RBC WEALTH MANAGEMENT

GLOBAL INSIGHT

PERSPECTIVES FROM THE GLOBAL PORTFOLIO ADVISORY COMMITTEE

The Winter of 69

The low-flying loonie is deeply undervalued and looks like a longer-term bargain.

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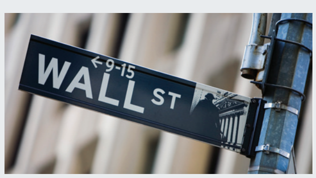

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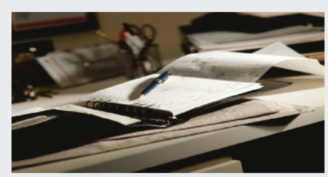

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RBC Wealth Management

There’s Wealth in Our Approach.™

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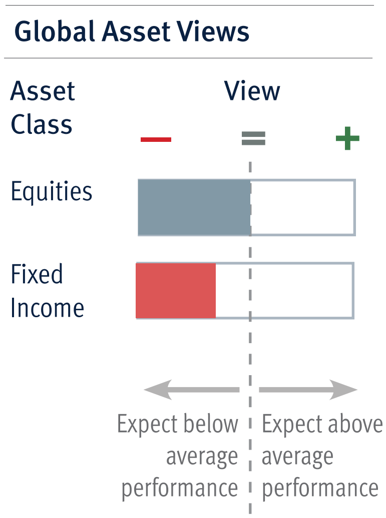
All values in U.S. dollars and priced as of January 29, 2016, market close, EST, unless otherwise noted.

RBC's Investment Stance



See "Views Explanation" below for details

Source - RBC Wealth Management

Equities

- While global equities may have more hurdles to clear in coming months, we continue to expect developed markets to deliver worthwhile returns for the year.
- Fears of a major global slowdown or U.S. recession seem overblown. The steep decline in crude oil reflects considerable oversupply and momentum selling rather than broader economic challenges. Despite a recent softer tone to the data, the U.S. expansion remains intact, underpinned by relatively sturdy consumer and employment trends.
- We recommend accumulating high-quality stocks amid the volatility and maintaining a full commitment to equities at the long-term targeted allocation level. Developed market valuations have become more attractive. Price-to-earnings ratios are lower than one year ago even if consensus earnings estimates are discounted. We favor the U.S., Japan, and Europe.

Fixed Income

- Attractive fixed income opportunities have emerged as the market absorbed further commodity declines and concerns about the global economy and China. In our view, investors should take advantage of the widening of credit spreads in segments of the U.S. and European investment-grade corporate bond market. In Canada, the preferred share sector offers a number of compelling opportunities.
- Monetary policy should remain a key driver in 2016. We expect the Federal Reserve's promise of "gradual" rate increases to develop even more slowly than investors expected just one month ago. We anticipate it will hold off raising rates again at least until this summer as it evaluates global and domestic economic uncertainties. The European Central Bank seems likely to provide additional stimulus this spring.

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

The Winter of 69

Barely three years from trading on par with the U.S. dollar, the Canadian dollar has fallen below the psychologically important US$0.70 mark and flirted with levels not seen since 2002. A collapse in most commodity prices, led by crude oil, and a related divergence in monetary policy between Canada and the U.S. have been the impetus for this move.

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In the September 2015 *Global Insight* we commented on how the future direction of the Canadian dollar, which then was trading at US$0.75, would likely be more sensitive to a developing divergence between Canadian and U.S. central bank policy. The near 50% slide in oil prices since September, combined with the Federal Reserve's decision to hike interest rates in December 2015 by 25 basis points (bps) and the Bank of Canada's (BoC) decision to hold rates steady at its January 2016 meeting, has resulted in the realization of the additional 10% downside risk we were wary of much sooner than expected.

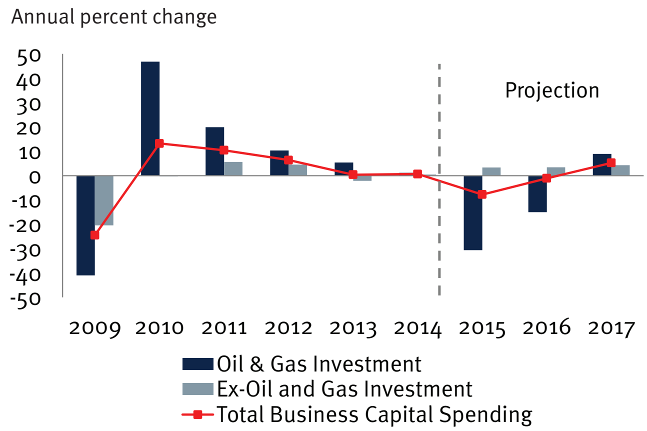
The Loonie Is More Than a "Petrol" Currency

Currencies are a function of many variables, primarily relative interest rates and expectations for inflation and economic growth. We don't see an inextricable link between changes in the price of oil and the value of the Canadian dollar but instead a link based on the economic implications of changes in the commodity price. Specifically, the link between the energy sector and the loonie is a function of how changes in commodity prices affect development spending in the oil patch and how these affect the prospects for Canadian GDP growth and inflation.

The energy sector represents nearly 10% of Canadian GDP and direct employment of 300,000, according to the latest data from Natural Resources Canada. It has been a significant contributor to Canada's economic growth over the last decade as a result of direct investment within the sector, together with the follow-on benefits felt in other parts of the economy. This meaningful share of Canada's GDP—and the sector's outsized contribution to overall GDP growth over the past 15 years—means the breathtaking decline in oil prices has had a significant impact on the country's near-term growth and inflation profile, a key consideration for the BoC as it sets monetary policy.

