After stabilising in 2015, revenues and cash flows should grow in 2016. With most investment programmes largely over, industry capital expenditures are likely to fall over the next five years. Improved cash flows mean the industry’s dividends should not only be sustainable, but also have the potential to grow.

With the expected QE-induced weakening of the euro, we again favour Consumer Discretionary, where we see media benefitting from digitalisation. Health Care is a well-owned sector and there are concerns regarding pricing in the U.S., but pipelines are full.

We are cautious on the banks as the low interest rate environment hurts profitability. Moreover, if sustained, the recent increase in bank credit spreads could dent margins. Valuations are very low, however, with the sector trading at a P/BV of less than 0.7x.

Focus
Article

# The Currency Learning Curve

**With its currency in part behind the turmoil that has plagued markets, China is finding out that joining the upper echelon of global currencies carries significant challenges. China's major goal now is to nurture stability in the renminbi and resurrect market confidence in its ability to smoothly manage the renminbi's journey to a freely tradable currency.**

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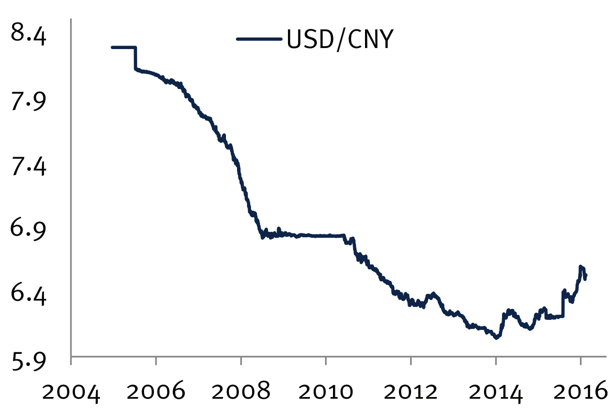
Over the past six months, financial markets have been focussed on the ability of China's central bank, the People's Bank of China (PBoC), to manage the country's currency[1], the renminbi. In August 2015, the PBoC, abandoned a "managed peg" for the CNY versus the U.S. dollar while also immediately depreciating it by nearly 3%. Questions about the PBoC's ability to smoothly transition the CNY to a market-oriented fixing have arisen as doubts continue to linger about China's pace of economic growth. Recent capital outflows suggest growing angst about the PBoC's ability to manage the new currency-fixing regime. The Bank's immediate challenge is how to act in a swift manner that will rebuild confidence without exhausting its foreign currency reserves.

## The Backdrop to Revaluation

We regard the transition away from a managed peg to the U.S. dollar as a revaluation exercise, not a competitive devaluation. The PBoC had maintained such a CNY/USD peg from July 2005 to August 2015, resulting in a long period of exchange rate stability as shown by the below chart. One of the major beneficiaries was the manufacturing industry which enjoyed cost certainty from investment (capital expenditure) and output (production) perspectives. One major risk of this approach was that a peg to the U.S. dollar left the currency vulnerable to dollar strength; a vulnerability that became reality as the greenback strengthened between 2012 and 2015.

PBoC Abandons Managed Peg After Over a Decade




Source - RBC Wealth Management, Bloomberg; data through 2/23/16

**Pressure building for policy makers in Beijing.**

[1] Renminbi is the name of China's currency, and the yuan is the unit. There is an onshore (CNY) and offshore (CNH) renminbi.

By August 2015, the impetus for changing the exchange rate fixing arrived in two forms. First, if China were to realize its long-stated ambition of joining the International Monetary Fund's (IMF) Special Drawing Rights (SDR) basket, it became clear that the managed peg needed to be revisited. Second, the renminbi's appreciation against other currencies in Asia, a function of the peg to a strengthening U.S. dollar, placed Chinese manufacturers at a significant competitive disadvantage and, thus, warranted attention.

## SDR Aspirations

The SDR basket is an international reserve asset created by the IMF to supplement its member countries' official reserves and help facilitate global trade. China's desire to have the renminbi included in the SDR basket had been the subject of IMF study for some time. In August 2015, as part of its five-year annual review, the IMF outlined the inclusion criteria for the renminbi in the SDR basket. The IMF noted that the SDR basket was to reflect the major currencies of countries and/or zones whose exports of goods and services had the largest value over the prior five-year period, and, whose currency was determined by the IMF to be "freely usable". While the renminbi met the IMF's export criterion, it fell short in tradability. Thus, China's move away from the managed peg seemed intended in part to address the IMF's feedback. In November 2015, the IMF announced that the renminbi would be included within the SDR as of the 1 October 2016.

