GLOBAL
Insight

Wealth Management

Perspectives from the Global Portfolio Advisory Committee

April 2023

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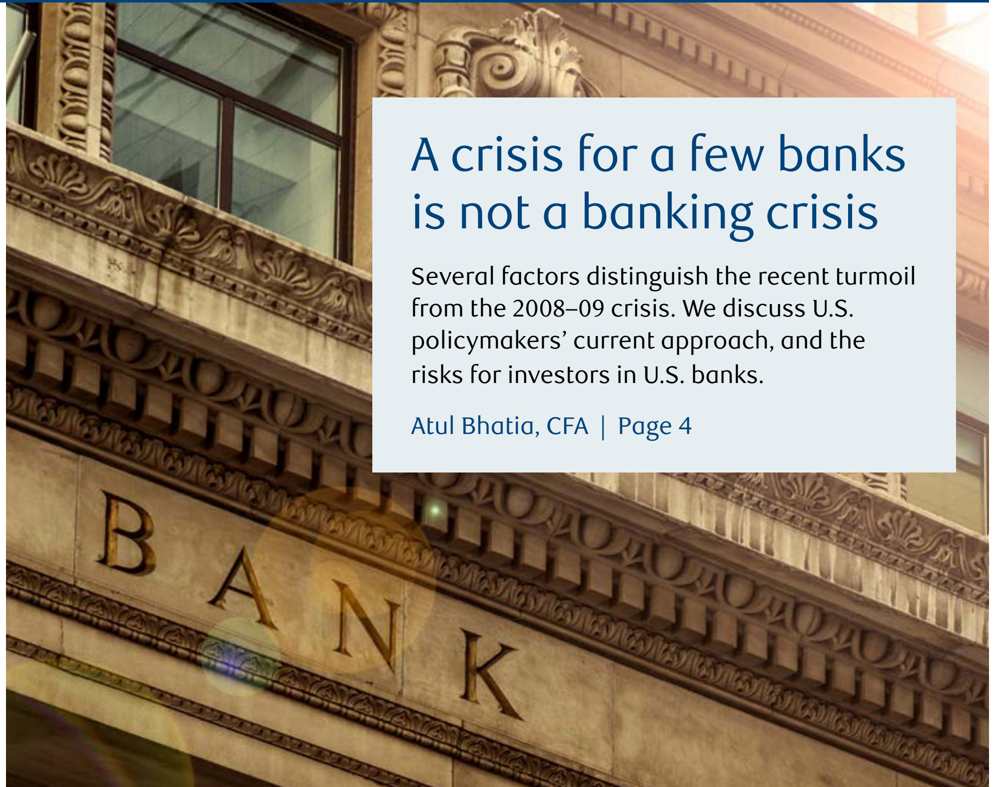

A crisis for a few banks is not a banking crisis

Several factors distinguish the recent turmoil from the 2008–09 crisis. We discuss U.S. policymakers' current approach, and the risks for investors in U.S. banks.

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April 2023

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All values in U.S. dollars and priced as of market close, March 31, 2023, unless otherwise stated.

Wealth Management

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Stance

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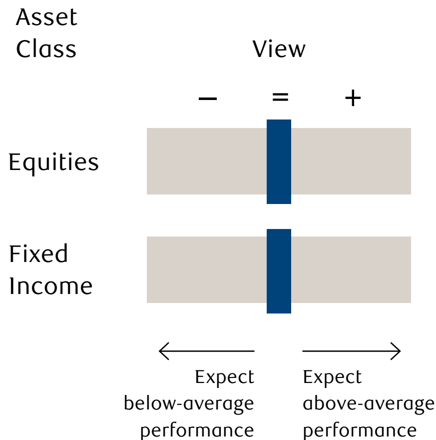

(+/=/–) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

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

= Market Weight implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

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

Source - RBC Wealth Management

Equities

- We think the most acute phase of the banking system stress has passed. But it's likely there are aftershocks to come—among them, further credit tightening by banks in the U.S. and other developed economies, and related constraints on economic growth. In our assessment, U.S. recession risks have intensified following the collapse of SVB Financial and Credit Suisse.
- A lot can happen within equity markets along the path toward and during recessions. The S&P 500 typically begins a new bull cycle before U.S. recessions end; indexes in other major markets usually follow a similar path. It's not too early for investors to start thinking about the economic recovery that will inevitably happen on the other side. In the near term, equity markets will likely focus on the degree to which credit tightening will impact recession risks, along with corporate earnings trends.
- We continue to recommend Market Weight exposure to U.S. and global equities, allocations that attempt to balance the heightened economic and volatility risks against what may have already been priced into markets.

Fixed income

- Government bond yield volatility remains high as markets digest the implications of the recent bout of bank turmoil. We believe potential changes in bank behavior and regulation are likely to act as a headwind to growth, as we see smaller lenders in particular looking to scale back lending growth. Though central banks largely remain hawkish, we continue to believe that rate hike cycles for many major global central banks will come to an end in the first half of 2023, meaning that sovereign yields—at least further out on the yield curve—have likely already peaked, leading us to lock in yields where possible.
- We remain Market Weight U.S. fixed income with a preference for longer-duration municipal bonds and the two- to 10-year maturity range for U.S. Treasuries. We believe these sectors offer both attractive yield and downside protection if growth slows. We also believe current pricing in preferred shares and speculative-grade issuers remains attractive, despite elevated recession risk.
- We reiterate our Market Weight stance in global fixed income, with a Market Weight allocation to corporate credit.

MONTHLY
Focus

A crisis for a few banks is not a banking crisis

It's understandable that investors remain scarred by memories of 2008–09 and that any word of bank failures brings fears. But several factors distinguish the current turmoil from the banking system crisis of 2008–09. We discuss the drivers of U.S. policymakers' current approach to today's stress, and the risks for investors in U.S. banks.

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- **With bank failures back in the headlines, investors are understandably concerned about the prospects of a return to the turmoil of 2008 and the global financial crisis.**
- **We believe that recent events are fundamentally distinct from the problems of 15 years ago and that policymakers' existing toolkit is sufficient to bring stability to the sector.**
- **Our concerns are focused on potential unintended consequences from regulators' attempts to assign losses and avoid moral hazard.**

Financial turmoil inevitably awakens memories of 2008–09 and the global financial crisis. We believe strongly that the recent events in the U.S. financial system are not the early stages of a 2008 repeat; 15 years ago, we had a banking crisis and today we have a crisis at a few banks. This distinction is critical for investors, in our view.

We see the relative paucity of new measures by U.S. policymakers to date as a reflection of the ultimate manageability of today's issues. But we also believe it could mark a potentially unwise attempt to assign losses between depositors and investors, a move that we see as fraught with potential unintended consequences.

Banking basics

Banking at its core is a relatively simple business. Depositors give an institution savings, and banks invest those savings. Sometimes banks buy existing investments such as U.S. Treasury bonds, and sometimes banks create their own investments by making loans. As long as the bank's investments return more in interest and principal than it owes depositors, the bank is in good shape. Since some borrowers don't pay and some bonds go bad, banks also have money from their owners, referred to as either capital or equity, to cover those losses.

One complication for banks is that depositors can, by and large, withdraw their money at any time, but banks don't always have the same luxury. Borrowers can't be forced to repay a mortgage on demand and bond prices may have temporarily declined. To allow for this, banks always try to keep plenty of cash on hand to meet depositor withdrawals, but they cannot

keep it all in cash or they would not have a way of generating the cash flow to pay interest or dividends to investors.

Past problems

In 2008, banks had a genuine problem. Assets they had carried on their books were worth less (and in some cases worthless) because of extremely lax loan standards that resulted in widespread loan defaults. That created a hole in the banks' capital and some banks were likely technically insolvent; if we added up all the money they would ever receive from their investments, the amount would have been insufficient to pay all the money that the bank owed.

Fixing this type of permanent drop in future income requires capital. Capital is risky, and as a result it's expensive, even in good times. In 2008–09, banks needed someone to replenish money that had already been lost, and that is a particularly difficult request. Ultimately, the government had to step in and provide assistance.

The easy part

Today's issue is not that the expected money from banks' assets will never be received. Many of the assets with the steepest price declines are U.S. Treasuries that we, and all market participants that we are aware of, fully expect to be repaid on time and in full.

The issue today is that more depositors than normal are demanding their cash, driven by fear of bank failure. It's a classic bank run that the existence of the deposit insurance is supposed to avoid.

There are two ways to deal with a bank run. One is to calm depositors' fears and discourage them from removing money. To a certain extent, that has worked. Much of the money being withdrawn isn't leaving the banking system overall but moving from a few small banks to larger ones. This is not ideal for the long-term health of a competitive banking system, but it is a far cry from 2008's global financial instability. It is also why we think this is a crisis for some banks but not for the banking system.

The other way to deal with a bank run is to find new money for the bank to use. To a large part, that's already happened. The Federal Reserve's new lending facility allows banks to use central bank financing to replace depositor money for certain U.S. Treasury and mortgage bonds. Critically, the Fed allows the banks to fund the bonds at the face value of the investment, meaning that in most cases this is a near seamless transition for depositor funding amounts; it's more expensive, but it's there.