In its January 2016 *Monetary Policy Report*, the BoC estimated capital spending in the energy sector fell by about 40% in 2015 with a further reduction of 25% expected in 2016 should the price of West Texas Intermediate (WTI) oil remain close to US$30/barrel. The chart on the following page captures how shrinking oil & gas capital expenditures will result in an overall drop in business spending that will not reverse until 2017, tempering overall economic growth in Canada and holding back any significant appreciation of the loonie.

Canada Business Investment by Industry



Source - Statistics Canada, RBC Economics Research

Shrinking oil & gas capital expenditures will result in an overall drop in business spending that will not reverse until 2017.

An Economic Reorientation

Part of the reason the currency has fallen so sharply in recent months is that growth in the non-energy sector has not been enough to offset the rapid contraction in energy sector capital spending. This may take years, which was tacitly acknowledged by the Bank of Canada when it noted that a "protracted process of reorientation towards non-resource activity is underway." Solid demand from an expanding U.S. economy, a key end market for Canadian products, will be a required ingredient for this reorientation to play out.

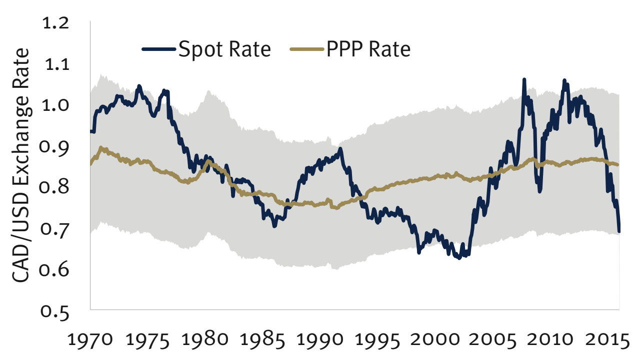
There are considerable stimulative benefits from a weaker Canadian dollar but context is important. While exporters will realize greater price competitiveness, the cost of imported capital equipment has increased, which could impact long-term productivity gains and competitiveness for Canadian firms. Similar considerations exist for Canadian consumers. Canadian retailers are likely to benefit from domestic consumers shopping and vacationing closer to home but the cost of imported goods will rise, crimping real consumer purchasing power.

Loonie Is Oversold As Divergence Arrives

The developing divergence of monetary policy in Canada and the U.S. that has concerned us for some time arrived in earnest in December when the Federal Open Market Committee (FOMC) raised interest rates by 25 bps. The FOMC cited "considerable" improvement in the U.S. labour market over the course of 2015 while noting that future hikes would be dependent on growth and inflation data. During the same month, and in stark contrast, the BoC expanded its monetary policy framework to include the potential use of negative interest rates to stimulate the economy should conditions warrant. The BoC left rates unchanged in January but seems poised to cut again should conditions warrant.

This divergence in policy should continue through 2016 but, in our view, it is already more than reflected in currency markets. Purchasing power parity for the Canadian dollar is estimated to be about US$0.85. At current levels the loonie is trading close to 20% below that mark. The chart on the following page illustrates how the Canadian dollar has been unable to sustain itself at more than 20% either side of purchasing power parity for more than a few months. Statistical history then would suggest the downside from here for the loonie should be limited.

Canadian Dollar Is Deeply Undervalued



Note: Shaded area represents 20% range above and below PPP exchange rate.
Source - DB FX Research, Haver Analytics, RBC Global Asset Management

The loonie is trading close to 20% below purchasing power parity.

Periods of extreme valuation for the currency produce big changes in behavior by both consumers and business. For example, while cross-border shopping trips to the U.S. surged as the currency traded near parity, the opposite is now true and the BoC itself noted how Canadians are likely to stay closer to home in 2016.

Modest, near-term downside risks aside, we believe the loonie represents a longer-term bargain at current levels. We expect the currency to stabilize in the coming months and to settle around the US$0.70 level before taking its next directional cue from Canada's developing growth and inflation prospects.

Focus Article

Bruised, Blemished, but Beckoning?

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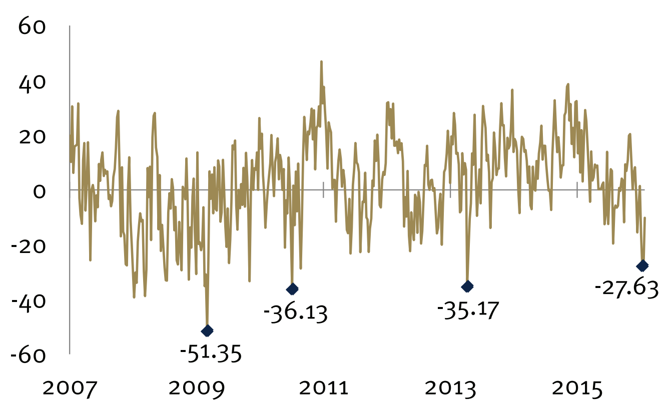
The chill that has blown over U.S. equities has many wondering if the stock market is headed for a deep freeze. While there are headwinds for the market, U.S. recession risks are still low and investors should avoid getting caught up in the pessimism. We think opportunities to bolster portfolios are emerging in high-quality stocks and select sectors. Investors should stick to a long-term roadmap.

The correction that began last summer hit the U.S. equity market with full force in January, taking the S&P 500 down 12.7% from its all-time high on January 20, before bouncing moderately. While China's currency policy was atop the worry list when the year began, the persistent crude oil collapse and concerns about U.S. recession risks became the primary forces pressuring the market.