## Love Thy Neighbour?

Between the beginning of 2012 and August 2015, the Japanese yen declined over 50% versus the U.S. dollar. The dollar strength was also renminbi strength, as a result of the managed peg, and placed Chinese manufacturers at a competitive disadvantage. Thus, the PBoC's transition to a market-oriented fixing from a managed peg can, in part, be viewed as a response to currency devaluations that had taken place in Asia in prior years that had hurt Chinese exporters' competitiveness.

The chart below illustrates the level of export growth in China since 2012. There are a number of factors that have impacted Chinese exports in recent years, including lower demand from certain developed markets; however, currency has undoubtedly played a large role.

**Chinese Exports Dwindling With Time**


Source - RBC Wealth Management, Bloomberg; data through January 2016

**CNY decline is driving exports lower.**

## PBoC Working to Avoid Crisis of Confidence

The international community cannot access China's onshore currency (CNY) directly. Instead, it is the offshore currency (CNH), which began life in July 2010, through which international investors can monetize their future expectations for the currency. As investors build bearish forward bets in the CNH, the differential between the CNY and CNH expands. In early February, this differential expanded to an eye-opening 1,000 pips, which arguably led the PBoC to further devalue the CNY to bring it in line with the CNH.

Based on a formula provided by the IMF, it is estimated that the PBoC must maintain a "minimum" level of reserves of $2.8T in order to effectively defend its currency. If this figure is breached, selling of the currency could potentially intensify and lead to an unwelcome one-time depreciation. China's currency reserves are approximately $3.2T, about 20% above the IMF's minimum threshold. However, in January alone, $100B flowed out of China, putting the $2.8T minimum uncomfortably within reach if the current level of outflows continues.

## Known Destination, Uncertain Path

We expect the PBoC to become more forceful in managing the CNY. We believe a major short-term risk for the PBoC is that it exhausts reserves in an attempt to support the currency, which may, ironically, spur fresh selling and lead to further depreciation. The draw toward a weaker CNY (USDCNY) remains strong, and a decline of 10% from current levels by the end of 2017 seems possible.

Over time, we believe it is inevitable that the CNY will one day be freely tradable. The major question is whether the PBoC can smoothly manage the entire journey to this destination, or if the path will be marked by a sharp one-time revaluation should the PBoC's reserves become exhausted.

# A Tale of Two Halves

Most major equity markets saw the challenging weakness/volatility of January extend through much of February. Investors lurched back and forth among central bank policies (Fed hiking, negative interest rates in Europe and Japan), sagging oil prices, capital outflows from China, distress in the high-yield and emerging economy bond markets, and currency volatility.

Through all this, our expectations for global equity markets, as expressed in our *Global Insight 2016 Outlook* published in December, have changed very little.

## Stocks in Limbo for Now…

It is not clear if the correction affecting most stock markets over the past several quarters has fully run its course. Potential Fed rate hikes, pre-election policy uncertainty in the U.S., and renewed oil price instability are just a few of the concerns that could keep equity markets on the back foot further into the first half of this year.

Embarking on a new sustainable up-leg, in our view, will require investor conviction on several fronts:

- **Stability in Energy Markets**: Some sustainable balance is more important than price level. Only then can the future earnings power of this important market segment be recalibrated with confidence.
- **Some Reacceleration in Global Growth**: This mostly depends on China. The market needs indications that inventories have been right-sized and that exports are growing again. Signs that monetary easing is working would be welcome, as would new fiscal initiatives.
- **Sustained Expansion in Developed Economies**: This requires conviction that monetary conditions remain accommodative. We think they are, although we expect the market will remain uncertain—and at times skeptical—on this issue over the next few months.

**Equity Views**

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

Source - RBC Wealth Management; see RBC's Investment Stance for "Views Explanation."

## … With the Bulls Back in Control in the Second Half

We do not think the Fed's efforts to "normalize" rates (not the same as tightening) jeopardize the U.S. expansion. We are encouraged by the employment and financial condition of the American consumer and the lack of destabilizing imbalances in the U.S. and in most developed economies.

We expect the long-term uptrend in equity prices, in place since the financial crisis lows of 2009, will have reasserted itself by the second half.

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# *Global* Equity

## Regional Highlights

### United States

- The worst of the U.S. equity correction seems to have passed. Technical indicators are firming, and the Volatility Index ("fear gauge") has pulled back from a five-month high and should decline further.