The existing Fed mechanism doesn't work for all types of bank investments. Commercial and individual loans are not homogenous risks like government bonds. But the central bank has plenty of experience in crafting joint solutions for these types of assets with the U.S. Treasury Department, where the Fed provides financing to non-government assets and Treasury absorbs any realized credit losses. Historically, these arrangements have worked to the Fed's and the government's advantage.

Turmoil in European banks could add to the pressure on certain U.S. financial institutions and potentially raise the stakes for the Fed and

Treasury. But with asset quality sound and with our view that major European banks are likely to continue to perform on their obligations, we think this remains a problem well within the capacity of the U.S. government.

Moral hazard

Since the current problem should be relatively easy to solve, the obvious question is why have policymakers failed to act more decisively.

We see three reasons. First, existing legal authority to act is murky, at best. The Federal Deposit Insurance Corporation (FDIC) has wide powers to resolve banks in receivership, but absent congressional action it is relatively hamstrung in preventive moves. Second, because the overall system is not in crisis—as noted, large banks have seen deposit inflows—there is less immediate pressure on regulators to push the limits of their authority. Finally, and we believe somewhat hazardously, policymakers, in our view, are willing to see bank failures in part to combat potential moral hazards created by the 2008 bailouts. We think they are using this episode to reinforce that investors in banks—buyers of bonds, preferred shares, and stocks—are at risk if a bank fails.

While this is not necessarily a bad message to send, it is a different message than investors had perhaps believed after 2008. In 2008, we think that investors largely—and reasonably—concluded that investments made in sound financial institutions would be respected in a resolution if the bank later fell as part of an external risk event. A full government guarantee may not have been thought likely, but given the highly regulated nature of the institutions and the key role banks play in the economy, some consideration for investors may have been expected.

We are worried that policymakers may get what they seem to wish for: a sudden repricing of the risks in investing in bank bonds and stocks. If that were to occur, it could make it difficult for some banks—particularly smaller institutions—to borrow sufficient money in the public markets at economically viable rates to support their current levels of lending, let alone the type of loan growth companies have come to rely on. The impacts would likely be felt across the economy but would be especially detrimental for small businesses that rely on local lenders.

For investors, we think it is key to remember that the primary support for any investment is the fundamental underlying business and, broadly speaking, we believe the U.S. banking system's fundamentals remain solid. Even if the goalposts have moved from 2008 on the impact to investors in the case of default, that change does not directly impact investors in institutions that remain in operation. To state it plainly, we think that will be the case for the overwhelming majority of U.S. banks.

Not the end

The 2008–09 global financial crisis was a critical, if not the critical, financial event of the century to date. It's understandable that investors remain scarred by the event and that any word of bank failures brings fears. But we believe the underlying causes of the current market upheaval are both less substantial for the banking system and more easily controlled by existing central bank and regulatory mechanisms.

MONTHLY
Focus

China pursues a balance of economic pragmatism, reforms

The annual gathering of China's political leadership saw policymakers formalize their economic goals, and introduce new measures aimed at reforming financial institutions and boosting the tech sector. We unpack the investment implications, as well as our views on commodity markets and the country's real estate sector.

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- **To the surprise of many market participants, the highest economic officials were retained. This, combined with the strong track record of the new premier, signals a pro-growth, stable, and market-friendly policy stance.**
- **The 2023 GDP growth target of about five percent seems achievable, and therefore China's economy should support global growth.**
- **The government is seeking to enhance financial stability, boost scientific and technological self-reliance, strengthen data security, and develop the digital economy.**
- **The toughest regulation of the real estate sector is likely behind us, although we think the government will avoid broad-based stimulus.**
- **China's reopening is bullish for commodities overall, but the impacts across individual commodities will likely differ.**
- **We think China equities are in a sweet spot given the policy agenda is business-friendly and the economy is improving, and earnings improvement should soon follow. Meanwhile, equity valuations are still below average.**

The Two Sessions: China's most important annual government meetings

"Two Sessions" refers to the annual meetings of China's two major political bodies: the National People's Congress (NPC), which is the national legislature and the highest organ of state power; and the Chinese People's Political Consultative Conference (CPPCC), the top political advisory body. The meetings include elected representatives of every region, ethnic group, and sector of society.

The Two Sessions this year were of great importance because they laid out the implementation plan for China's long-term development over the next 25 years based on the blueprint set forth during the all-important 20th National Congress of the Communist Party of China (CPC) in October 2022. This year is a milestone in China's intended march to achieve the Second Centennial Goal of building China into a modern socialist country in all respects by 2049.

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China pursues a balance of economic pragmatism, reforms

The main surprise: Key economic officials retained

The appointments of China's president and premier were widely expected. Xi Jinping was reelected to a third term as president. Li Qiang, former party secretary of Shanghai, was appointed as premier.

To the surprise of many market participants, the highest officials in the economic team were retained. Yi Gang, Liu Kun, and Wang Wentao were reappointed as People's Bank of China (PBoC) governor, finance minister, and commerce minister, respectively. The heads of most ministries are keeping their positions, including the ministers of transportation, education, and industry and information technology. We think this arrangement reflects the government's focus on stability and policy continuity.

Chinese policymakers focusing on institutional reform

The NPC approved a plan for the reform of government institutions which focuses on optimizing and adjusting their responsibilities with the aim of improving governance efficiency and coordination. We think the reform plan shows the intensifying efforts of the Chinese government to enhance financial and economic stability, boost scientific and technological self-reliance, enhance data security, and promote the development of the digital economy. The retention of key officials should help ensure reform implementation during the transition period.

On the financial regulatory front, there were noteworthy changes. China will establish a national financial regulatory administration directly under the State Council (the Central People's Government), to regulate institutions outside the securities sector. The proposed administration will replace the current China Banking and Insurance Regulatory Commission. Importantly, certain functions of the PBoC and the China Securities Regulatory Commission (CSRC), such as investor protection, will be transferred to the new administration. The CSRC will become a government agency directly under the State Council, a higher status than it currently holds.

We think the proposed changes aim to promote integrated regulation in the financial industry and avoid regulatory arbitrage. They will concentrate regulatory functions under the new administration. The decision to retain

Major areas of institutional reform

Finance			Tech	Data
Establish National Financial Regulatory Administration	CSRC reform	Local financial regulatory reform	Restructure the Ministry of Science & Technology	Establish a national data bureau
• Regulate the financial industry for institutions outside the securities sector • Take over responsibilities for protecting consumers of financial products and investors from PBoC and CSRC	• Become a government agency directly under the State Council • Take over responsibility for reviewing corporate bond issuance from NDRC	• Streamline financial regulation at the local level	• Focus on driving major technological breakthroughs and facilitating the application of new technologies	• Coordinate data regulation • Facilitate the development of the digital sector

Source - Xinhua News Agency, RBC Wealth Management

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China pursues a balance of economic pragmatism, reforms

the CSRC and upgrade its status may demonstrate China's objective of developing the equity market and boosting equity financing, in our view.

The Ministry of Science and Technology will be restructured to promote the development of core technologies and move the country towards greater self-reliance in science and technology. The restructured ministry will focus on driving major technological breakthroughs and innovations, and facilitating the application of new technologies. We believe this will promote the integration of sci-tech with economic and social development needs, helping enhance the contribution of science and technology to industry.

To better coordinate data regulation, and to facilitate the development of the digital sector, a national data bureau will be established under and administered by the National Development and Reform Commission (NDRC), the country's top economic planner. The bureau will be responsible for advancing the development of data-related fundamental institutions, and for coordinating the integration, sharing, development, and application of data resources, while also pushing forward the planning and building of the digital economy and a digital society.

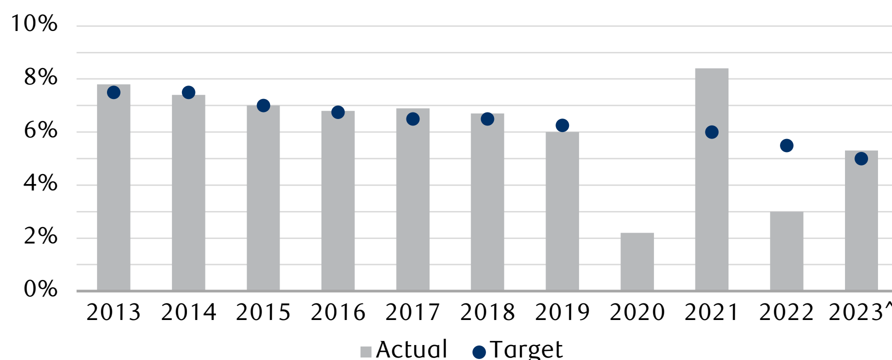
Economic growth: A pragmatic target

The Chinese government set a 2023 GDP growth target of around five percent. In contrast to many market participants who viewed this target as being below expectations, we believe this is a pragmatic and achievable target. Given the economic uncertainties China is facing, such as global economic vulnerabilities, we believe the government wants to leave some room to deal with unexpected risks.

The five percent growth target was part of a government report that also indicated managing major economic and financial risks would be a key focus for 2023. We think China will seek to lay a solid foundation for quality economic growth in the medium to long term, instead of pushing up growth in the short term through aggressive stimulus.