Market sentiment has become quite negative. The percentage of investors who are bullish declined sharply in the past three months to 18%, the lowest level since 2005. The percentage of bears climbed to 49%.

Sentiment is a useful measuring rod for the stock market. Historically, extreme sentiment readings—negative or positive—have been contrarian indicators. The more bearish they become, the greater likelihood the selling is near a climax, and vice versa when levels are extremely bullish.

Bull-Bear Spread:
Percentage of Bulls Minus Percentage of Bears



Source - RBC Wealth Management, Bloomberg, American Association of Individual Investors (AAII) weekly survey; data through 1/28/16

Sentiment about U.S. equities turned negative in mid-January.

This correction could have further to go given that crude oil has yet to stabilize and momentum selling has at times gripped the stock market. However, we believe the negative sentiment readings make it likely the market turmoil is closer to the end than the beginning.

Normally when sentiment reaches such bearish levels, it is prudent to consider moving in the opposite direction from the herd. We believe investors with a 12-month time horizon and longer should slowly add high-quality equity positions to portfolios. We would focus on growth stocks in our overweight-rated sectors of Information Technology, Consumer Staples, and Consumer Discretionary.

A Tale of Two Economies

Our view is not predicated solely on sentiment. Rather, it is rooted primarily in our assessment of the U.S. economy and its prospects for continued growth.

Some aspects of the economy are worrisome. The manufacturing sector has been contracting partly due to the strong dollar, while energy capital spending has dried up because of the oil collapse. Furthermore, retail spending pulled back recently. Preliminary Q4 2015 GDP growth registered at a sluggish 0.7% rate. However, weak growth is not uncommon for this recovery cycle; it has occurred in eight other quarters since mid-2009.

On the opposite end of the spectrum, the roughly 70% of output that is tied to consumer spending seems stable enough to withstand the current headwinds and able to grow at a 2.5% rate or higher in 2016 with the help of a stronger job market, rising wages, low gas prices, and sturdy household balance sheets. At this stage, none of our six major U.S. recession indicators are flashing red.

RBC's Recessionary Scorecard

Start of Recession	Yield Curve	ISM Mfg.	Inflation Trends	Capacity Utilization	Housing Starts	Labor Market
Dec-69	x	x	x	x	x	x
Nov-73	x	x	x	x	x	x
Jan-80	x	x	x	x	x	x
Jul-81	x	x	✓	✓	x	✓
Jul-90	x	x	x	x	x	x
Mar-01	x	x	x	x	—	x
Dec-07	x	x	x	x	x	—
Jun-15	✓	✓	✓	—	✓	✓
Present	✓	—	✓	—	✓	✓

Key: x Recessionary Territory
✓ Expansionary Territory
— Neutral

Source - RBC Capital Markets, Haver Analytics, U.S. Census Bureau, ISM, BLS, Federal Reserve, NBER, S&P

Four of six indicators point to expanding GDP growth; two are neutral.

We expect GDP growth to resume its moderate 2%–2.5% growth rate in 2016—roughly the average annual pace since the recovery began in 2009. This is subpar by historical standards, yet is enough to create opportunities for well-managed public companies and small businesses.

Port in a Storm

Stocks rarely go "on sale," and when they do, it is usually the most difficult time to step in and add exposure. Negative headlines abound and risk perceptions are often magnified. But we believe investors will be rewarded by adding high-quality U.S. equity holdings during this correction.

We define “high quality” as companies that have sustainable cash flow, sturdy balance sheets, strong and predictable earnings growth, and solid revenue growth prospects compared to peers. They also tend to deliver high returns on capital and equity and enjoy high credit ratings. They are led by proven, skilled management teams that outcompete their peers and deliver innovative industry-leading products and services. While high-quality companies don’t always pay a dividend, many do.

Long-term Roadmap

For investors who are willing to think beyond the correction and consider longer-term opportunities, we would concentrate on adding growth stocks in the Information Technology, Consumer Staples, and Consumer Discretionary Sectors.

With the U.S. economy in the midst of a multiyear subpar recovery, strong profit and revenue growth for S&P 500 companies are harder to come by as time passes. Earnings rose almost 15% y/y in 2011, but stalled out to mid-to-high single-digit growth in the three subsequent years, and could end up being slightly negative in 2015 largely due to the oil bust. Revenue growth declined from 8.6% to -1.3% over the same period.

We expect additional challenges in 2016. The Energy Sector will likely subtract from S&P 500 earnings growth again, at least in the first half of the year, and the rest of the index may grow profits in the mid-single digits, on average. Revenues excluding the Energy Sector might rise by only the low-single digits.

Because profit and revenue growth are rarer commodities in a challenging environment, we believe investors will “pay up” for growth, putting stocks that can deliver in greater demand.

We segment growth stocks into two main categories:

- **Strong secular (long-term) growers**: Such stocks almost always trade at a premium valuation to the S&P 500. That premium has shrunk since the correction began. Many companies with solid revenue growth now trade at multiples below their 5-year average. There are a number of strong secular growers among Internet, cloud computing, and security software companies. We find those that are geared toward the “new economy” (i.e., companies that are exploiting technological advances or structural changes within the economy) most attractive.
- **Stable growers**: These are mature companies that tend to grow year in and year out when the economy is expanding. In a slower economic environment, this is difficult for most companies to achieve. Therefore, stable growers should be rewarded by the market in 2016. For example, consumer packaged goods, home improvement retail, and defense companies fit into this category.

We believe strong secular and stable growth companies should reassert their leadership role once the correction passes and will outperform over the longer term if subpar economic momentum lingers.