- The bounce in crude oil and domestic economic improvement are supporting the market. GDP growth could register around 2% in Q1, much higher than the anemic 1.0% pace in Q4 2015, and we believe it will be relatively durable for the balance of the year.

- In coming months, we expect market leadership to shift back to growth stocks as they are positioned to deliver much-stronger earnings and revenues than the S&P 500. For investors with a 12-month or longer time horizon, we would focus on secular and stable growers in Information Technology, Consumer Discretionary, and Consumer Staples.

- Moreover, bank stocks have become too inexpensive to ignore. Some valuation measures are near the low levels reached during the eurozone sovereign debt crisis. Yet U.S. banks' capital positions are as strong as they ever have been since 1938, and balance sheets are solid. Exposure to bad energy loans seems manageable at the nation's 20 largest banks. Commercial banks' loan growth should accelerate from January's respectable 8.6% y/y rate.

### Canada

- The valuations of certain cyclical industrial and consumer stocks appear to reflect a degree of economic pessimism that is not justified by economic data. We believe this presents opportunities as many companies could outperform on earnings growth that is above low expectations.

- Our cautious approach to sectors with direct exposure to commodity prices leaves us with an underweight recommendation to those sectors in aggregate. Within these sectors, we recommend investors focus on companies whose balance sheet strength is not reliant on any forecast increase in commodity prices.

- Within the Energy Sector, our focus is on well-capitalized names that are positioned to weather depressed energy prices. However, with crude oil recently having dipped below $30 per barrel, we recognize that dividend payouts of even the best-capitalized companies will likely be reviewed in order to preserve financial flexibility.

- We continue to be cautious on base metal producers, given slowing growth in China amidst a shift from investment-led growth to a more service/consumer-oriented economy. The debt-burdened capital structures that are prevalent within this sector could deliver extreme share price volatility in response to shifts in global risk sentiment.

### Continental Europe & U.K.

- After years of underperformance, the U.K., a market heavily weighted towards commodities and energy, could outperform should these embattled sectors stabilize. Despite this possibility, we remain cautious, due to the risk of "Brexit," i.e., the U.K. leaving the EU.

- This highly disruptive event is not our base-case scenario, however. For now, we favour companies with high, sustainable dividends.

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We see opportunities for growth and attractive valuations in the Consumer Discretionary and Health Care Sectors.

- RBC Capital Markets believes the probability of Brexit is currently some 33% for the June 23 EU membership referendum, leaving it a significant risk. Brexit is already ushering in uncertainty in the short term, restraining growth and weakening the currency. The long-term impact would depend on new trade agreements being reached.
- Should the U.K. vote to leave the EU, we would favour pure exporters (weak GBP). We would be more cautious on domestic cyclicals and, in particular, retailers which import much of their merchandise. We would also be wary towards financials, where regulatory policies will have to be redrawn.
- It is likely Brexit would raise collateral issues for the EU and the prospect of some Continental equity market volatility.

## Asia

- Asian markets stabilized towards the end of February after a tough start to the year. Benchmark indexes in Hong Kong and Singapore currently trade close to book value, a rare occurrence. The MSCI AC Asia Pacific Index is trading at price levels last seen during the European sovereign debt crisis.
- PBoC Governor Zhou Xiaochuan stated that the major near-term goal for China is stability in the currency. The fixing rate for the CNY was set higher, a setback for the growing chorus of international investors positioned for further weakness.
- Japanese equities reacted negatively to a strong rally in the yen. This briefly sent the benchmark TOPIX Index down to book value. The strength in the yen, a function of risk aversion, was unexpected as the Bank of Japan (BoJ) had recently implemented negative interest rate policy for the first time.
- The TOPIX trades at just under 1.1x book value. The index would need to rally by 50% to reach its prior cycle peak in 2006–07, when index earnings were actually lower than they are now. Furthermore, the strength in the yen, a disinflationary force, has increased the chance of the BoJ adding further stimulus in March.

