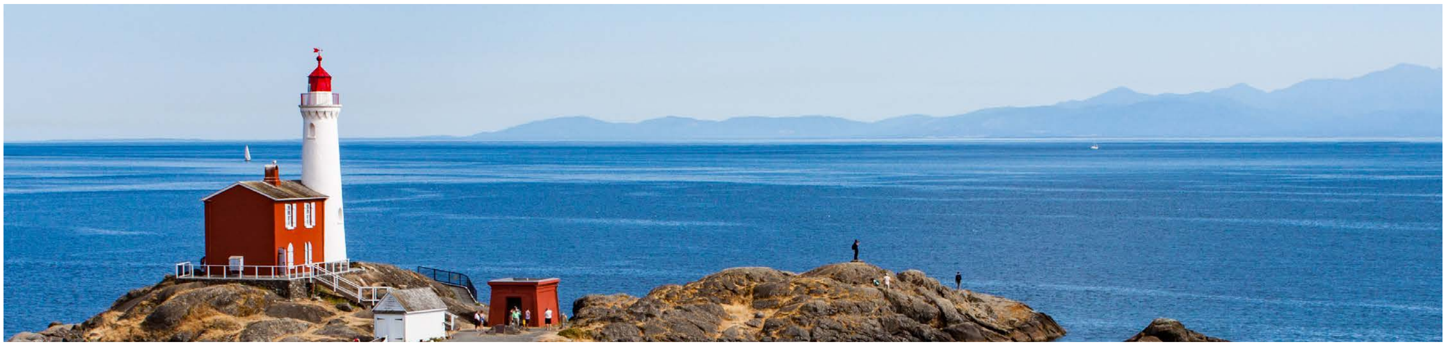
January 2019

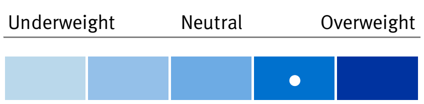
RBC WEALTH MANAGEMENT

Asset Allocation Guide



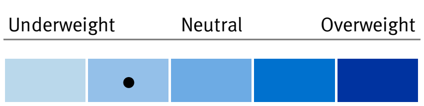
This publication provides guidance and direction on asset allocation from the Canadian Investment Committee, including updated thoughts and recommendations for various asset and sub-asset classes. It can be used to help investors tilt their own strategic asset mix in a direction that reflects the 12–18 month investment views at RBC Wealth Management. The Guide will be updated quarterly or on an ad-hoc basis should an asset allocation view change.

Cash



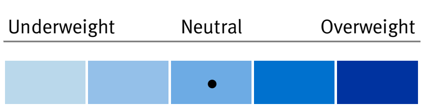
Prospects that markets have transitioned into a late-cycle environment raise the risk of volatility bursts across asset classes. We would exercise patience and retain a modest Overweight in cash, balancing our desire to maintain liquidity to take advantage of potential rebalancing opportunities stemming from market dislocations with gradually rising opportunity costs. To reduce the opportunity cost of holding an above-benchmark weight in cash, we recommend using cash-like vehicles, such as money market funds, which now provide a more worthwhile yield.

Fixed Income



We maintain a modest Underweight and think lower-quality corporate bonds are a good place to start the overall portfolio de-risking process because compensation for taking those risks is currently minimal and credit quality has weakened. This allows investors to take advantage of higher short-term bond yields while still acknowledging that rewards for taking both credit and interest rate risk are modest in the context of narrow credit spreads and a flat yield curve.

Equities



We maintain a Neutral weight amid a more volatile macro backdrop. Cheaper valuations after the correction over the past few months, low recession risk for major economies, and a reasonable outlook for corporate profits suggest to us that stocks can deliver gains over the next 12 months. However, these supportive factors are offset by mounting concerns about the prospect of a possible Federal Reserve policy error triggering a U.S. recession, which joins China-U.S. trade as a key market worry in 2019. A fully invested stance in equities allows participation in potential price upside but acknowledges that prospective returns could be lumpy and more moderate, given slowing earnings growth and limited scope for multiple expansion in the current environment.

Click here for a list of Canadian Investment Committee members.

For important and required disclosures, see page 6.