Global Equity

On the Back Foot for Now

January was a rugged month for global equity markets. Most indexes undercut the lows set in the August/September plunge of last year. Oil/commodity-heavy indexes fared worse. Depending on the day, investors became intensely concerned with China—GDP slowdown, currency devaluation, capital outflows, stock market volatility—and on alternate days with Fed tightening, the collapsing oil price, an apparent slowdown in U.S. manufacturing, etc.

The declines in all major markets since last spring have brought valuations down to more compelling levels. The chart on the following page reveals the extent to which price-to-earnings multiples (P/Es) have fallen over the past year. P/Es are now at or below their long-term average levels. In the case of the U.S. market, the current P/E, between 15x and 16x current earnings, has yielded worthwhile positive returns in the following year 85% of the time. We expect the probabilities of a favourable one-year return outcome have improved to a similar degree for most markets.

The factors which have been giving investors pause over the past few months could quite possibly keep global equity markets on the back foot through the first half of the year. Current conditions don't rule out further volatility, perhaps even lower prices. However, through the second half greater stability should emerge on all these fronts.

In particular, we expect the most telling factor for investors will be the recognition the ongoing economic expansion in the U.S. and most developed countries, supported by accommodative credit conditions, has further to run. That would imply continued growth in corporate earnings and hold out the prospect for a commensurate expansion of share values.

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."

Regional Highlights

United States

- Volatility should reign over the U.S. equity market for at least a few more months. It will take time to confirm the economy is not slipping into a recession and some technical indicators are flagging additional vulnerabilities.
- The crude oil decline is weighing on equity sentiment. While the perception is that stock prices are moving along with oil, the daily correlation between the S&P 500 and WTI crude is only moderately elevated at 0.53 in January compared to 0.33 for the past 10 years. As oil prices begin to stabilize, we believe investors will shift attention to corporate fundamentals.
- We expect the Q4 2015 earnings season to signal the economy is in better shape than the market's recent downdraft would suggest.

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Outside of the Energy Sector, S&P 500 earnings seem on target to deliver respectable mid-single-digit y/y growth. Moderate ex-Energy profit growth should also be achievable in 2016.

- We recommend using periods of weakness to slowly accumulate high-quality stocks with sustainable cash flow, predictable earnings, sturdy balance sheets, and reasonably "safe" dividends. For investors willing to take a 12-month or longer view, our preferred sectors are Information Technology, Consumer Staples, and Consumer Discretionary.

Canada

- The landscape for Canadian equities remains split between those with significant resource exposure—either directly or indirectly—and those without. We believe that the selling pressure accompanying the recent equity market pullback has unduly punished the stock prices of certain companies whose businesses are not overly reliant on a recovery in commodity prices. We remain alert to these types of opportunities given the potential for continued volatility in equity and commodity markets.

- Within the Energy Sector, we are focused 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 could be reviewed in order to preserve financial flexibility.

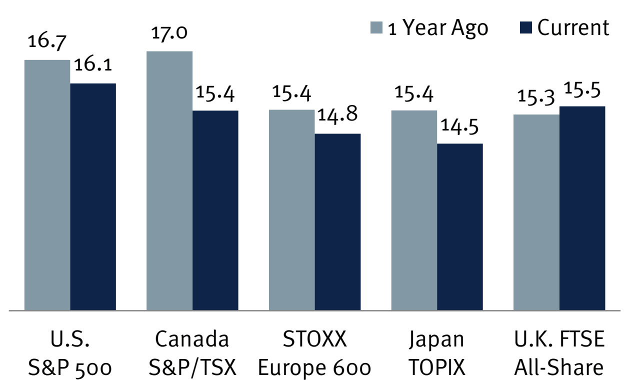
- We continue to be cautious on base metal producers given a slowing China and its shift from investment-led growth to a more service-oriented economy.

- Bank equity valuations now reflect some of our concerns over slowing loan growth, margin pressure, and the risk of increasing credit losses. The magnitude of credit losses remains a key uncertainty, leaving us underweight bank shares relative to the index but ready to be opportunistic on further weakness.

Continental Europe & U.K.

- We remain cautious on U.K. equities. Despite strong economic growth, consensus earnings growth forecasts are anaemic, at less than 1% y/y for 2016, held back by mining, energy, and related industries. The prospect of a referendum on EU membership further clouds prospects. For European equities, we are more optimistic. ECB President Mario Draghi's soothing comments have

12-Month Forward P/E Ratios



Source - RBC Wealth Management, Bloomberg; data through 1/29/16

Most major developed markets have become cheaper over the last year.

suggested more monetary measures will be taken sooner rather than later. Valuations now appear more attractive and earnings momentum should improve from here onwards.

- Our preferred sectors in Europe and the U.K. remain Consumer Discretionary, Telecoms, and Health Care.

- With rates on hold in the U.K., and upcoming enhanced quantitative easing in Europe, we expect disposable incomes to continue to expand in 2016. The windfall from lower oil prices should also help. This is supportive of the Consumer Discretionary Sector where we see media as the main beneficiary.

- We also view the Telecom Sector in a positive light. With better macroeconomic conditions and improved pricing power, revenues and EBITDA have stabilised in 2015 and should grow in 2016. Free cash flows are also recovering, as capital investment requirements going forward should be much less onerous. Moreover, the cost of debt should decline as loans get refinanced while consolidation in the sector, for example in the French market, should give a supportive backdrop to the industry.

- U.K. and European Health Care companies, with solid pipelines, trade at a discount to U.S. peers and offer a generous dividend.