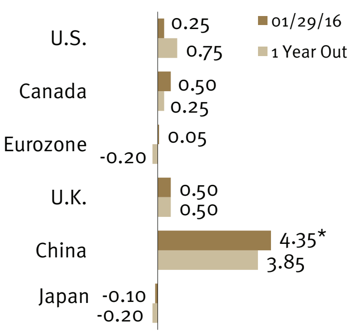
**TOPIX Index Price-to-Book Ratio**


Source - RBC Wealth Management, Bloomberg; data through 2/24/16

**Japan's valuation has become depressed following the global equity correction.**

# It's About to Get Easier

**Central Bank Rate (%)**




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

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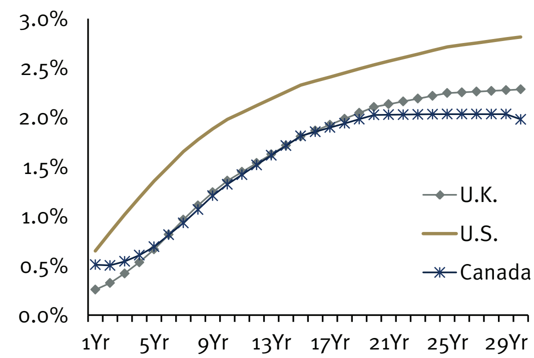
Expectations are growing that central banks around the world will ease monetary policy in some form this month. We see opportunities for investors to extend duration and selectively take advantage of widening credit spreads ahead of these decisions.

The Federal Reserve is expected to leave interest rates unchanged at its March policy meeting and to confirm that fewer rate hikes should be expected for the remainder of the year. Such a decision would represent a marked departure from the more-hawkish tone established at its December meeting when the central bank ended seven years of near-zero interest rates with a 25 basis point rate hike

The Bank of Canada may also stand pat at its March policy meeting, but is expected to maintain its bias in favor of future interest rate cuts. Financial markets are currently pricing in a better than 50% probability of an interest rate cut by the end of 2016 amidst a protracted period where the non-energy sector of the economy is looked at to drive growth.

The European Central Bank is expected to cut its benchmark deposit rate further into negative territory on concerns the economy is sputtering. This comes just weeks after the Bank of Japan surprised financial markets with the introduction of negative interest rates in an attempt to spur economic activity with a pledge to cut rates even further if conditions warrant.

**Sovereign Yield Curves**



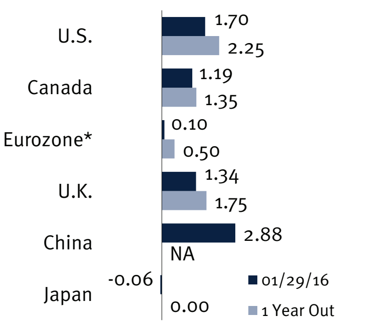

Source - Bloomberg

## Regional Highlights

### United States

- We are not expecting the Fed to raise rates at its March meeting and in fact believe the central bank may communicate a slower pace to hikes this year via the "Fed dots." Renewed concerns over global economic/financial conditions and low inflation are the reason for a more-patient Fed, but, in our opinion, recession concerns in the U.S. are misplaced. Q1 GDP is forecast to come in above 2%, which suggests to us the 10-year Treasury yield could push back above 2% in the coming weeks.
- A flatter yield curve and concerns about earnings power have led to credit spreads of the U.S. banks widening. We believe spreads have overshot fair value given the strength of bank balance sheets and would-be buyers of senior and subordinated U.S. bank debt. Investors with greater risk tolerance may find value in certain preferred share structures that now offer more than 200 basis points of yield pickup over senior debt.

**10-Year Rate (%)**




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

- Investors have flocked to short-term municipals in 2016, resulting in rich valuations at the 5-year part of the curve. Munis beyond 20 years have cheapened since December with the 30-year muni/Treasury ratio recovering back above 100%, presenting an opportunity for extension swaps.

## Canada

- The market continues to price in an approximate 45% likelihood of a Bank of Canada rate cut by the end of 2016. Investors concerned about lower rates should avoid having significant holdings in cash or short-dated bonds. Within preferred shares, we suggest adding exposure with Pfd-2L or better rated perpetuals.

- A core fixed income portfolio of GICs and investment-grade bonds laddered out to 10 years continues to be our recommended strategy. Including additional products to supplement yield on a tactical basis should be based on market opportunities.

- In light of recent spread widening, risk-tolerant investors should consider adding high-yield bond exposure. Valuations currently reflect many of the headwinds facing the market. A basket of high-yield bonds currently yields approximately 8%–10%. An increase in default rates or incremental spread widening could occur in this space and still offer an annualized total return in the 4%–5% range.