Wealth Management
Dominion Securities

Asset allocation balanced profile

Asset class	Long-term targets % of portfolio: Global	Long-term targets % of portfolio: Domestic	Current qualitative recommendations: –		=		+	Commentary
Cash	2%	2%				●		
Fixed Income	43%	43%		●				
Core	32%	32%				●		
Government bonds	9%	11%				●		**Maintain modest Overweight**. Government of Canada (GoC) bonds have rallied in response to a reduction in the number of expected interest rate hikes in Canada as well as increased uncertainty in the global economic outlook. We continue to believe it is timely for fixed income investors to increase liquidity and credit quality despite GoC bonds offering lower yields than they had for much of 2018. The value case for bonds that are heavily discounted to par remains in place. Until we see a clearer indication that the Canadian economy, as well as that of the U.S., may be slowing down materially or, if their respective government bond yield curves re-steepen from here, our focus remains on shorter-dated bonds.
Corporate - investment grade	13%	16%		●				**Maintain modest Underweight**. The average yield differential between Canadian IG corporate bonds and government bonds has moved to the widest level in over two years. Despite an improved valuation case, we remain somewhat cautious given the high levels of financial leverage outstanding and what we expect to be a more challenging operational environment over the coming years. Where possible, we continue to recommend issuers that have less exposure to the highly indebted Canadian consumer.
Global bonds CAD-hedged	10%	5%				●		**Maintain modest Overweight**. Credit diversification is a key attraction of global bonds and as we move closer towards the end of the cycle, we think this will improve risk-adjusted returns. We believe it is sensible for investors to take steps to diversify credit exposure away from businesses that are exposed to the Canadian consumer. Current hedging conditions are also appealing, in our view, in that many global sovereigns (especially U.S. Treasuries) can be hedged back to Canada at higher levels than the equivalent GoC yields.
Non-core	11%	11%		●				
Canadian preferred shares	3%	3%			●			**Maintain Neutral**. The valuation case for preferred shares has increased substantially over the past couple of months given the relative underperformance (versus other risk assets) that was experienced. This relative underperformance transpired from a point when preferred share valuations were not as rich as other risk assets, which enhances our constructive view. We are cognizant that preferred shares are perpetual credit products and we are closer towards the end of the cycle than the beginning, which is why we are not increasing the recommended exposure. However, we are seeing opportunities to rotate existing positions into more deeply discounted issues.
High yield	4%	4%	●					**Maintain Underweight**. Despite a drastic improvement in valuation, we continue to view the risk-reward profile as unattractive for HY given compensation for credit risk remains somewhat modest and deal structures have weakened this year. The high-yield market has underperformed government bonds on a multi-year holding period return basis when credit spreads are in the narrowest quartile, which is where they currently reside. One risk facing the high-yield market resides in the investment-grade market, where nearly half of all borrowers carry a BBB rating. This represents a potentially significant source of high-yield supply if there are a series of negative ratings actions in the future, in our opinion.
Emerging markets	4%	4%			●			**Maintain Neutral**. EM bonds have posted positive total returns of late as lower government bond yields have more than offset a further widening in credit spreads. While EM bonds now exhibit spreads that are at their widest levels since 2016, we refrain from adding to positions at current levels as we think our risk budget is better spent elsewhere.