New Premier Li Qiang sent strong pro-growth messages during his first press conference. His remarks appeared pragmatic and market-friendly, in our

China's GDP growth targets vs. actual growth in the past 10 years



GDP growth targets: 2013–14, around 7.5%; 2015, around 7%; 2016, 6.5%–7%; 2017–18, around 6.5%; 2019: 6%–6.5%; 2020, no target due to COVID-19; 2021, above 6%; 2022, around 5.5%; 2023, around 5%. ^2023 growth data is Bloomberg consensus forecast.

Source - Chinese Government Work Reports, Bloomberg, RBC Wealth Management

view. Li mentioned that "macro policy combinations" would be introduced to expand domestic demand, push forward reforms and innovation, and limit risks. He also cited his work experience at the local government level in the economically developed regions of Zhejiang, Jiangsu, and Shanghai, and encouraged policymakers to "visit local communities to solicit public opinions" as part of their work. He stated that "government officials should not just slam on the brakes but also hit the accelerator," which to us is a sign of a more pro-growth policy direction going forward.

Property market: Less drag on growth this year

In the government's report, the policy stance that "housing is for living in and not for speculation" was only mentioned in the "past achievements" and was not included in the 2023 policy suggestions. We think this indicates the toughest regulation of the real estate sector is behind us.

But the report stuck to the theme of ensuring risk limitation while promoting stable development of the real estate sector. We think the government will avoid broad-based stimulus, but will continue to support "high-quality, leading real estate enterprises."

We expect the real estate market to gradually recover and to impose a milder drag on GDP growth this year. The National Bureau of Statistics' 70-city house price data suggest the weighted average property price in the primary market edged up sequentially in February after seasonal adjustments. The increase in house prices was broad-based among all city tiers, with the proportion of cities that experienced sequentially higher property prices rising sharply in both the primary and secondary markets.

Commodities: Reopening beneficial, but divergent performance expected

RBC Capital Markets, LLC Global Energy Strategist Michael Tran believes that while China's reopening is bullish for commodities overall, the impacts across individual commodities will likely differ. Sentiment on metals like copper and iron ore shifted upwards swiftly after China's reopening, as investors expect industrial economic activity will pick up. However, WTI and Brent crude oil have drifted lower recently amid global financial sector stress and concerns about the potential knock-on effects for economic growth in the U.S. and Europe.

In Tran's view, the divergent performance of different commodities makes sense with regard to Chinese demand. He recently wrote that "Commodity investors see the metals trade as the first derivative of the reopening, while individual consumer-linked commodities tied to societal behavior (like the oil complex) have lagged the space, for now, but will play catch up once societal behavior shows a steadfast degree of strength." China's latest data confirmed positive dynamics for the economy during the reopening, thanks to consumption and infrastructure investment.

A surge in air travel and a recovery in demand from China could drive global oil demand to record highs in 2023, according to the International Energy Agency (IEA). Global oil demand should accelerate over the year, rising to 2.6 million barrels/day in the fourth quarter from just 710,000

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China pursues a balance of economic pragmatism, reforms

China apparent oil demand is gradually picking up after the reopening

Millions of barrels per day

Note: According to the IEA, apparent demand is an estimate of domestic demand. Calculation varies by country; in China, apparent demand is defined as refinery output plus net product imports (adjusted for fuel oil and direct crude burning, smuggling, and stock changes).

Source - Bloomberg, National Bureau of Statistics, China Customs General Administration, RBC Wealth Management; monthly data through January 2023

barrels/day in the first quarter, the IEA estimates. While China's reopening should provide some support for crude oil output and prices, economic headwinds in the U.S. and Europe could detract from global oil demand if the two regions fall into recession.

Equity investment implications

The "Two Sessions" should allay investors' concerns about China's growth outlook and the policy direction of the new leadership team, in our view. We think China equities are in a sweet spot right now as the policy agenda is business-friendly, the economy is improving, and earnings improvement should soon follow. Meanwhile, low inflation leaves room for accommodative policies. Furthermore, equity valuations are still below their five-year historical average. The recent heightened U.S.-China tensions and global equity market turmoil surrounding the U.S. regional banking and European banking segments have led to a pullback in China equity indexes that, in our view, provides investors with opportunities to gradually build positions.

We prefer companies that are positioned to benefit from China's economic reopening. We also see the reform of state-owned enterprises (SOE) as a theme that should play out positively over the medium to long term. Deepening SOE reforms and enhancing SOEs' competitiveness are among the key tasks of the government this year. Several officials have stated recently that the SOEs are undervalued in the financial market. During the NPC, Shanghai Stock Exchange General Manager Cai Jianchun called for boosting central SOE valuations to a "reasonable level." As reform continues, we believe SOEs can deliver profitability improvements. With good corporate governance and decent dividend payouts, they could outperform. Companies in defensive sectors can also provide investors with attractive spots to park funds during periods of market volatility, in our view.

GLOBAL
Equity

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Markets, recessions, and telltale signs

- **We expect a U.S. recession to arrive later this year.**
- **Timing differences between the economic cycle and the ebbing and flowing of stock prices can be useful to know.**

We look for a U.S. recession to get started sometime in the second half of this year. Our Recession Scorecard update adds some detail.

U.S. recessions have always been associated with bear markets for U.S. equities. But American economic downturns have always reverberated beyond the U.S., ushering in challenging periods for stocks in Canada, Europe, the UK, and Japan, as well as in most of the developing world.

Following are some historical observations that might be useful references for investors looking to navigate through the coming 12 to 18 months.

It's not over until it's over ... the economic expansion that is

The economy goes on growing right up to the point where it rolls over into recession. Today, it is still in that pre-recession growth phase. Q1 2023 data has so far fared somewhat better than most expected going into the quarter. As we see it, credit conditions are not yet restrictive enough nor the all-important consumer weakened enough to make the start of recession imminent.

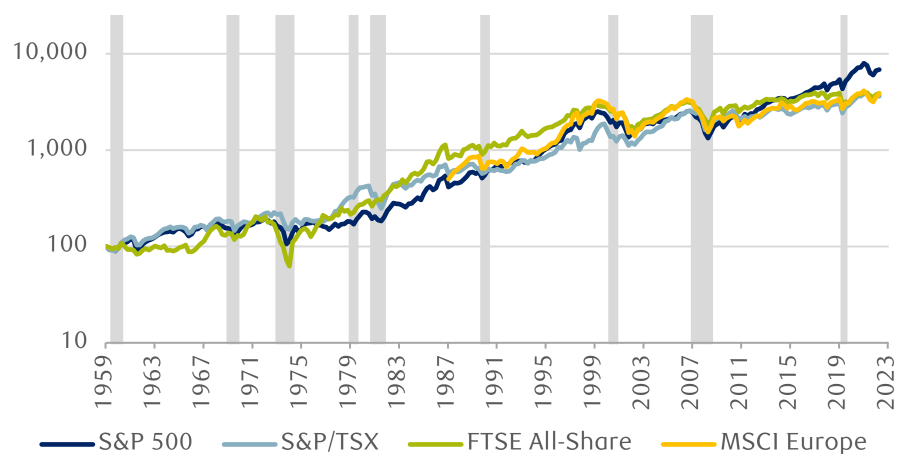
Along with GDP, Q1 earnings are likely to have held their own vis-à-vis Q4 2022 results. Nor can some further improvement be ruled out for Q2—one of the reasons why major stock

Equity views

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

+ Overweight; = Market Weight; – Underweight
Source - RBC Wealth Management

U.S. recessions and global equity bear markets go hand in hand



Source - Standard & Poor's, Toronto Stock Exchange, FactSet; quarterly data through 3/31/23, shown on a logarithmic scale, indexed to December 1959 = 100.

GLOBAL EQUITY

indexes have been able to remain above their October lows despite the banking turmoil.

Now S&P 500 earnings estimates for 2023, after falling steeply from $251 per share in May last year to $218 per share recently, look to have pulled out of that drop and have stabilised around current levels. We believe the index, already up some 18% from October, may be able to post further advances for some weeks or months as long as the economy remains able to gain some ground.

But it will be over later this year

The two most reliable leading indicators of U.S. recession—the inversion of the yield curve and the year-over-year downturn in the Conference Board's Leading Economic Index—gave negative signals in July and September of last year, respectively. Both have "perfect" track records of signalling a U.S. economic downturn is on the way well in advance of the recession getting started.

Their respective histories would point to mid-2023 as the most likely start date for the coming U.S. recession. A bit earlier or somewhat later is always possible, but as far as these two series are concerned, the U.S. economy is now about to enter "the zone" where a recession could be expected to get underway.

Waiting for two more shoes to drop

Two other recession indicators we follow normally flip to negative just before or just as a recession starts. The first of these is the unemployment rate. Usually, it declines rapidly during an economic expansion, then plateaus at a low level over several quarters before reversing course and trending decisively higher. In this case, it has meandered at or near current levels for 12 months. It would only take a move up to 4.0% from the latest reading of 3.6% and January's cycle low of 3.4% to turn the series trend higher and start the countdown clock for recession in earnest.

