RBC Dominion Securities Inc.

Wealth Management REVIEW

Wealth Management
Dominion Securities

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Room to run

By Jim Allworth

Our principal focus is always on the health and direction of the U.S. economy, the world's largest. Getting that right is an important first step in formulating the outlook for the Canadian economy, among others, and for financial markets. U.S. expansions tend to be good for the Canadian economy, corporate earnings and stock prices while recessions are unequivocally bad. We are optimistic the U.S. economic expansion has further to run supported by interest rates that are still low and generally accommodative credit conditions. That said, this expansion is eight years old, so knowing how much longer it can run would be valuable.

The economics team at RBC Global Asset Management looked at 17 measures of the U.S. economy and financial markets that, taken together, can give a reliable indication of where that economy is in the business cycle. The data comes down in favour of the economy being in the "late cycle" phase. That's not too surprising: most observers are in that camp. What is surprising is that it's a reasonably close call between late cycle and mid-cycle. Chief Economist Eric Lascelles concludes: "There is a chance the next [U.S.] recession is a bit more distant than previously imagined."

Most developed economies – certainly the U.S., Canada, Europe and Japan – are running at a growth pace that is at or above their long-term potential. Activity indexes and new orders all point to further growth in the coming months and quarters, as do reliable leading indicators.

Corporate revenues and earnings are growing faster than the economies those companies live in. And the guidance offered by management about the prospects for the coming quarters suggests this very good profit picture will prevail into next year. So, while price-to-earnings multiples are somewhat higher than they were a couple of years ago – the growth prospects today comfortably support those more elevated valuations.

We expect that, eventually, adverse changes in credit conditions will build to a level that produces an economic downturn. And it's true that most major central banks have turned an important corner and are now headed toward "normalizing" monetary conditions. It's also true

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In brief

Insights into giving and receiving wealth

Within a generation, Canadians are expected to receive over $400 billion in inheritances. To provide some insight into this historic transfer of wealth between generations, RBC Wealth Management recently published three new reports:

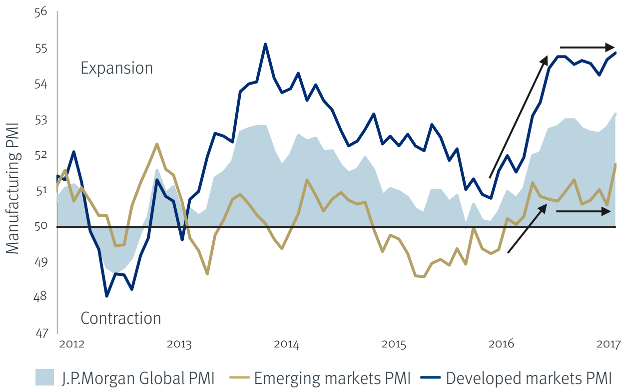
Families and wealth transfer – Diverse family structures and their influence on wealth preservation

Millennials and wealth transfer – A generation poised for responsible wealth transfer

Business owners and wealth transfer – Applying the lessons learned in business to wealth transfer

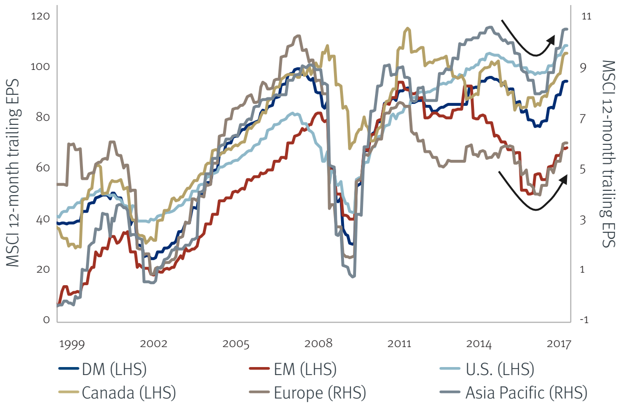
To read the reports, visit www.rbcwealthmanagement.com. For more information, please contact your advisor.