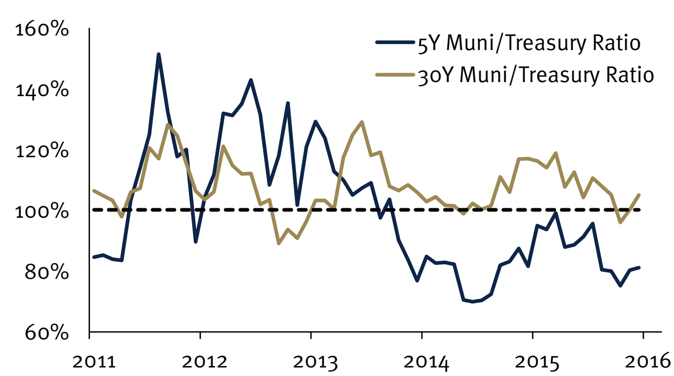
## Continental Europe & U.K.

- Widening spreads for periphery sovereign issuers (versus German Bunds) have increased the likelihood the European Central Bank will increase stimulus this month. Recent economic data has hinted at disinflationary pressure although PMI activity readings remain positive, as are expectations for Q1 GDP growth. Any further ECB actions should be regarded in the context of support for periphery country debt.

- The Bank of England reduced its outlook for growth and inflation in February as we had expected. An announcement by the U.K. government of a referendum on EU membership (June 23) likely means the Gilt market is in for a rather bumpy road in the coming months. We expect most of the volatility to occur in the longer end of the curve, although a potential reduction of supply could provide some support.

- We expect corporates to perform well as we move away from trading on market sentiment and more on credit fundamentals.

**U.S. Municipal Market: Rich Valuations at the Short-end**




Source - RBC Wealth Management, Bloomberg

**A flight to safety has 5Y munis yielding just 80% of comparable Treasuries; some value at the long-end with this ratio back above 100%.**

# Real Rally or Fool's Gold?

**Commodity Forecasts**

| | 2016E | 2017E |
|---|---|---|
| Oil (WTI $/bbl) | 40.28 | 56.53 |
| Natural Gas ($/mmBtu) | 2.50 | 3.00 |
| Gold ($/oz) | 1,150 | 1,200 |
| Copper ($/lb) | 2.00 | 2.25 |
| Corn ($/bu) | 3.87 | 4.07 |
| Wheat ($/bu) | 5.10 | 5.40 |

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

The price of gold has spiked up since the start of the year as investors flock to safe-haven investments amid turbulent financial markets. Looking forward, there are several supports to the market including robust demand, less mine supply, U.S. dollar weakness, and an uncertain global economic outlook. While gold may have further to run in the short term, we have a neutral medium-term outlook.

## Demand

Fundamental demand has been strong from emerging market buyers of gold bars, coins, and jewellery; from central banks purchases; and, more recently, from investors via ETF holdings. China and India represent about 50% of global demand for physical gold. The selloff in Chinese equities appears to have spurred strong demand for gold in recent months. Limits on the purchase of foreign currency also make gold an alternative for wealthy Chinese families seeking capital preservation. In India, jewellery demand in 2015 eclipsed each of the prior four years and hit its third-highest level on record.

Overall, global demand for jewellery remains at very strong levels, off modestly from the 2013 peak. Global demand for bars and coins is down some 40% from the 2013 peak, but remains in line with 2014 demand and above pre-global financial crisis levels.

Central banks around the world showed no slowdown in 2015 from the period of heavy investment seen over the prior five years. Diversification of assets has been recognized as a key priority for foreign reserves amid the turbulent financial markets observed in the first half of this decade.

## Supply

The collapse of gold prices since 2013 has led many to anticipate a decline in mine production for some time. As prior investment commitments have run their course, Q4 2015 saw the first year-on-year decline in mine production in over seven years, impacted by cost-cutting measures and falling ore grades.

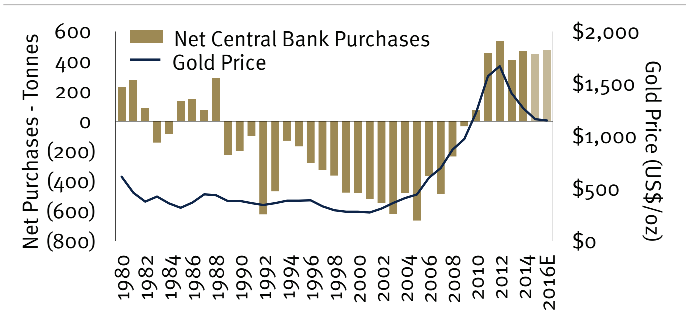
## U.S. dollar

A diminished outlook for the path of central bank rate hikes in the U.S. has led to recent weakness in the dollar. With gold priced in U.S. dollars, a weakening dollar typically coincides with strength in the price of gold.