The second indicator that typically crosses its "red line" just as a recession is getting underway is the federal funds rate moving higher than the six-month annualised run rate of nominal GDP growth. (Nominal GDP is GDP that is not adjusted for inflation, and distinct from the most often cited real GDP, which takes out the effect of price increases.) As of Q4, the run rate of nominal GDP growth had subsided to 7.2% (down from a cycle high of 12.8% in Q2 2021), still well above today's fed funds rate of 5%. We expect nominal GDP will slow further and by Q3 of this year will have fallen below the fed funds rate, meeting that pre-condition of all previous recessions of the past 70 years.

Fed cutting won't save the day

But the sooner the rate cutting happens, the shorter and shallower the recession will likely be. The Fed and most other central banks, mindful of the late '70s experience, are leery of cutting too soon. However, the banking turmoil now has them reconsidering the wisdom of any further increases. We think a pause may be seen within the next couple of months. (The Bank of Canada has already gone there.)

But rate cutting, in our view, probably awaits a year-over-year inflation rate of close to 3% (it was down to 5% in February) with a clear indication of lower inflation readings on the way. We expect inflation could reach those encouraging levels by late summer. More often than not, the Fed began cutting before most past recessions started. Notable exceptions were the downturns of 1973–75, 1980, and 1981–82—all ultra-high inflation periods—when Fed rate cutting started only after the recession was already underway.

GLOBAL EQUITY

Nobody rings a bell

In the U.S., the job of officially determining the start and end of recessions (and expansions) goes to the National Bureau of Economic Research, a private, nonprofit, nonpartisan organisation. Its objective is accuracy, not speed. On average, it has made the call about a year after the event. So there can be a long stretch where debate continues to rage about whether the U.S. economy is or is not in recession without "a referee" making the call.

And the same goes for recoveries from recession. The global financial crisis and the accompanying recession ended in Q2 2009, but it was 2012 before most consumers and many businesses came around to accepting that.

While one waits for the referee's call, the yield curve has proven to be a useful timing tool. One of the yield curve's great strengths as a leading indicator, in our view, is that it works equally well in both directions. Inversion happens on average about 11 months before the recession starts, while normalisation (i.e., short-term interest rates fall back below long-term rates) occurs about 11 months before the economy pulls out of recession.

The stock market peaks before the recession starts ...

The market has set its bull market high on average about seven months before the recession begins. If the peak of the S&P 500 almost 15 months ago in early January 2022 marked the beginning of the bear market associated with the coming recession, then the time gap between the start date of the market downturn and that of the recession will be the longest on record. Even more so if the recession doesn't get underway until Q3.

The rally from the October lows is still intact despite the Russia-Ukraine war, banking turmoil, as well as Fed and other central bank tightening. Breadth among the large-cap stocks has been stronger than the S&P 500 Index and is already close to setting a new all-time high—often a sign the index is going to follow suit. However, small caps have lagged badly both in index performance and breadth, usually an indication that the overall market advance has limited room and time to run.

... and the market typically turns higher before the recession ends

Such upward moves have usually emerged four to six months **before** the recession concludes. However, the market has never bottomed before the associated recession even began.

Bottom line

We expect a U.S. recession will get underway later this year, ushering in another period of challenging stock market performance with knock-on negative implications for economies and stock markets in other developed countries. We recommend a global balanced portfolio be Market Weight to equities for now with a focus on quality, resilient balance sheets, sustainable dividends, and business models that are not intensely sensitive to the economic cycle. More aggressive defensive positioning may be called for in coming months.

That said, we believe bear markets can provide once-in-a-decade buying opportunities. The yield curve, when it normalises, should give some idea of when the recession will end. Stock indexes would typically embark on a new bull market upleg some months/quarters prior to that.

REGIONAL EQUITY

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Regional highlights

United States

The U.S. equity market, particularly the large-cap indexes, has thus far taken the banking system stress in stride. After a short-term selloff when tensions were most acute, both the S&P 500 and Dow Jones Industrial Average stabilized and are above where they were when the SVB Financial crisis began.

In our view, this initial resiliency can be attributed to regulators acting swiftly to stabilize the banking system and stem deposit flight out of regional banks, and to the Fed becoming less hawkish about future interest rate hikes. We believe the Fed is either finished or almost finished hiking rates. RBC Capital Markets anticipates inflation receding further in the coming months, which should give the Fed at least some breathing room. Historical data show the S&P 500 has often performed well after the Fed paused its rate hike cycle, as the exhibit illustrates.

Recession risks are arguably more elevated now due to ongoing rates-related challenges for banks and the economy overall. We think interest rates are prohibitively too high, and credit conditions will tighten further; both conditions are typically precursors to recessions. But recession risks have been present for many months, and we believe they are already at least partially factored into stock prices. Over the near term, the market will likely focus on the degree to which credit tightening will impact economic trends, along with the Q1 earnings season that will begin in mid-April.

We continue to recommend Market Weight exposure to U.S. equities, an allocation that attempts to balance the heightened economic and volatility risks against what may have already been priced into the market. Within large caps we favor the Communication Services sector, and we still see opportunities in the small-cap and midcap segments of the market.

Canada

Despite pockets of evident resiliency, tighter financial conditions resulting from central banks' efforts to tame inflation have dampened the global economic outlook. Higher interest rates have taken a toll on the Canadian housing market, with prices in retreat, while consumer spending also appears at risk given elevated household debt levels, higher debt servicing costs, and declining net worth. RBC Economics continues to expect the domestic economy will slip into a mild recession this year.

The Canadian banks are trading at historically discounted valuations as earnings forecasts are clouded by the outlook for credit losses with the housing market and household leverage vulnerabilities in focus. Furthermore, investor trepidation

Historical U.S. market performance when Fed policy shifts

Before and after the final rate hike in a Fed tightening cycle: Downside risk right before the Fed pauses, but typically strong gains afterwards

S&P 500 performance	Before final rate hike			After final rate hike		
Final Fed rate hike	6 months	3 months	1 month	1 month	3 months	6 months
Median 1970 – 1979	-1.0%	-2.5%	-4.5%	2.6%	-4.4%	2.8%
Median 1980 – 1989	9.0%	7.3%	-0.5%	1.2%	1.4%	8.0%
Median 1990 – 2018	2.4%	2.3%	1.0%	0.6%	7.2%	13.3%
Median since 1970	**2.9%**	**0.5%**	**-0.7%**	**1.0%**	**1.7%**	**5.9%**

Source - RBC Capital Markets U.S. Equity Strategy, Bloomberg; periods of positive performance shaded in green, periods with negative performance shaded in red

REGIONAL EQUITY

has been elevated on the back of recent bank failures and liquidity-driven concerns, further pressuring Canadian bank valuations. In our view, the structure of the banking sector in Canada along with robust regulatory oversight suggests the Canadian banks should once again prove resilient relative to global peers.

While a global recession would no doubt prove to be a headwind to demand in 2023, in our opinion, we remain constructive on the energy complex. The near-term outlook is more mixed, but we believe oil supply tightness points to higher prices through the cycle.

On balance, we believe the Canadian equities market deserves a Market Weight stance as valuations remain discounted relative to historical levels while its exposure to the resource complex provides a hedge of sorts to continued persistence in inflation.

Continental Europe

The Credit Suisse woes put the spotlight on the European banking system, the backbone of the economy. Swiss authorities' swift actions contained the crisis. Given that European banks are subjected to a relatively strong regulatory environment and they enjoy heathy liquidity and capital positions, there are few parallels with the global financial crisis of 2008, in our view. Yet, scars heal slowly, and concerns about the sector are likely to linger.

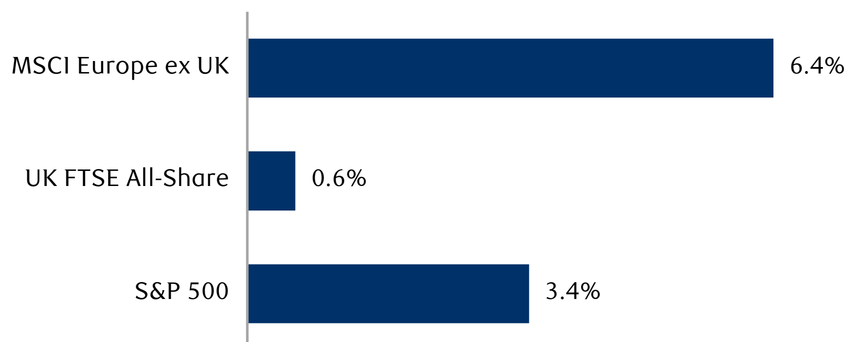
This episode complicates the outlook for banking and European equities. With the European Central Bank intent on hiking rates further to fight sticky inflation, bank lending standards are now likely to tighten further at a time loan demand is already softening. The banking sector is likely to face higher capital costs, and we expect its net interest margins to peak as it pays up for deposits in a higher interest rate environment. Meanwhile, planned capital distributions, such as share buybacks, are at risk as capital preservation may take precedence. These uncertainties will likely hold back banking sector shares for now.

With cyclicals, including banks, having a relatively high weight in the MSCI Europe ex UK Index, it's difficult to see Europe's outperformance versus other regions persisting. The MSCI Europe ex UK Index trades at a relatively undemanding 13x forward earnings, but we prefer to maintain our Underweight in European equities.