Global manufacturing expanding robustly



Note: PMI refers to Purchasing Managers Index for manufacturing sector, a measure for economic activity.
Sources: Haver Analytics, RBC GAM

Global corporate earnings on upswing



Note: Earnings per share (EPS) in U.S. dollars for developed markets (DM), emerging markets (EM), U.S. and Asia Pacific; euros for Europe; Canadian dollars for Canada.
Sources: MSCI, Bloomberg, RBC GAM

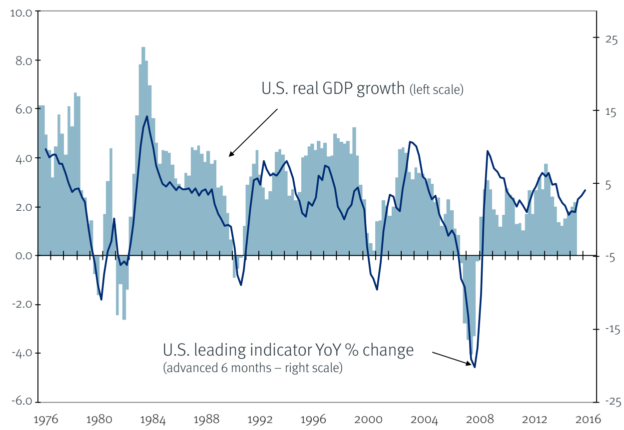
that no central bank, including the Bank of Canada, is interested in snuffing out the better GDP growth rates that have emerged. Given that inflation readings remain benign, they are under no pressure to do so. They have all indicated that the path toward normal conditions will be a gradual one.

In the case of the U.S., it has typically taken a "real" federal funds rate (i.e., the effective fed funds rate minus the rate of price inflation) that was higher than the growth rate of the economy before a recession was imminent. Today core inflation is running at about 1.7% and the effective fed funds rate is just 1.15%, making the "real" fed funds rate a very accommodative minus 0.55%. Meanwhile, the year-over-year growth in GDP stands at 2.2%. So, if nothing else changes, the fed funds rate will have to rise by another 2.75% before credit conditions would pose a serious risk to the economy and to any continuation of the equity bull market.

The Fed has led the market to expect there will be three or four more rate hikes between now and the end of next year. That would bring the posted funds rate to between 2% and 2.25% as we head into 2019. Assuming nothing else has changed – i.e., the U.S. economy is still growing at 2.2% and inflation is running at 1.7% – then the "real" fed funds rate, after adjusting for inflation, would be just 0.5%, a full 1.7% below the growth rate of the economy, the threshold that history suggests would make a recession imminent.

As it stands, we think the earliest Fed rate hiking that could bring us to that juncture would be well into 2019. And, of course, all things won't remain equal. The kind of developments that would provoke a central bank into raising rates more aggressively would be a pick-up in growth that produced an unwanted flare-up in inflation. All of which would require an even higher fed funds rate than laid out above.

Leading indicators say there's more to come



Sources: Conference Board; Dept. of Commerce; RBC Wealth Management

Despite valuations that are not compellingly cheap, we are comfortable with our moderate overweight recommendation for global equity portfolios. In particular, we point to our overweight commitment to Europe where we can find outstanding, quality businesses trading more cheaply and often offering a better earnings growth outlook than their counterparts elsewhere.

For more thoughts on the prospects for financial markets, ask for our latest issue of Global Insight.

Jim Allworth is co-chair of the RBC Global Portfolio Advisory Committee.

Happy spouse, happy house

Four reasons to keep your spouse involved in managing your family's wealth

In families, there's often a division of labour between spouses when it comes to running the household. For example, one spouse might handle the household's wealth management concerns. However, there are many good reasons to consider working together on money matters.

1. Maintain marital bliss

It's no secret that money is a leading cause of marital discord, but it doesn't have to be. Being upfront about your finances and sharing responsibilities can help a couple get on the same page. As a first step, consider creating or updating a family financial plan.

"It's important for couples to discuss financial matters openly," says Grant Richmond, Vice-President & Director, RBC Dominion Securities. "The process of creating a financial plan together can help couples work through potential conflicts like different spending priorities and financial values."

That doesn't mean that you have to make every single financial decision together. Even in a marriage, people need some independence. It also doesn't mean that both spouses have to be equally involved – everyone is different. But being open about money matters and conferring with each other about the big financial decisions can help avoid conflict.

2. Stay focused on common goals

Money often goes in hand in hand with the big goals in life. Earlier in your marriage, you may have shared the same big goals. But people change, and financial situations change, and it may be different now.