Asset allocation balanced profile

Asset class	Long-term targets % of portfolio: Global	Long-term targets % of portfolio: Domestic	Current qualitative recommendations (– = +)	Commentary
Equities	55%	55%	=	
Canada	20%	33%	=	**Maintain Neutral**. Valuations remain discounted relative to the U.S., which we believe provides appropriate compensation for domestic-specific challenges (e.g., the impact of higher interest rates on highly-leveraged households, constrained oil pipeline capacity, and waning economic competitiveness). Resolution of free trade negotiations with the U.S. and Mexico appears poised to reduce uncertainty; however, the agreed accord must now be passed into law. Bank valuations have contracted but better reflect expectations for slower earnings growth. Mandatory production cuts should alleviate a glut of crude in storage, but visibility on increased pipeline capacity remains limited.
U.S.	20%	12%	=	**Maintain Neutral**. U.S. stocks have buckled under persistent concerns about tightening monetary policy, signs of slowing global growth, and domestic political discord. With most data indicating the domestic economy remains on a solid footing, and our recession risk indicators not flashing any warning signals, we retain a modestly constructive view towards the U.S. market. While valuations have cheapened following the latest downdraft, we refrain from upgrading given a higher-than-normal hurdle for positive earnings surprises in the near term and unusually high uncertainty surrounding both fiscal and monetary policy.
Developed international	10%	6%	=	**Maintain Neutral**. Brexit remains a worrisome overhang on European indexes, which comprise more than 60% of the market cap of international developed markets. Japanese bourses offer relatively more attractive opportunities, in our view, thanks to a combination of compelling valuations, improving shareholder-friendly behaviours, and decent earnings growth. That said, we believe the higher representation of cyclical sectors in these regions' indexes leaves their overall earnings outlook relatively more vulnerable to the global trade and manufacturing soft patch. We maintain a bias towards high-quality companies with global franchises and a structural growth runway.
Emerging markets	5%	4%	=	**Maintain Neutral**. The current macro backdrop of lingering trade protectionism, tightening financial conditions and lack of clarity on China's growth policy is not conducive to sustained EM share price outperformance. Although the prospect of China intensifying its current stimulus campaign to shore up its economy from the impact of U.S. tariffs could help to bolster near-term sentiment, we believe EM's earnings trends could continue to lag developed markets. Valuations have cheapened, but we recommend maintaining a selective approach, focusing on businesses with more resilient growth fundamentals, such as those tied to consumers and health care.

Long-term strategic allocation targets

Cash & Fixed Income

	Current view	Very conservative		Conservative		Balanced		Growth		Aggressive growth	
		Global	Domestic	Global	Domestic	Global	Domestic	Global	Domestic	Global	Domestic
Cash	+	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Fixed Income	–	78%	78%	63%	63%	43%	43%	28%	28%	0%	0%
Core	+	78%	78%	52%	52%	32%	32%	17%	17%	0%	0%
Government bonds	+	30%	32%	19%	21%	9%	11%	4%	5%	0%	0%
IG corporate bonds	–	38%	40%	23%	26%	13%	16%	8%	9%	0%	0%
Global bonds (CAD-hedged)	+	10%	6%	10%	5%	10%	5%	5%	3%	0%	0%
Non-core	=	0%	0%	11%	11%	11%	11%	11%	11%	0%	0%
Canadian preferred shares	=	0%	0%	3%	3%	3%	3%	3%	3%	0%	0%
High yield	–	0%	0%	4%	4%	4%	4%	4%	4%	0%	0%
Emerging markets	=	0%	0%	4%	4%	4%	4%	4%	4%	0%	0%

Equities

	Current view	Very conservative		Conservative		Balanced		Growth		Aggressive growth	
		Global	Domestic	Global	Domestic	Global	Domestic	Global	Domestic	Global	Domestic
Equities	=	20%	20%	35%	35%	55%	55%	70%	70%	98%	98%
Canada	=	10%	12%	15%	21%	20%	33%	24%	41%	31%	58%
United States	=	5%	5%	10%	9%	20%	12%	24%	15%	31%	22%
International	=	5%	3%	10%	5%	10%	6%	14%	8%	26%	11%
Emerging markets	=	0%	0%	0%	0%	5%	4%	8%	6%	10%	7%

Interpreting the recommendations

For investors looking for more specific ways of interpreting the recommendations, we offer the table below as a guide on how to quantify the qualitative recommendations.

"Global balanced" profile

	—		=		+
	UW	Modest UW	Neutral	Modest OW	OW
Interpreting qualitative asset class recommendations above:					
Absolute % (of portfolio)	-10%	-5%	0%	5%	10%
Interpreting sub-asset class (i.e., within Equity or Fixed Income) recommendations above:					
Relative % (of asset class)	-40%	-20%	+/- 5%	20%	40%

Research resources

This document is produced by the Canadian Investment Committee within RBC Wealth Management. This group consists of members from various investment areas at RBC Capital Markets and RBC Wealth Management, including RBC Dominion Securities and RBC Global Asset Management. It meets monthly and is responsible for providing views on asset allocation, fulfillment selection, portfolio construction, and management for the firm's investment advisors. The Committee leverages the firm's vast resources, including asset allocation, asset class, manager, and individual security research from RBC Global Asset Management, RBC Capital Markets, and third-party resources.

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As of December 31, 2018

			Investment Banking Services Provided During Past 12 Months	
Rating	Count	Percent	Count	Percent
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