We would Overweight defensive stocks and focus on quality companies with strong balance sheets and resilient growth outlooks. We also continue to like opportunities linked to the energy transition such as enablers of electrification.

European outperformance may prove hard to maintain given the continent's more cyclical nature

Comparable year-to-date price returns



Source - RBC Wealth Management, FactSet; data through 3/28/23

REGIONAL EQUITY

United Kingdom

UK equities stand out for their very low valuations. The FTSE All-Share trades at a meagre 9.4x forward earnings and close to a record-high discount to U.S. equities even accounting for sector differences. The 4% yield is generous and the highest in developed markets. Moreover, dividends are also well covered.

With foreign markets dominating their revenue exposure, companies listed on the index should also benefit from the pound's weakness. The Bank of England's relative dovishness is likely to put renewed pressure on the currency. Many companies are shielded from the domestic economy's subdued outlook.

UK equities are well known for their defensive qualities, with Utilities, Health Care, and Consumer Staples accounting for a high 29% of the index, a higher exposure than developed market peers. As such, the index has historically outperformed when global economic activity levels start to decline as could be the case as interest rate hikes start to bite.

However, the index also has a twice as high an exposure to Financials and commodities as the United States. This is likely to hold back performance in the short term, given the banking sector woes and concerns about global economic growth.

Given this tug of war between the defensive and cyclical qualities of the index, we maintain our Underweight in UK equities for now. We would seek out companies with exposure to international revenues, with leading global franchises, many of which trade at a substantial discount to their peers.

Asia Pacific

Japan banking share prices have been underperforming their peers in other developed markets since the Silicon Valley Bank crisis in the United States. Analysts at our national correspondent firm broadly expect low capital adequacy risks for Japan's regional banks, and the analysts do not anticipate any issues with the banking sector's average capital level. In our view, financial system concerns should ease further given the strong response by U.S. and European banking authorities. We believe much of the negative sentiment has been largely priced into Japan bank stocks. Going forward, we expect Japan equities to be relatively resilient among developed market equities. Our constructive view is underpinned by solid corporate earnings prospects amidst the economy's reopening in H1 2023, additional boosts in H2 2023 from China's reopening, and mild inflation risks, along with the market's below-average valuation.

Last month, Bank of Japan Governor Haruhiko Kuroda chaired his last Monetary Policy Meeting with no surprises. The incoming governor, Kazuo Ueda, will inherit the mission of normalizing monetary policy. We believe the longer he delays changing yield curve control policy, the higher the costs would be, which could cause inflation to overshoot. China equities are likely to regain momentum as China recently cut the required reserve ratio to boost liquidity and the Chinese renminbi slightly strengthens against the U.S. dollar after the U.S. regional banking stress. Further upward earnings revisions could come after the Q4 2022 earnings season. Due to the banking stress in the U.S. and Europe, some overseas investors may start to consider diversifying their investments to China.

GLOBAL

Fixed income

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Stress fractures

This time last year, many global central banks were just embarking on their rate hike journeys—journeys that would quickly morph into some of the most aggressive interest rate hiking campaigns that markets and economies have had to contend with in decades.

Now one year later, and largely as a result of central banks' actions, stress fractures have begun to form in the global financial system.

At the epicenter of recent turmoil was a handful of U.S. regional banks uniquely exposed to the numerous impacts of a high interest rate environment. Market volatility subsided enough over the course of March to give Federal Reserve policymakers sufficient confidence to push forward with another 25 basis point rate hike, bringing the top of the target range to 5.00%. But whereas markets had been expecting the Fed to continue hiking towards 6.00% this year, rate cuts towards 4.25% are now the base case.

Inflation in North America remains elevated but continues to trend in the right direction. This could give the Federal Reserve additional cover to take a cautious approach, or even to pause and assess the impact of rate hikes to this point—something the Bank of Canada has already stated it plans to do. The same can't quite be said for Europe and the UK.

Fixed income views

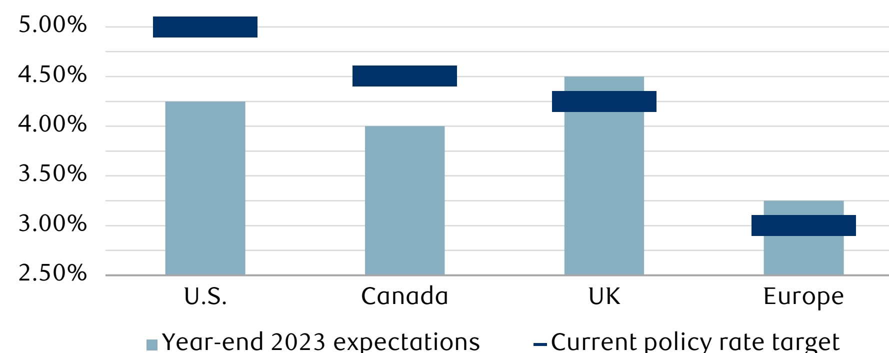
Region	Gov't bonds	Corp. credit	Duration
Global	=	=	5–7 yr
United States	+	=	3–7 yr
Canada	=	+	5–7 yr
Continental Europe	–	=	3–5 yr
United Kingdom	=	=	3–7 yr

+ Overweight; = Market Weight; – Underweight
Source - RBC Wealth Management

Though banking stress has also manifested itself in Europe, inflationary pressures in the region have reaccelerated in recent months, leaving central banks in the precarious position of balancing financial stability and price stability. Nonetheless, we believe major global central banks are indeed nearing the end of their rate hike cycles.

That's not to say the impending end of rate hikes will be an all-clear for markets and investors. In a basic sense, the fallout of financial system stress—in the form of reduced credit lending and lower economic activity—will act as a substitute for rate hikes, even if the disruptions prove to be isolated rather than systemic.

Further rate hikes expected in Europe as North American central banks pivot to cuts this year



Source - RBC Wealth Management, Bloomberg; market expectations based on overnight index swap rates

GLOBAL FIXED INCOME

So, as is the case with most stress fractures, the best remedy may be simply to rest. We expect most central banks to take this approach in coming months, lest these stress fractures become broken bones.

Regional highlights

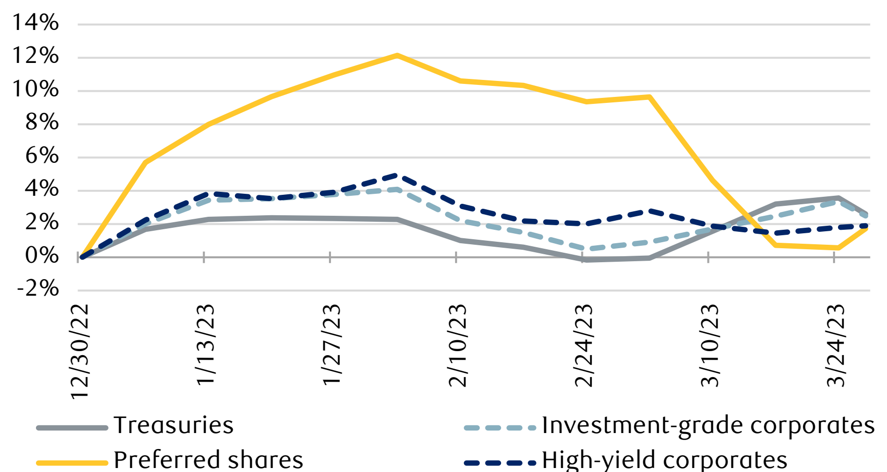
United States

The Federal Reserve's rate hike campaign appears, for all intents and purposes, to be over. In our view, while it is possible the Fed could proceed with one more rate hike at its May 2–3 meeting, investors should now shift their focus to the timing of interest rate cuts. Prior to stress appearing in global banking systems, we were already anticipating multiple cuts this year, and this remains our base case. Recent stress and market volatility only suggest to us that the balance of risks may be tilted toward further rate cuts.

Credit markets have been rattled, but not fundamentally disrupted, by recent economic and market turmoil. Across the risk spectrum, from Treasuries to riskier parts of the market such as high-yield corporate bonds and preferred shares, total returns remain positive on the year. Preferred shares—largely issued by financial sector companies, including the regional banking segment that was at the center of March stress—were hardest hit during the month. Their underperformance was particularly noticeable because it followed a historically strong start to the year, with the asset class having rallied nearly 12% in January alone. We think preferred shares issued by regional banks are likely to remain under pressure as concerns percolate, but there could be attractive entry points in preferreds issued by larger and more strongly regulated banks as a result.

Municipal market investors increasingly need to buy into longer-dated bonds in order to find value relative to comparable Treasury yields. A lack of new supply along with strong demand for shorter-dated maturities (inside of approximately 10 years) has pushed valuations toward historically expensive levels. As a result, investors focused on tax-exempt income may want to adopt a "barbell" strategy in their portfolios by incorporating Treasury notes inside of 10 years and municipal bonds beyond that.