## Conclusion

While robust demand, moderating supply, a weaker U.S. dollar, and macroeconomic uncertainty have led to a spike in the price of gold of late, we believe a sustained multi-year rally in gold would require an extended period of global economic malaise, which we view as a lower probability outcome. As such, we are neutral on gold.

**Net Central Bank Purchases vs. Gold Price**




Source - GFMS, RBC Capital Markets estimates

**Central banks remain buyers of gold as a form of asset diversification.**

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## U.S. Dollar

The dollar has struggled against a backdrop of uneven economic data and diminished expectations for interest rate hikes from the Federal Reserve. We observe ample momentum in the U.S. economy to justify at least one hike by the Fed this year, assuming recent market jitters prove to be transitory.

## Euro

March has the potential to be a significant month for the European Central Bank (ECB) and the EUR. The EUR has continued to strengthen despite attempts by ECB President Mario Draghi to verbally "manage" the currency. We expect a cut in the deposit rate and an extension to the existing targeted longer-term refinancing operations (TLTRO) program at the March policy meeting. These measures should go a long way to help to reverse the recent EUR gains and stimulate the flagging euro area economy. With this in mind, we maintain our bearish EUR bias.

## Canadian Dollar

Sentiment towards the Canadian dollar has improved thanks to profit-taking and a reduction in short CAD positions. There is also a growing expectation of relative strength in the CAD and other G10 commodity currencies (NOK, AUD, and NZD). Given the turbulent state of oil markets, we see potential for near-term downside but also expect support to be found as fiscal and monetary stimulus impact economic growth.

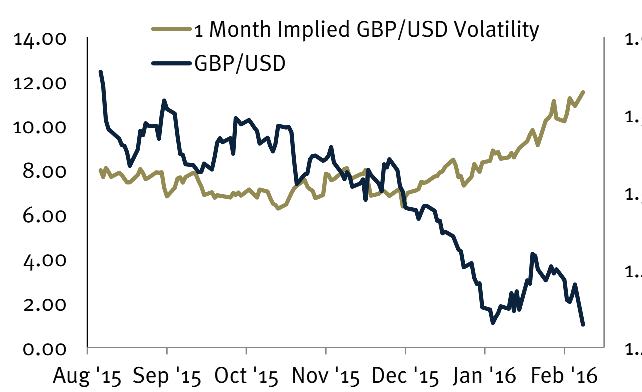
## British Pound

Volatility in the sterling crosses has remained heightened over the past month. Whilst the one-way sterling decline, which had been a theme for the pound since the beginning of this year, has temporarily abated, the market is still vulnerable to "referendum risk" and a slowdown in economic activity. Either (or both) of these factors have the capacity to send sterling back down to the recent lows again over time. We expect further sterling weakness in this environment.

## Japanese Yen

The Bank of Japan has shifted interest rates into negative territory, although safe-haven inflows wiped out this move and more by taking USD/JPY to below 111 for the first time since 2014. A small pullback to below 114 came with resurgent risk appetite, and we would expect the yen to stay within a fairly broad range for now, although price action is likely to remain highly volatile, and we only fear further intervention if there is a material move below 110.

**Sterling Implied Volatility**
**Increases on Increased EU Referendum Risk**




Source - RBC Wealth Management, Bloomberg; data through 2/22/16

**Increasing expectations of price swings pressurising spot.**

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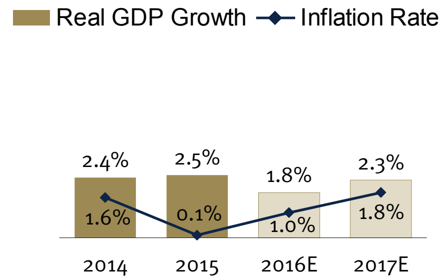
# *Key* Forecasts

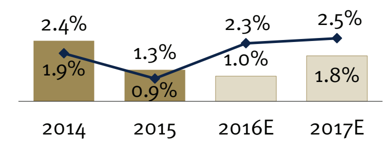



## United States — Sustained Growth

- Q4 growth slow at 1.0%, mostly due to inventory drag. Q1 rate should be closer to 2%. Consumer balance sheets, income growth, employment all strong. Spending in line with incomes. Home sales, permits near 8-year high. Capex, exports softer. Mfg. new orders improving. Leading indicators, confidence point to sustained, albeit slower, domestic growth.