Asia

- The tone in Asian markets quickly turned negative in January. Markets were significantly weaker, following global equities lower as oil plumbed new lows. Renewed volatility in mainland Chinese stocks also contributed.

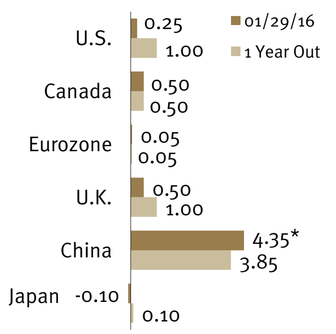
- China published its economic growth figures for 2015. The economy grew by 6.9% y/y. The "two-speed" economy persists. The sluggishness in China's heavy industry, manufacturing, and construction sectors persists, while the services sector continues to register robust growth.

- In the short term, investors are focused on capital outflows from China. These have accelerated rapidly as the currency has weakened against the dollar, albeit modestly. It appears that a large part of the outflow has been due to corporates switching from USD-denominated debt to RMB debt. China is changing its currency regime to follow a basket of currencies rather than tracking the dollar. RBC Capital Markets forecasts the USDCNY to continue to appreciate in 2016 and 2017. Please see our overview on China in the *Global Insight Weekly* dated January 15.

- Japanese equities, among the best performers in 2015, corrected strongly in January and now trade at an attractive P/E multiple. Benchmark indexes in Hong Kong and Singapore trade at book value, a rare occurrence.

Aversion Presents Opportunity

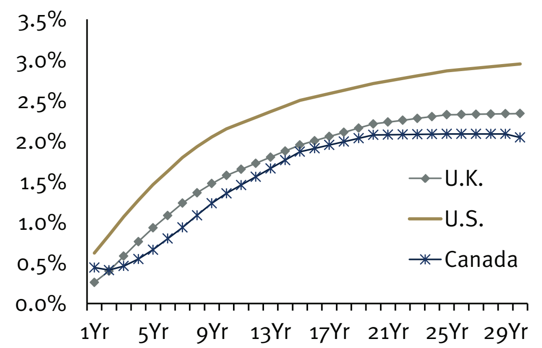
Central Bank Rate (%)



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

The decline in commodity prices coupled with concerns about the Chinese economy has led to risk aversion in fixed income markets. Financial markets have, in some cases, priced in worst-case scenarios for some issuers that we believe are unlikely to materialize even as the global economy digests the impact of sharply lower oil prices. We believe investors with a time horizon of 12+ months should consider taking advantage of these opportunities.

Sovereign Yield Curves



Source - Bloomberg

In the U.S. and Europe, we continue to see pockets of value in the investment-grade bond market. Credit spreads of high-quality issuers in the energy sector have widened materially despite these companies having strong balance sheets and ample liquidity. In Europe, telecoms appear attractive given improving free cash flow profiles. In Canada, the preferred share market still offers attractive yields that we feel are best taken advantage of with a basket of perpetual and rate-rest issues.

The Bank of Canada (BoC), Federal Reserve, and European Central Bank (ECB) are not scheduled to meet until early March. We believe economic data over the coming weeks could be especially important in determining whether the Fed continues on its tightening path and whether the BoC and ECB introduce further stimulus to stoke growth and inflation.

Regional Highlights

United States

- The Federal Open Market Committee's January meeting confirmed that the Fed is once again "closely monitoring" global developments and the potential impact on the inflation and growth outlook, with increasing downside risks to each. We think the bar for a March rate hike is exceptionally high, with the Fed likely to stay on the sidelines into the summer.
- A key challenge for the Fed reaching its 2% inflation target has been the strong dollar—a rally that shows few signs of losing steam. Since December's rate hike, the dollar has gained 2.10%, even as market expectations for future rate hikes have fallen. The central banks of Europe, Japan, and China—representing 45% of U.S. trade partners—have all signaled further easing ahead, which should keep upward pressure on the dollar, and downward pressure on inflation and yields.
- Municipals have outperformed most asset classes year to date, but that outperformance has driven 30-year muni/Treasury ratios below 100% for the first time in one year. Rich valuations have some muni investors seeking opportunities in corporates—where spreads to Treasuries have risen amidst market volatility. We see value in sectors outside of energy and materials, and within sectors exposed to the U.S. economy and consumer.

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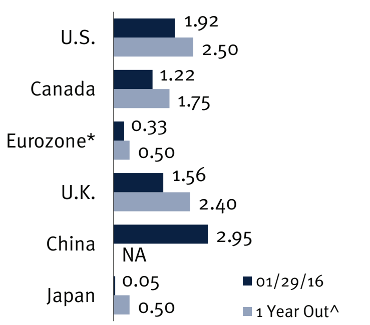
Global Fixed Income

10-Year Rate (%)



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

Canada

- The BoC held the overnight rate constant at 0.50% at its January 20 meeting and delivered a surprisingly upbeat policy statement, stating that "global growth is expected to trend upwards in 2016" and that the economic shift from the Canadian oil patch into the manufacturing sector is underway, albeit, at a moderate pace.

- Spreads on bonds issued by Canadian provinces have been trending wider since the fall. The yields on longer-dated provincial bonds have moved approximately 0.25%–0.30% wider versus Government of Canada bonds since the beginning of August. Investors concerned with continued weakness in this space should consider buying Government of Canada bonds instead of provincial issues.

- While medium-term headwinds of credit market weakness and lower rates remain in place for preferred shares, valuations appear attractive for long-term investors and new money would be best allocated to a basket of rate-resets and perpetuals that offer yields in the 5%–7% range.