High-flying preferred shares have come back down to earth following recent market volatility



Source - RBC Wealth Management, Bloomberg indexes, S&P Preferred Stock Total Return Index

REGIONAL FIXED INCOME

Canada

The Bank of Canada (BoC) has hiked interest rates eight consecutive times since March 2022, lifting the policy rate to a 16-year high in an attempt to tame some of the highest inflation readings since the early 1980s. That being said, the BoC has recently entered a new phase of monetary policy: A "data-dependent" conditional pause while it assesses the lagging economic impacts of the 425 basis points worth of hikes already delivered. Therefore, data releases such as retail sales, employment, the Consumer Price Index, and GDP are being closely dissected by market participants. This new phase of monetary policy has been conducive to heightened rates volatility, as the absence of BoC forward guidance has allowed investors more room to consider a variety of outcomes.

The collapse of Silicon Valley Bank and other U.S. regional banks, as well as the forced merger of Credit Suisse/UBS, has certainly exacerbated the volatility, with markets aggressively recalibrating expectations for the path of future monetary policy away from additional hikes in 2023 to potential cuts sooner than initially expected. Interestingly, this heightened rates volatility has not yet extended to corporate credit. Despite some widening, credit spreads remain at levels well below recent peaks.

Given an unusually wide range of potential economic and monetary policy outcomes in the near term, we see the balance of risks as favouring short-to-intermediate-term investment-grade bonds that lock in historically attractive yields without taking on excessive interest rate risk or credit risk.

Continental Europe

Market expectations for the European Central Bank's (ECB) peak interest rate have declined to around 3.5%, from 4%, as the fallout from recent turmoil in the banking sector will likely lead to tighter borrowing conditions. We anticipate two or three further hikes, and a terminal rate of 3.50%–3.75%, given the record estimated core services inflation reading in March. RBC Capital Markets now expects inflation in the region to average 6% y/y in 2023, exceeding the latest ECB staff forecasts. In addition, economic activity indicators point to a more resilient economy, and this could give central bank hawks more confidence to push for further hikes.

The global rally in sovereign bonds has resulted in lower German Bund yields, which we currently view as less attractive. We also think there is potential for euro area peripheral sovereign spreads to widen relative to Bunds as borrowing costs start to bite. We thus prefer to be Underweight for now.

We maintain our up-in-quality bias, preferring investment-grade over high-yield within the credit market. We remain cautious on credit due to increasing borrowing costs for issuers and tightening borrowing conditions for households and businesses, which could tip the economy into a deeper slowdown than currently anticipated by the ECB. Though banking sector volatility has calmed, fundamentally strong and well-capitalised euro area banks were caught in the storm, and their corporate spreads widened as a result. Therefore, we also remain selective in senior-ranking bank bonds.

United Kingdom

Our base case is that the Bank of England's (BoE) recent decision to raise interest rates by 25 basis points (bps), which brought the Bank Rate to 4.25%, marks the end of its hiking cycle. Future inflation data could present a risk to that view, however; according to the latest BoE guidance, additional hikes may be warranted if there are "more persistent inflation pressures." Further out, we do not expect rate cuts this year due to inflation likely remaining much above target, and the market has now

REGIONAL FIXED INCOME

pushed rate cut expectations to Q1 2024 from Q3 2023.

As for Gilt issuance for the 2023–2024 tax year, the Debt Management Office (DMO) forecasts it will reach nearly £241 billion. This is above economists' consensus estimate and would be the second-largest historically.

We therefore see room for Gilt yields to drift higher as the market digests the increased supply anticipated by the DMO. Moreover, the rush for "safe-haven" assets in the wake of the banking sector scare continues to ease. That being said, we believe yields are unlikely to go back to the highs reached during the March selloff due to the challenging macro backdrop.

While default rates remain low, corporate borrowing costs have increased, putting pressure on bond issuers. Spreads have widened recently, but we think they could widen further as financing conditions tighten. Furthermore, the aggressive pace of the corporate bond sales by the BoE is likely to be a headwind for credit in the near term.

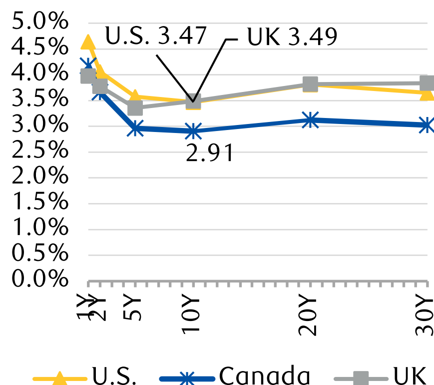
Asia Pacific

Asian investment-grade credit spreads have been largely unchanged year to date. They also remained relatively resilient throughout February when U.S. interest rate volatility increased. We attribute that resilience to the low supply in the asset class as issuance in February slowed from the previous month. Bond redemptions also outpaced issuance in the first two months of the year. Going forward, Asian investment-grade credit spreads are likely to remain resilient despite some widening as risk sentiment worsened in the weeks since banking troubles erupted in the U.S. We expect gross issuance to be easily absorbed by investors' internal cash generated from bond redemptions and coupons.

Year-to-date total returns for longer-duration Asian investment-grade bonds have outperformed those for shorter-duration bonds. However, after the recent drop in U.S. Treasury yields, we continue to prefer shorter-to-medium-duration Asian investment-grade bonds as yields can be slightly higher for those bonds with a relatively shorter time left to maturity.

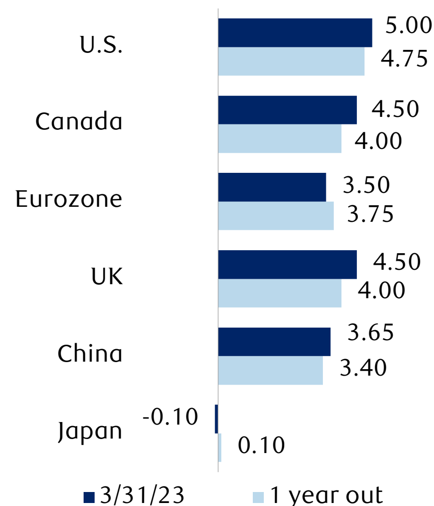
We also prefer to stay in higher-quality Asian investment-grade credit rather than high yield, as the attractiveness of higher-risk credit may be tested in the coming months as developed market central banks continue on their rate hike paths.

Sovereign yield curves



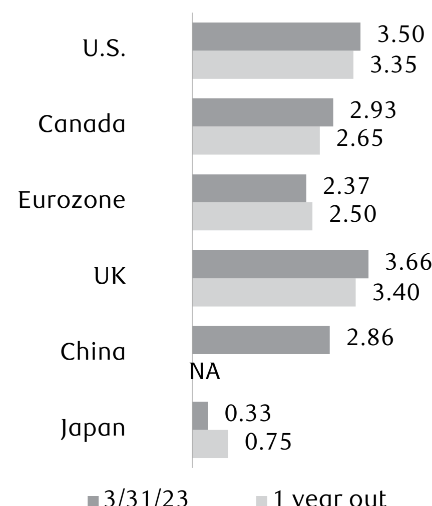
Source - Bloomberg; data through 3/31/23

Central bank rates (%)



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

10-year rates (%)



Note: Eurozone utilizes German Bunds.
Source - RBC Investment Strategy Committee, Global Portfolio Advisory Committee, RBC Global Asset Management

U.S. RECESSION

Scorecard

A U.S. recession moves ever closer

Three of our seven leading indicators of U.S. recession continue to signal an economic downturn is on the way. Two others are still firmly in expansionary territory but are moving (slowly) in the wrong direction. The two employment-related indicators—weekly unemployment claims and the unemployment rate—are at or near their cycle lows and not yet threatening to generate a negative signal.

The indicators that have flipped to recessionary status so far point toward a recession getting underway by late Q2 or early Q3 2023, in our view.

Yield curve (10-year to 1-year Treasuries)

The position of short-term interest rates relative to long-term rates—a.k.a. the shape of the yield curve—has been the most reliable leading indicator of a U.S. recession. Before the start of every recession for the past 75 years, the 1-year Treasury yield has risen above the 10-year yield, indicative of the arrival of tighter credit conditions. About a year after this crossing occurs, on average, a recession begins.

The 1-year yield rose above the 10-year yield decisively last July. The negative gap has widened further over the intervening seven months. **The history of this indicator suggests the U.S. economy will be in recession by summer 2023.**

Adding weight to the "tight money" message coming from the yield curve, January's Fed Senior Loan Officer Survey revealed that a growing majority of U.S. banks have continued to raise lending standards on almost every category of business and consumer loan, extending a trend begun about a year ago. The bank turmoil of the past several weeks is likely to add to the upward pressure on lending standards.

The survey also disclosed that a majority of banks are reporting reduced demand for commercial and industrial loans as well as for credit card and car loans, presumably in response to the much higher interest rates that now prevail.