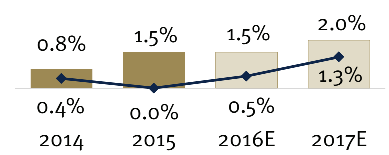
## Canada — In Transition

- Q4 was the second quarter of positive growth in 2015. Q1 should extend the streak. House construction firm, business capex (mostly energy), and government weak. Consumer attitude restrained by resource sector weakness. Mfg. sales ex-petroleum products growing consistently, led by autos. Energy capex plans down sharply. Weak loonie helping services, tourism, and now some mfg.



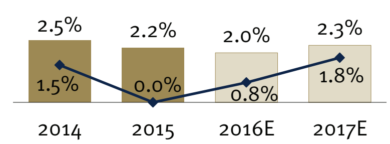

## Eurozone — Strengthening

- Q4 was 11th successive quarter of positive growth. Spain GDP up a very solid 3.5% in 2015. France uneven, Italy lagging. Bank lending standards continue to ease, loans to private sector up year over year.
- PMIs weaker in Feb., but still solidly in expansion, implying further growth in Q1. Refugee crisis, fractious politics could weigh on consumer sentiment. Full year GDP growth should improve on 2015.



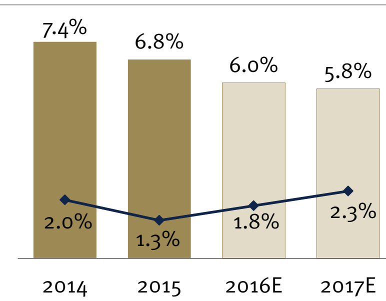

## United Kingdom — Growing

- Q4 GDP up 0.5%, brought full year growth to 2.2%. Led by dominant services sector, consumer spending. Construction, oil sector subtracted from growth. Employment strong, but household earnings growth stuck at 2%. PMIs and new orders positive.
- Growth pace sustainable for 2016, but uncertainty around EU membership referendum is weighing on business/investment confidence.



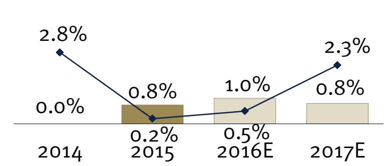

## China — Slowing

- Full year GDP at +6.8%, close to official full-year target, but internals remain mixed/weaker. Fixed asset investment steady. Domestic loans surged in January as cos. paid down $US debt. Mfg. PMI in contraction territory, but service sector PMI is doing somewhat better. Employment, wages, retail sales all growing.
- Gov't reduced bank reserve ratio for 6th time in 14 months. House prices higher y/y in major centers.




## Japan — Conflicted

- GDP growth slipped back in Q4, but finished up on the year. Leading indicators have weakened, but new orders have firmed recently. Services PMI strong, manufacturing weaker, but still in expansion. PMIs, corporate earnings, and business confidence firm.
- Wages growing, consumer confident, but household spending weak. Low oil prices putting inflation targets in jeopardy.




