June 2017

RBC WEALTH MANAGEMENT

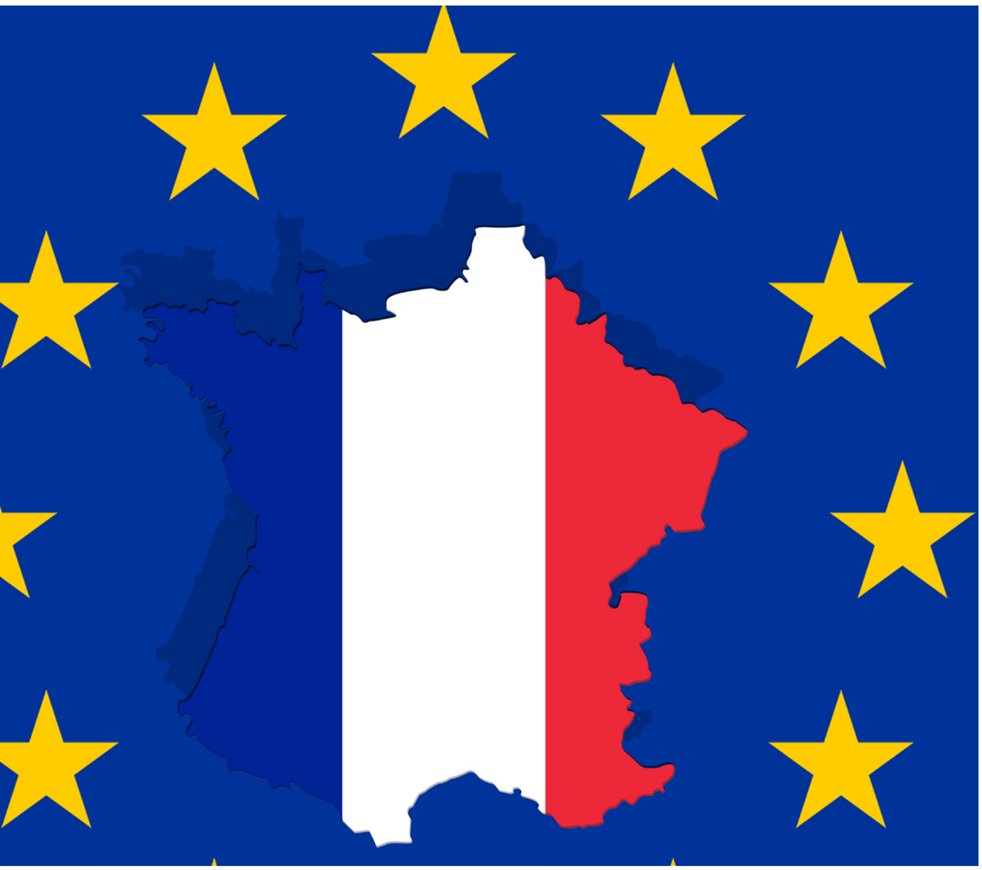
Global Insight

Perspectives from the Global Portfolio Advisory Committee

French connection

The economic revival in Europe and France's "vote of confidence" in the EU increase the appeal of European equities.

Frédérique Carrier | Page 4



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RBC Wealth Management

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RBC’s investment stance

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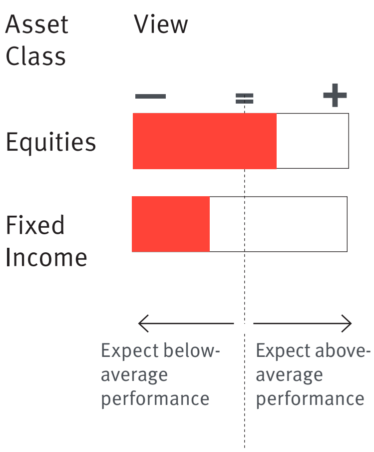

See “Views explanation” below for details

Source - RBC Wealth Management

Equities

- While virtually all major equity markets have worthwhile year-ahead potential when viewed in isolation, a global equity portfolio can and should lean against risk and toward opportunity. We recommend rebalancing portfolios by moderately trimming U.S. equity exposure, especially in outsized positions, and shifting those funds to Continental Europe (ex-U.K.). This reflects our upgrade of Europe to Overweight and downgrade of the U.S. to Market Weight.
- We continue to believe the U.S. economy is sturdy and the secular (long-term) equity bull market remains intact. However, with other major developed economies finally gaining momentum, the attractive opportunities in Europe should not go unnoticed. We expect investors to be rewarded by strong revenue and earnings growth together with some narrowing of the overly large valuation gap between Europe and the U.S.

Fixed Income

- Steadier and improving global economic trends are a signal that the period of peak monetary policy stimulus could soon be behind us. We foresee a long, unwinding process during which government and corporate bond yields gradually increase on a global basis as the Federal Reserve slowly hikes interest rates and other major central banks ease off the gas.
- Nevertheless, even if yields drift somewhat higher, they will likely remain stubbornly low compared to previous periods when central banks shifted away from loose monetary policies. Additionally, we see tight credit spreads persisting, which, in our opinion, makes it important for investors to take a “quality is king” approach. We believe corporate credit still offers selective yield opportunities, but with stretched valuations, now is the time to evaluate fixed income positions and upgrade the quality of portfolio holdings.

Views explanation

(+/=/–) 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.