ISM New Orders minus Inventories

The difference between the New Orders and the Inventories sub-indexes of the ISM Purchasing Managers' Index has turned negative near the start of most U.S. recessions. But it has also registered occasional false positives—signaling a recession was imminent when none subsequently arrived. Moreover, this indicator only relates to activity in the manufacturing sector (some 15% of the U.S. economy) and is derived from a survey rather than

U.S. recession scorecard

Indicator	Status		
	Expansionary	Neutral	Recessionary
Yield curve (10-year to 1-year Treasuries)			✓
Unemployment claims	✓		
Unemployment rate	✓		
Conference Board Leading Economic Index			✓
Free cash flow of non-financial corporate business	✓		
ISM New Orders minus Inventories			✓
Fed funds rate vs. nominal GDP growth	✓		

Source - RBC Wealth Management

U.S. RECESSION SCORECARD

hard data. Therefore, we view this as a corroborative indicator—one to pay attention to if other longer-term indicators are implying a recession is on the way. It has been negative since May 2022 from which point it has steadily worsened. **This measure has never reached this depth before without a recession eventually following.**

Conference Board Leading Economic Index

Historically, this series has given reliable early warnings of recession. When the index has fallen below where it was a year earlier, a recession has always followed—usually two to three quarters later.

This indicator turned decisively negative in Q3 2022, shifting it to the red column on our scorecard. It strongly suggests a U.S. recession will be underway sometime in Q2 2023.

Unemployment claims

This series set its monthly low, so far, for this cycle in March 2022 at 178,000. The cycle low for claims has typically been registered about 12 months before the start of the next recession. So, if no lower reading is posted in the coming months, its history would suggest a recession could get underway this spring.

As it happens, new monthly claims sagged sharply in January (down to 192,000) and got much closer to the cycle low posted last March. They look to have stayed at about the same level through February and March. If a new low for claims were to be posted in the coming months then this particular "clock" would have to be reset, pushing out the expected start date of the coming recession. However, so far, the weekly claims numbers have remained above the old lows. It would take a sustained stretch of weekly claims below 180,000 to turn this indicator back to an unequivocally positive rating.

Unemployment rate

The unemployment rate set a new five-decade low of 3.4% in January, but it has bounced back up to 3.6%. In our view, a move above 4.0% for the unemployment rate would signal a recession is on the way. Once that signal is given, on average, it has been eight to nine months from the lowest monthly reading until a recession gets underway, although there have been several instances where the time gap was only two to three months.

Free cash flow of non-financial business

This gives an indication of the ability of such businesses in aggregate to finance capital spending for expansion. Whenever it falls below where it was a year earlier a decline in corporate capital spending has typically followed, as has a recession. This number dipped slightly in Q4 2022 but remained elevated and appears a long way from giving a negative signal.

Fed funds rate vs. nominal GDP growth

It has always been the case that before a U.S. recession has started the fed funds rate has risen above the six-month annualized run rate of nominal GDP. (Nominal GDP is GDP not adjusted for inflation.) That run rate has been declining since peaking in Q2 2021. By Q4 2022 it was down to 7.2% but still well above the funds rate, which at the time was up to 4%. Now the fed funds rate is up to 5%. We expect nominal GDP will slow further and by Q3 of this year will have fallen below 5%, meeting that precondition of all previous recessions of the past 70 years.

Weighing up the current positioning of all seven indicators and projecting their likely paths over the next couple of quarters continues to point to a growing probability the U.S. will enter recession sometime late in the first half or in Q3 of 2023, in our view. However, absent some notable weakness in the employment data in the coming months, the start date could easily move out later into the second half.

Commodities

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Crude oil: Contagion

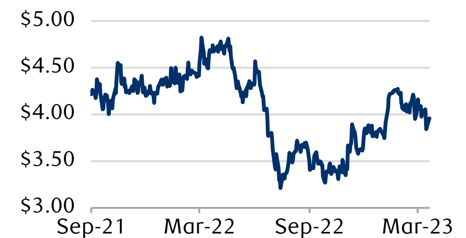
Oil prices broke below $70/barrel (bbl) following the collapse of select U.S. regional banks and the bailout of Swiss bank Credit Suisse. While near-term fundamentals have softened, RBC Capital Markets is still calling for tighter oil balances in the second half of 2023. The WTI retracement to the mid-$60/bbl level is pricing in a 2008-like recession, according to RBC Capital Markets' commodity strategist.

Natural gas: Overhang

Natural gas prices have plunged more than 40% year to date driven in part by a weak withdrawal season, growing supply, and limited upside in U.S. 2023 liquefied natural gas (LNG) exports. Looking ahead, above-average storage levels remain an overhang in RBC Capital Markets' view, but it also believes a floor has likely been reached. RBC Capital Markets' commodity strategist expects natural gas prices to average $2.98/MMBtu in 2023.

Copper: Flat

All things considered, copper held on well despite turmoil in the financial markets. Copper prices are roughly flat year to date, helped in part by easing inflationary pressures and the reacceleration of the Chinese economy. North American bond markets are now pricing in rate cuts in the second half of the year, and if this plays out it could stimulate incremental demand, in our view.



Gold: Rallying

Fears of financial instability and bearish sentiment propelled gold to fresh one-year highs, supported by a weaker U.S. dollar and lower real interest rates. The situation remains fluid and we believe gold will likely ebb and flow based on developments within the financial system, the path of major central bank policies, and global economic growth. Gold is trading within RBC Capital Markets' commodity strategist's high-end scenario.

Soybeans: Firm

Despite a softer global economic outlook, soybean prices have largely held firm year to date. In our opinion, the strength is mostly attributable to the reacceleration in China's economy. For context, the U.S. Department of Agriculture (USDA) projects that China will import about 90 million metric tons in 2023 or roughly 60% of global imports. Prices will likely move along with macroeconomic conditions with an emphasis on China.

Wheat: Balanced

Looking into the 2022/23 season, the USDA expects global production to come in at approximately 789 million metric tons, relatively in line with the estimate for global consumption. Growing exports from key producing countries allowed prices to normalize to mid-2021 levels (i.e., pre-Russia-Ukraine war). Prices are likely close to a floor, in our view.

Chart source - RBC Wealth Management, Bloomberg; date range: 9/1/21–3/20/23

Commodity forecasts

Commodity	2023E	2024E
Oil (WTI $/bbl)	$81.25	$84.50
Natural gas ($/MMBtu)	$2.98	$2.93
Gold ($/oz)	$1735	$1700
Copper ($/lb)	$3.75	$3.75
Soybeans ($/bu)	$14.30	$13.75
Wheat ($/bu)	$7.25	$7.55

Source - RBC Capital Markets forecasts (oil, natural gas, gold, and copper), Bloomberg consensus forecasts (soybeans and wheat); oil data as of 3/29/23; all other data as of 3/22/23

Currencies

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Currency forecasts

Currency pair	Current rate	Forecast Mar. 2024	Change
Major currencies			
USD Index	102.50	107.79	5%
CAD/USD	0.73	0.73	0%
USD/CAD	1.35	1.37	1%
EUR/USD	1.08	1.03	-4%
GBP/USD	1.23	1.14	-7%
USD/CHF	0.91	0.92	1%
USD/JPY	132.86	140.0	5%
AUD/USD	0.66	0.65	-2%
NZD/USD	0.62	0.62	0%
EUR/JPY	144.09	144.0	0%
EUR/GBP	0.87	0.90	3%
EUR/CHF	0.99	0.95	-4%
Emerging currencies			
USD/CNY	6.87	6.30	-8%
USD/INR	82.18	82.50	0%
USD/SGD	1.33	1.29	-3%

Change is defined as the implied appreciation or depreciation of the first currency in the pair quote. Examples of how to interpret currency data can be found in the Market Scorecard.

Source - RBC Capital Markets forecasts, Bloomberg

U.S. dollar: Banking turmoil halts rally

After a 4.5% drop from the January high, the U.S. Dollar Index rallied following a series of strong U.S. economic data, reaching a new high for the year in March before banking woes triggered a reversal in the index through lower U.S. Treasury yields. The U.S. dollar could recover in H2 should the bank stress and recent global monetary tightening result in an abrupt slowdown worldwide. RBC Capital Markets notes that such instances are typically associated with dollar gains against most G10 currencies except for the yen and Swiss franc.

Euro: Consolidation after ECB hikes

The European Central Bank (ECB) hiked interest rates by 50 basis points (bps) in March to 3.5%, following a 50 bps increase in February. ECB President Christine Lagarde, however, did not provide any firm forward guidance on rates, though she reiterated a commitment to bringing inflation down to 2%. We look for some consolidation on the EUR/USD between 1.05–1.10, with risk of a break higher after the recent collapse in U.S. Treasury yields.

Canadian dollar: USD/CAD edging towards 1.39

The Canadian dollar has been a middle-of-the-pack performer among G10 currencies in Q1. The deceleration in Canada's inflation rate to 5.2% in February should help the Bank of Canada make a case for holding its key interest rate at 4.5% throughout Q2. RBC Capital Markets strategists expect the loonie to recover in 2024 on higher expected oil prices, even though its sensitivity to oil prices has fallen lately.