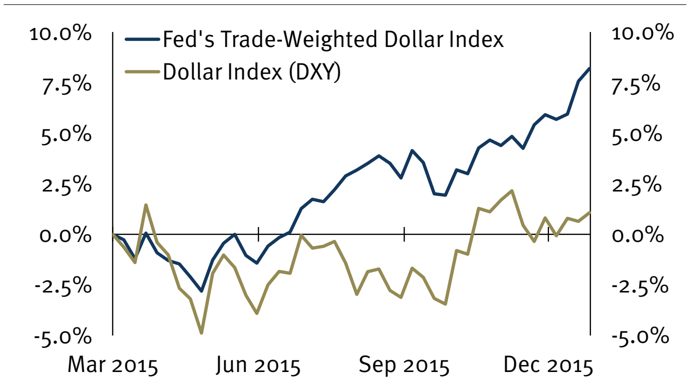
Continental Europe & U.K.

- The probability of further monetary stimulus in Europe continues to rise as global economic headwinds overshadow domestic improvements. The market now pegs March as the most likely time for ECB President Mario Draghi to unveil new stimulus. Potential measures expected include an increase in the speed of bond purchases as well as a further cut to the negative deposit rate. German yields should be anchored by the measures while increased demand for peripheral sovereigns will likely continue to tighten spreads.

- Growth and inflation prospects over the coming months appear to be worsening for the U.K. Financial markets are firmly pricing in no central bank action for 2016 following dovish comments from the Bank of England. The Gilt market is entering February with little sense of direction, which is likely only to change with the influence of global developments. We favour positioning around the middle of the U.K. curve given its steepness. We expect less noise on this part of the curve and regard yield pickup as most rewarding relative to interest rate risk.

- Opportunities within credit abound, in our view, given spreads are at levels not seen since 2013. We feel the recent move wider is purely sentiment-driven as fundamentals in Europe and the U.K. remain supportive. We currently favour financials as well as the consumer goods and services sectors.

Tale of Two Dollars: Strength in Trade-Weighted Terms Continues



Source - RBC Wealth Management, Bloomberg; data through 1/15/16

The dollar's rise continues to challenge the Fed as the central banks of major trade partners have all signaled easier monetary policy ahead.

Oil: Non-OPEC Supply Pinched

Commodity Forecasts

	2016E	2017E
Oil (WTI $/bbl)	40.00	57.00
Natural Gas ($/mmBtu)	2.50	3.00
Gold ($/oz)	1,150	1,200
Copper ($/lb)	2.00	2.25
Corn ($/bu)	3.98	4.08
Wheat ($/bu)	4.90	5.30

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

Oil prices have taken a sharp move lower in recent weeks on concerns of potentially weakening demand and the impending ramp-up of Iranian production following sanctions relief.

The oil market is oversupplied by about 1.3 million barrels per day (bbl/d), with Iran set to add an additional 0.5–1.0 million bbl/d. Saudi Arabia has not been able to coordinate a supply reduction with Russia or its partners within OPEC despite a stated desire to do so. In the absence of supply reductions from OPEC, a rebalancing of the oil market has for now been thrust on supply contraction from non-OPEC players and continued demand growth.

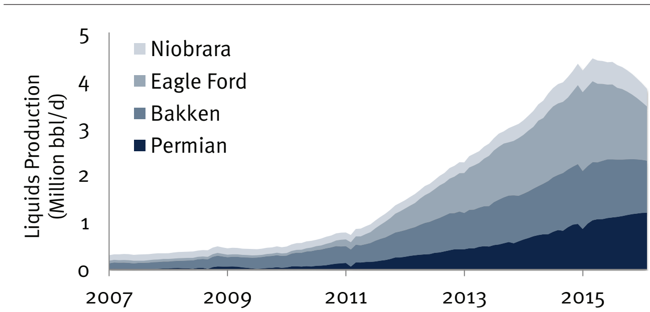
Supply contraction from non-OPEC sources is widely expected given reduced spending levels. RBC Capital Markets forecasts aggregate spending by U.S. exploration and production companies that it follows to decline to less than $50B in 2016 from $90–$100B in 2013 and 2014. Similarly, spending from the top nine global majors, such as Exxon, Shell, BP, etc., is expected to fall to about $150B in 2016 from $200–$250B in 2013 and 2014. A drop in production, which RBC Capital Markets forecasts at 0.8 million bbl/d for 2016, seems reasonable as investment in new production drops rapidly and natural production decay sets in.

Global demand for oil has increased at a pace of 1%–1.5% per annum for the last several decades, albeit with some hiccups. Softer economic data from the world's two largest economies—the U.S. and China—does raise the spectre of slowing demand growth. RBC Capital Markets expects 1.2 and 1.0 million bbl/d of demand growth in 2016 and 2017, respectively, of which China represents 0.3 million bbl/d in each forecast year. This demand growth is critical to restoring market balance for oil in the next year or two.

The chart highlights spending cuts having a meaningful impact on U.S. shale oil production. We believe a contraction in non-OPEC supply will provide a meaningful, if not complete, offset to incremental Iranian barrels entering the market. Demand is the key risk, which will hinge to a large extent on economic stability in the world's largest economies.

Over the short term, it's difficult to predict the path of spot oil prices given the price discovery process is digesting developments on both the supply and demand side of the equation. Longer-term, we believe the market clearing price will be higher than current prices as demand should absorb the current supply glut.

U.S. Shale Oil Production



Source - EIA, RBC Wealth Management

Shale oil volumes dropping as investment falls.