Source - RBC Investment Strategy Committee, RBC Capital Markets, GPAC

# Market Scorecard

| Index (local currency) | Level | 1 Month | YTD | 12 Months |
|---|---|---|---|---|
| S&P 500 | 1,932.23 | -0.4% | -5.5% | -8.2% |
| Dow Industrials (DJIA) | 16,516.50 | 0.3% | -5.2% | -8.9% |
| NASDAQ | 4,557.95 | -1.2% | -9.0% | -8.2% |
| Russell 2000 | 1,033.90 | -0.1% | -9.0% | -16.2% |
| S&P/TSX Comp | 12,860.35 | 0.3% | -1.1% | -15.6% |
| FTSE All-Share | 3,345.84 | 0.3% | -2.9% | -10.6% |
| STOXX Europe 600 | 333.92 | -2.4% | -8.7% | -14.9% |
| German DAX | 9,495.40 | -3.1% | -11.6% | -16.7% |
| Hang Seng | 19,111.93 | -2.9% | -12.8% | -23.0% |
| Shanghai Comp | 2,687.98 | -1.8% | -24.1% | -18.8% |
| Nikkei 225 | 16,026.76 | -8.5% | -15.8% | -14.7% |
| India Sensex | 23,002.00 | -7.5% | -11.9% | -21.3% |
| Singapore Straits Times | 2,666.51 | 1.4% | -7.5% | -21.6% |
| Brazil Ibovespa | 42,793.86 | 5.9% | -1.3% | -17.0% |
| Mexican Bolsa IPC | 43,714.93 | 0.2% | 1.7% | -1.1% |
| **Bond Yields** | **2/29/16** | **1/29/16** | **2/27/15** | **12-mo. Chg** |
| US 2-Yr Tsy | 0.774% | 0.774% | 0.618% | 0.16% |
| US 10-Yr Tsy | 1.735% | 1.921% | 1.993% | -0.26% |
| Canada 2-Yr | 0.519% | 0.422% | 0.472% | 0.05% |
| Canada 10-Yr | 1.191% | 1.225% | 1.301% | -0.11% |
| UK 2-Yr | 0.378% | 0.337% | 0.434% | -0.06% |
| UK 10-Yr | 1.337% | 1.560% | 1.796% | -0.46% |
| Germany 2-Yr | -0.571% | -0.487% | -0.227% | -0.34% |
| Germany 10-Yr | 0.107% | 0.325% | 0.328% | -0.22% |
| **Commodities (USD)** | **Price** | **1 Month** | **YTD** | **12 Months** |
| Gold (spot $/oz) | 1,238.74 | 10.8% | 16.7% | 2.1% |
| Silver (spot $/oz) | 14.90 | 4.5% | 7.5% | -10.2% |
| Copper ($/metric ton) | 4,705.50 | 3.0% | 0.0% | -20.6% |
| Uranium ($/lb) | 33.50 | -3.6% | -2.2% | -13.5% |
| Oil (WTI spot/bbl) | 33.75 | 0.4% | -8.9% | -32.2% |
| Oil (Brent spot/bbl) | 35.97 | 3.5% | -3.5% | -42.5% |
| Natural Gas ($/mmBtu) | 1.71 | -25.5% | -26.8% | -37.4% |
| Agriculture Index | 273.99 | -2.4% | -3.4% | -10.7% |
| **Currencies** | **Rate** | **1 Month** | **YTD** | **12 Months** |
| US Dollar Index | 98.21 | -1.4% | -0.4% | 3.1% |
| CAD/USD | 0.74 | 3.2% | 2.2% | -7.7% |
| USD/CAD | 1.35 | -3.1% | -2.2% | 8.2% |
| EUR/USD | 1.09 | 0.4% | 0.1% | -2.9% |
| GBP/USD | 1.39 | -2.3% | -5.6% | -9.9% |
| AUD/USD | 0.71 | 0.8% | -2.0% | -8.5% |
| USD/CHF | 1.00 | -2.4% | -0.4% | 4.6% |
| USD/JPY | 112.69 | -7.0% | -6.3% | -5.8% |
| EUR/JPY | 122.53 | -6.6% | -6.2% | -8.5% |
| EUR/GBP | 0.78 | 2.7% | 6.0% | 7.7% |
| EUR/CHF | 1.09 | -2.0% | -0.2% | 1.6% |
| USD/SGD | 1.41 | -1.2% | -0.8% | 3.2% |
| USD/CNY | 6.55 | -0.4% | 0.9% | 4.5% |
| USD/BRL | 4.02 | 0.4% | 1.4% | 41.3% |

All markets closed well off their lows in February. Canada and the U.K. were among the better performing developed markets.

Short-term sovereign yields pulled back; Germany's 2-year sunk deeper into negative territory.

Crude oil rose for the first time in four months.

The dollar and euro lost ground against the yen following the BoJ's surprise rate cut.

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 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD -7.7% return means the Canadian dollar has fallen 7.7% vs. the U.S. dollar during the past 12 months. USD/JPY 112.69 means 1 U.S. dollar will buy 112.69 yen. USD/JPY -5.8% return means the U.S. dollar has fallen 5.8% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 2/29/16.

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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: Large Cap (RL 7), the Guided Portfolio: Dividend Growth (RL 8), the Guided Portfolio: Midcap 111 (RL9), the Guided Portfolio: ADR (RL 10), 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.

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Distribution of Ratings - RBC Capital Markets, LLC Equity Research
As of December 31, 2015

| Rating | Count | Percent | Investment Banking Services Provided During Past 12 Months Count | Investment Banking Services Provided During Past 12 Months Percent |
|---|---|---|---|---|
| Buy [Top Pick & Outperform] | 933 | 52.59 | 271 | 29.05 |
| Hold [Sector Perform] | 727 | 40.98 | 102 | 14.03 |
| Sell [Underperform] | 114 | 6.43 | 8 | 7.02 |

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