British pound: Medium-term weakness

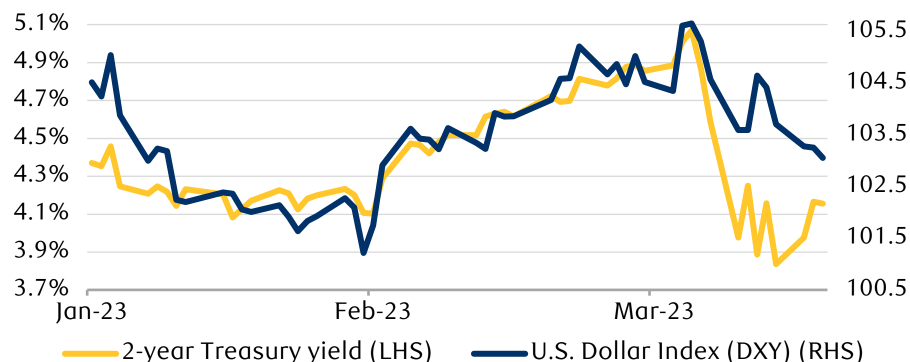
The Bank of England hiked interest rates by 25 bps to 4.25% in March, following an unexpected rise in inflation to 10.4% in February after a 10.1% reading the month before. GBP/USD has remained confined in a 1.18–1.24 range in Q1, but RBC Capital Markets strategists' longer-term expectation is for a cheaper pound to balance the UK's twin deficits (the fiscal deficit and current account deficit).

Japanese yen: Mild weakness

The yen weakened following the announcement of Kazuo Ueda as the next Bank of Japan governor, disappointing investors who were looking for a more overtly hawkish candidate. USD/JPY has since retreated nearer to 130 from 137 following the Silicon Valley Bank turmoil. While we look for interest rate differentials between the U.S. and Japan to keep USD/JPY supported, the decline in U.S. Treasury yields could potentially cap rallies on the pair in the short-to-medium term.

U.S. Dollar Index has followed movements in the 2-year Treasury yield

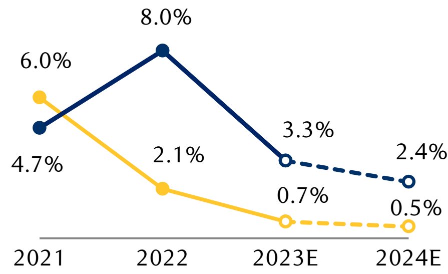
We expect the U.S. dollar to recover in H2 2023 on recession risks



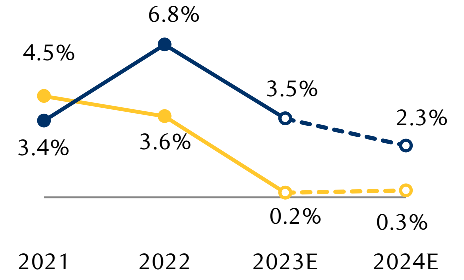
Source - RBC Wealth Management, Bloomberg; data through 3/22/23

KEY
Forecasts

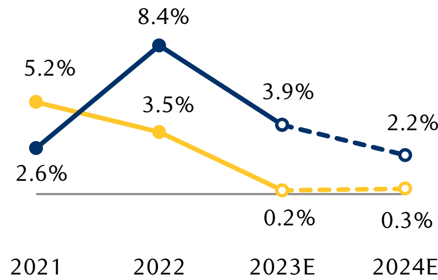
United States



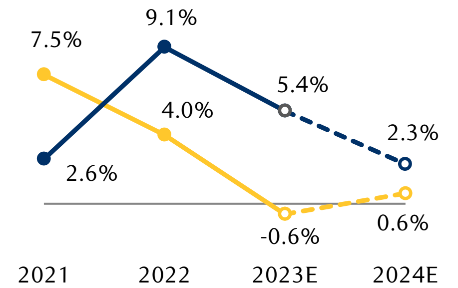
Canada



Eurozone



United Kingdom



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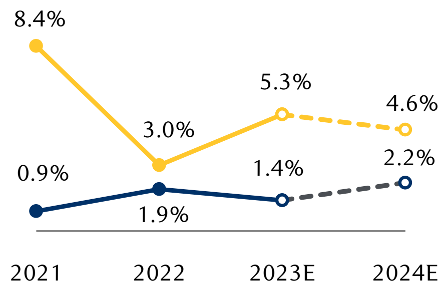
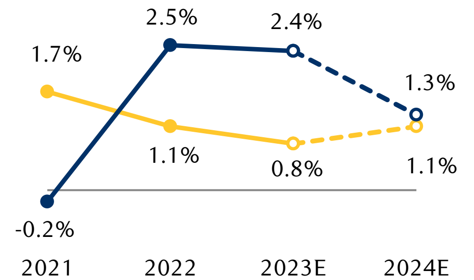


Japan



Real GDP growth

Inflation rate

Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management, Bloomberg consensus estimates

Market Scorecard

Data as of March 31, 2023

Equities

U.S. equity markets mostly outperformed their global counterparts. The S&P 500 and Nasdaq posted strong gains, while the Dow Industrials' gains were more muted.

Bond yields

Global bond yields drifted lower with the largest move seen on the U.S. 2-year Treasury yield, which fell by nearly 70 basis points from the end of February.

Commodities

Investor concern over the stability of the banking sector provided a boost to metals, with gold, silver, and copper posting strong gains.

Currencies

The U.S. dollar weakened against major currencies including the CAD, EUR, and GBP after the Fed raised rates by 25 basis points.

Index (local currency)	Level	1 month	YTD	12 month
S&P 500	4,109.31	3.5%	7.0%	-9.3%
Dow Industrials (DJIA)	33,274.15	1.9%	0.4%	-4.0%
Nasdaq	12,221.91	6.7%	16.8%	-14.1%
Russell 2000	1,802.48	-5.0%	2.3%	-12.9%
S&P/TSX Comp	20,099.89	-0.6%	3.7%	-8.2%
FTSE All-Share	4,157.88	-3.4%	2.0%	-0.7%
STOXX Europe 600	457.84	-0.7%	7.8%	0.4%
EURO STOXX 50	4,315.05	1.8%	13.7%	10.6%
Hang Seng	20,400.11	3.1%	3.1%	-7.3%
Shanghai Comp	3,272.86	-0.2%	5.9%	0.6%
Nikkei 225	28,041.48	2.2%	7.5%	0.8%
India Sensex	58,991.52	0.0%	-3.0%	0.7%
Singapore Straits Times	3,258.90	-0.1%	0.2%	-4.4%
Brazil Ibovespa	101,882.20	-2.9%	-7.2%	-15.1%
Mexican Bolsa IPC	53,904.00	2.2%	11.2%	-4.7%
Bond yields	**3/31/23**	**2/28/23**	**3/31/22**	**12 mo. chg**
U.S. 2-Yr Tsy	4.025%	4.816%	2.335%	1.69%
U.S. 10-Yr Tsy	3.468%	3.920%	2.338%	1.13%
Canada 2-Yr	3.737%	4.205%	2.290%	1.45%
Canada 10-Yr	2.897%	3.329%	2.405%	0.49%
UK 2-Yr	3.444%	3.689%	1.352%	2.09%
UK 10-Yr	3.490%	3.826%	1.610%	1.88%
Germany 2-Yr	2.683%	3.137%	-0.074%	2.76%
Germany 10-Yr	2.292%	2.651%	0.548%	1.74%
Commodities (USD)	**Price**	**1 month**	**YTD**	**12 month**
Gold (spot $/oz)	1,969.28	7.8%	8.0%	1.6%
Silver (spot $/oz)	24.10	15.2%	0.6%	-2.8%
Copper ($/metric ton)	9,003.25	0.6%	7.6%	-13.2%
Oil (WTI spot/bbl)	75.67	-1.8%	-5.7%	-24.5%
Oil (Brent spot/bbl)	79.77	-4.9%	-7.1%	-26.1%
Natural Gas ($/mmBtu)	2.22	-19.3%	-50.5%	-60.7%
Agriculture Index	460.16	2.9%	-2.2%	-15.1%
Currencies	**Rate**	**1 month**	**YTD**	**12 month**
U.S. Dollar Index	102.5060	-2.3%	-1.0%	4.3%
CAD/USD	0.7398	1.0%	0.3%	-7.5%
USD/CAD	1.3516	-1.0%	-0.3%	8.1%
EUR/USD	1.0839	2.5%	1.3%	-2.1%
GBP/USD	1.2337	2.6%	2.1%	-6.1%
AUD/USD	0.6685	-0.7%	-1.9%	-10.7%
USD/JPY	132.8600	-2.4%	1.3%	9.2%
EUR/JPY	144.0900	0.1%	2.6%	7.0%
EUR/GBP	0.8790	-0.1%	-0.7%	4.3%
EUR/CHF	0.9922	-0.4%	0.3%	-2.8%
USD/SGD	1.3309	-1.3%	-0.6%	-1.7%
USD/CNY	6.8736	-0.9%	-0.4%	8.4%
USD/MXN	18.0462	-1.4%	-7.5%	-9.2%
USD/BRL	5.0631	-3.3%	-4.1%	6.8%

Equity returns do not include dividends, except for the Brazilian Ibovespa. 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 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD -7.5% return means the Canadian dollar has fallen 7.5% vs. the U.S. dollar during the past 12 months. USD/JPY 132.86 means 1 U.S. dollar will buy 132.86 yen. USD/JPY 9.2% return means the U.S. dollar has risen 9.2% vs. the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 3/31/23

Research resources

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As of March 31, 2023

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
Buy [Outperform]	824	56.05	236	28.64
Hold [Sector Perform]	591	40.20	132	22.34
Sell [Underperform]	55	3.74	4	7.27

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