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Currencies

U.S. Dollar

Whilst an overview of the performance of the DXY (dollar index) might suggest that the beginning of 2016 has been highlighted by a sideways move for the dollar, a closer look reveals a somewhat different story. The dollar has continued its strong rally against both emerging market currencies and the commodity bloc, which is a continuation of the trend from 2015, whereas the EUR has fared somewhat better. We maintain our bullish bias for the dollar.

Euro

After markets were left somewhat disappointed by the actions of the European Central Bank (ECB) in December, Mario Draghi stated at the January meeting that the ECB may be ready to increase stimulus measures in March—in response to the recent bout of global risk aversion. The suggestion this has further increased risks to the euro area economy has helped drive the EUR lower, after beginning 2016 on a sounder footing. Given the prospect of more quantitative easing and deeper negative interest rates, we remain bearish for the EUR.

Canadian Dollar

The Bank of Canada refrained from introducing further stimulus at its most recent meeting, citing Prime Minister Justin Trudeau's fiscal stimulus plans and the decline in the Canadian dollar as providing enough for the time being to keep monetary policy on hold. Despite this, the CAD has followed the energy markets lower. Until we see stability in energy markets we would remain bearish on the loonie.

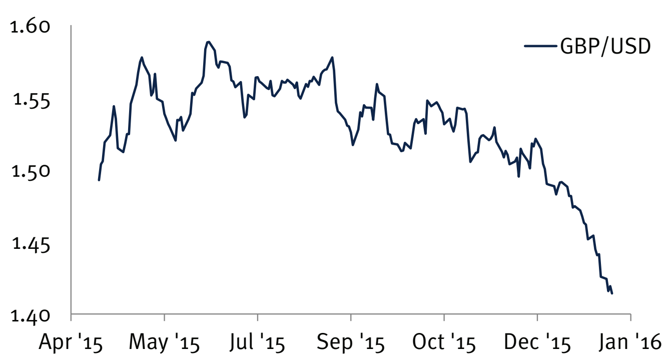
British Pound

2016 has not started off well for sterling bulls. Fears over the impending referendum on EU membership, a slowdown in U.K. economic activity, the BoE pushing out interest rate hike expectations, and a "risk off" climate driving asset prices lower have all culminated in widespread weakness for the pound. Given this uncertain backdrop, we have recently revised our projections for the pound lower, and would expect these continuing headwinds to drive further sterling weakness as the year progresses.

Japanese Yen

The market is net long yen for the first time since before the Abenomics era due to safe-haven flows into the currency during the market turbulence at the start of the year. This yen resurgence is raising the prospects that the BoJ will ease further, which is the main risk to any outright bullish view in the longer term. For now, we would hold a neutral stance and see if any more evidence builds to support the case for even looser monetary policy.

Sterling's Collapse Into the New Year Approaches 1.40



Source - RBC Wealth Management, Bloomberg

Confluence of factors increases the pressure on sterling since the start of the year.

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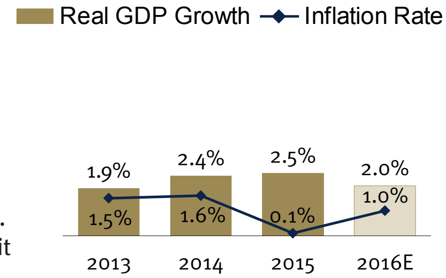
Key Forecasts

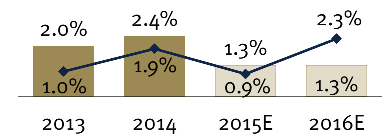


United States — Sustained Growth

- Q4 growth slow at 0.7% mostly due to inventory drag. Q1 should be better. Private sector domestic demand stronger than overall GDP growth. Home sales, permits near 8-year high. Unemployment claims not far off 40-year low. Real wages growing, spending somewhat slower. Capex, exports soft. Mfg. new orders improving. Leading indicators, confidence point to sustained, albeit slower domestic growth.

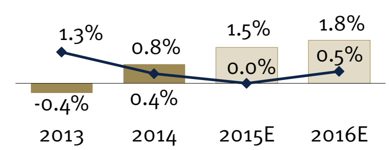
Canada — In Transition

- Q3 was the first quarter of positive growth in 2015. Q4 likely weaker. House construction firm, business capex (mostly energy) and government weak. Consumer attitude restrained by resource sector weakness/ job loss. Mfg. sales ex-petroleum products growing consistently, led by autos. Energy capex plans down sharply. Loonie weakness helping services, tourism, and now some mfg.



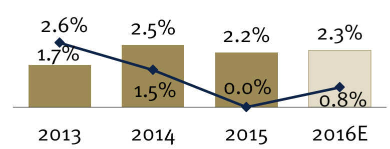
Eurozone — Strengthening

- Q3 was 10th successive quarter of positive growth. Spain reported a very solid 2015, up 3.2%. France uneven, Italy strengthening. Bank lending standards continue to ease, loans to private sector up year over year.
- PMIs strengthened in Dec. implying good Q4 GDP result. Driven by domestic demand and growing industrial production. Refugee crisis, fractious politics could weigh on consumer sentiment.



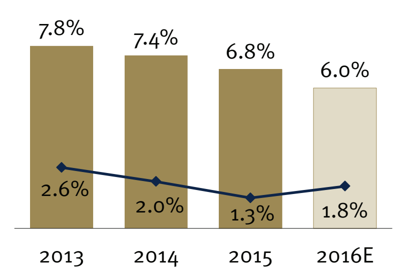
United Kingdom — Growing

- Q4 GDP up 0.5%, brought full-year growth to 2.2%. Led by dominant services sector, construction. Oil sector subtracted from growth. Employment strong but household earnings growth slowing. PMIs and new orders positive but off best levels.
- Growth pace sustainable for 2016, but uncertainty around EU membership referendum may weigh on business/investment confidence.