"It's important to keep the conversation going, and ensure you're both agreed, where possible, on major financial priorities as you go through life's changes," says Richmond.

"You need to answer important questions like how much you should save for retirement. Or simply what you want to do in retirement. Your personal dream may be to sail around the world, but does your spouse share that dream?"

Often, people are so busy, they don't have time to think about these sort of questions. Creating a financial plan can give couples the structure they need.

3. Prepare for one of you to live longer

It is very common for women, especially, to outlive their spouses. According to Statistics Canada, there are nearly two women for every man aged 85+.

Regardless of which spouse outlives the other, it's very likely that one spouse will be solely responsible for the household finances at some point.

"If the surviving spouse was not involved with financial matters, it can be overwhelming for them to suddenly be responsible for making all of these decisions, especially when they're dealing with the death of their spouse," says Richmond.

"That's why it's important for both spouses to be involved in financial matters, and to know where they can get the support they need from professional tax, legal and financial advisors."

And it's never too late to start, Richmond adds.

"We often talk about financial education being important for children – but it can really start at any age."

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Happy spouse ... Continued from page 3

4. Take care of each other

With better health care, people today are generally living longer, but often living with health issues. Who makes decisions about the household finances if one spouse is incapacitated? Or how do you fund their health-care needs beyond what's covered by government plans?

"It's important to plan ahead for incapacity with your spouse," says Richmond. "Two important things to consider are your Power of Attorney and health-care arrangements."

Consider who you name as your Power of Attorney ("mandatary" in Quebec) – the person responsible for making decisions about your finances if you are unable. Sometimes, your Power of Attorney document will also include instructions regarding your personal care or medical treatment. Depending on your province, you may need an additional document for this, called a Power of Attorney for personal care, or a "living Will."

"Spouses will often name each other," Richmond says. "That's another reason why both spouses should have a good understanding of the household's wealth management concerns."

Couples should also think about the financial implications of their future health-care needs.

"What if one spouse is the primary income earner, but can no longer earn an income for health reasons? Or one spouse needs specialized health-care that you have to pay for out of pocket?"

You may need additional insurance to cover situations like these and it's important that both spouses are aware of what to do when the time comes to use it.

Marriage can be complicated – and even more so when you add money to the mix. We can help, with wealth planning that includes both you and your spouse. To learn more, please contact your advisor.

Interest rates applied to account balances as of September 22, 2017*

	Canadian dollar accounts	U.S. dollar accounts
All credit balances	0.05%	0.05%
Debit balances under $10,000	5.20%	6.50%
Debit balances $10,000 – $24,999	4.95%	6.25%
Debit balances $25,000 – $49,999	4.70%	6.00%
Debit balances $50,000 – $99,999	4.45%	5.75%
Debit balances $100,000 and over	4.20%	5.50%
All debit balances for registered accounts	5.20%	6.50%
All credit balances for registered accounts	0.05%	0.05%

The interest rates that will be in effect for debit balances in cash and margin accounts fluctuate with the Royal Bank prime rate as follows:

Debit balances	Canadian dollar rates†	U.S. dollar rates†
Under $10,000	CAD Prime + 2.00%	USD Prime + 2.25%
$10,000 – $24,999	CAD Prime + 1.75%	USD Prime + 2.00%
$25,000 – $49,999	CAD Prime + 1.50%	USD Prime + 1.75%
$50,000 – $99,999	CAD Prime + 1.25%	USD Prime + 1.50%
$100,000 and over	CAD Prime + 1.00%	USD Prime + 1.25%

† Based on Royal Bank prime rates as of September 22, 2017. CAD Prime = 3.20% and USD Prime = 4.25%. Rates are subject to change.

* RBC retains the right to change interest rates on a discretionary basis. A committee comprised of individuals representing various authorities within RBC Dominion Securities administers these interest rates. These rates are adjusted from time to time based on various factors, including, but not limited to, competitive analysis, Bank of Canada and other bellwether rates and/or cash rates. Interest amounts less than $5 are neither charged nor paid on regular accounts, and interest amounts less than $1 are neither charged nor paid on special product accounts. Rate changes of less than 1% will be processed on the 22nd of the month. The average daily cash balance for the month determines the tier that will be used to establish the rate. For interest rates on balances other than CAD or USD, speak to your advisor, or go to www.rbcds.com/cash-margin-rates.html.

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