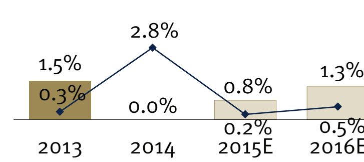
China — Slowing

- Full-year GDP at +6.8% close to official full-year target, but internals remain mixed/weaker. Fixed asset investment steady. Loans growing faster than GDP. Mfg. PMI in contraction territory but PMI excluding state-owned cos. doing better as are exports. Services growth undiminished. Employment, wages, retail sales all growing.
- Government has cut rates six times, more could come. House prices higher year over year in major centres.



Japan — Conflicted

- GDP growth rebounded back into positive territory in Q3. Leading indicators firm but new orders have eased recently. PMIs, corporate earnings, and business confidence firm.
- Employment, wages growing, consumer confident, but spending stagnant. Weak 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	1,940.24	-5.1%	-5.1%	-2.7%
Dow Industrials (DJIA)	16,466.30	-5.5%	-5.5%	-4.1%
NASDAQ	4,613.95	-7.9%	-7.9%	-0.5%
Russell 2000	1,035.38	-8.8%	-8.8%	-11.2%
S&P/TSX Comp	12,822.13	-1.4%	-1.4%	-12.6%
FTSE All-Share	3,335.90	-3.1%	-3.1%	-7.9%
STOXX Europe 600	342.27	-6.4%	-6.4%	-6.8%
German DAX	9,798.11	-8.8%	-8.8%	-8.4%
Hang Seng	19,683.11	-10.2%	-10.2%	-19.7%
Shanghai Comp	2,737.60	-22.6%	-22.6%	-14.7%
Nikkei 225	17,518.30	-8.0%	-8.0%	-0.9%
India Sensex	24,870.69	-4.8%	-4.8%	-14.8%
Singapore Straits Times	2,629.11	-8.8%	-8.8%	-22.5%
Brazil Ibovespa	40,405.99	-6.8%	-6.8%	-13.9%
Mexican Bolsa IPC	43,630.77	1.5%	1.5%	6.5%
Bond Yields	**1/29/16**	**12/31/15**	**1/30/15**	**12-mo. Chg**
US 2-Yr Tsy	0.774%	1.048%	0.449%	0.32%
US 10-Yr Tsy	1.921%	2.269%	1.641%	0.28%
Canada 2-Yr	0.422%	0.481%	0.394%	0.03%
Canada 10-Yr	1.225%	1.394%	1.251%	-0.03%
UK 2-Yr	0.337%	0.651%	0.351%	-0.01%
UK 10-Yr	1.560%	1.960%	1.330%	0.23%
Germany 2-Yr	-0.487%	-0.345%	-0.184%	-0.30%
Germany 10-Yr	0.325%	0.629%	0.302%	0.02%
Commodities (USD)	**Price**	**1 Month**	**YTD**	**12 Months**
Gold (spot $/oz)	1,118.17	5.3%	5.3%	-12.9%
Silver (spot $/oz)	14.26	2.9%	2.9%	-17.3%
Copper ($/metric ton)	4,570.00	-2.9%	-2.9%	-17.5%
Uranium ($/lb)	34.75	1.5%	1.5%	-13.1%
Oil (WTI spot/bbl)	33.62	-9.2%	-9.2%	-30.3%
Oil (Brent spot/bbl)	34.74	-6.8%	-6.8%	-34.4%
Natural Gas ($/mmBtu)	2.30	-1.7%	-1.7%	-14.6%
Agriculture Index	280.77	-1.0%	-1.0%	-5.9%
Currencies	**Rate**	**1 Month**	**YTD**	**12 Months**
US Dollar Index	99.61	1.0%	1.0%	5.1%
CAD/USD	0.72	-1.0%	-1.0%	-8.9%
USD/CAD	1.40	1.0%	1.0%	9.8%
EUR/USD	1.08	-0.3%	-0.3%	-4.1%
GBP/USD	1.42	-3.3%	-3.3%	-5.4%
AUD/USD	0.71	-2.8%	-2.8%	-8.7%
USD/CHF	1.02	2.1%	2.1%	11.2%
USD/JPY	121.14	0.8%	0.8%	3.1%
EUR/JPY	131.21	0.4%	0.4%	-1.1%
EUR/GBP	0.76	3.2%	3.2%	1.5%
EUR/CHF	1.11	1.8%	1.8%	6.6%
USD/SGD	1.42	0.4%	0.4%	5.2%
USD/CNY	6.58	1.3%	1.3%	5.2%
USD/BRL	4.00	1.0%	1.0%	49.1%

China's market greatly underperformed in January as concerns about its currency policies, financial market regulation, and economic growth resurfaced.

Safe-haven bonds rallied and yields declined as global growth jitters reemerged and expectations for U.S. and U.K. rate hikes were pushed back.

Crude oil has declined in six of the past eight months.

CAD/USD fell to 0.6859 mid-month, the lowest level since 2003, before rebounding modestly.

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 0.72 means 1 Canadian dollar will buy 0.72 U.S. dollar. CAD/USD -8.9% return means the Canadian dollar has fallen 8.9% vs. the U.S. dollar during the past 12 months. USD/JPY 121.14 means 1 U.S. dollar will buy 121.14 yen. USD/JPY 3.1% return means the U.S. dollar has risen 3.1% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 1/29/16.

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