Focus article

French connection

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- We have upgraded European equities to Overweight
- Economic revival is yielding better earnings growth while valuations are less demanding than elsewhere
- Political risk has receded in the short term

Europe's moment?

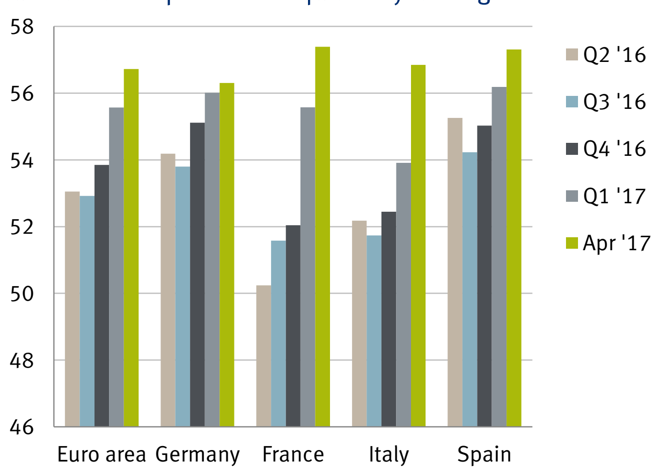
Europe has become a more attractive destination for investment as political risk has receded following the French election. But there is more to the European investment case than the victory of a centrist president at the helm of the region's second-largest economy.

Of greatest importance, the revival of Europe's economy has proven not only stronger than expected, with many leading indicators reaching a six-year high, but also much broader, with all major countries, bar Greece, now expanding at a healthy clip.

Loose monetary policy, fewer fiscal headwinds, and a credit mechanism which is now working have all helped. So have a relatively weak euro and the recovery in emerging economies, to which the region is highly exposed.

Economic activity heading in the right direction.

Euro area composite PMI quarterly average



All major countries show continued improving economic momentum.

Source - RBC Capital Markets, Haver Analytics

ECB to remain accommodative

This unexpectedly strong GDP growth may allow the European Central Bank (ECB) to plot a path towards very gradual further reductions in monetary stimulus. It has already reduced its asset purchase programme from €80B to €60B per month. For now, it is likely to stay on hold given subdued core inflation and still uncomfortably high unemployment in certain countries.

Moreover, potential upsets from Europe's heavy political cycle are still possible. While the German elections in September should produce a centrist government, the Italian elections pencilled in for Q1 2018 (though snap elections could be called before) could prove more problematic. The confluence of Italy's importance as Europe's third-largest economy, its heavy indebtedness, the precarious state of its banking system, and growing anti-EU sentiment could conspire to make this a preoccupying event. Somewhat reassuringly, the ruling Democratic Party has recently re-established its lead in the polls over the populist, anti-EU 5 Star Movement.

Conclusive evidence in several areas is needed before the ECB tightens

Decrease in political uncertainty	✓✓✓	French elections
	✓	Italian elections
		Brexit negotiations
Macroeconomic improvements	✓✓✓	All indicators positive
Bond market stability	✓	Government bond market stable
Inflation 2% target	✓	Close at 1.9%, but core inflation only 1.2%
Inflation expectations 2% target	✓	Now at 1.6%

✓ Some evidence ✓✓✓ Conclusive evidence

Source - RBC Wealth Management

Euro no longer a headwind for equities …

A weak euro may have improved regional competitiveness and revived growth, but it also induced a sustained outflow of foreign investor funds from European equities. However, since the turn of the year progressively stronger economic data culminated in better-than-expected Q1 GDP growth. This, together with the prospect of some additional scaling back of monthly bond purchases by the ECB, has produced a stronger euro. Centrist Emmanuel Macron's victory in France provided the icing on the cake.

Despite European equities' 10% rally YTD, with earnings improving more than expected, shares continue to trade at an unduly steep discount to those in the U.S.

Fund flows into equities have turned decidedly positive—up \$170B in the first four months of the year. At one point last year, outflows topped \$170B.

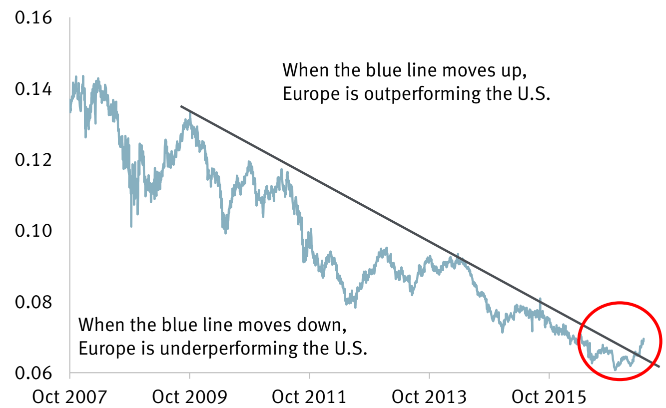
… As revenues and earnings surge

Against this positive background, the current earnings season has featured the strongest growth in seven years. With almost all results out, revenues and earnings have grown some 9% and 20% y/y, respectively, well ahead of the U.S.'s 8% and 14%. Moreover, all sectors in Europe—bar Utilities—have posted mostly double-digit earnings gains; mid-teens growth for the full year is now a real possibility.

Importantly, valuation levels in the eurozone are unusually compelling, in our view. Despite European equities' 10% rally year to date, with earnings improving more than expected, shares continue to trade at an unduly steep discount to those in the U.S. Europe is trading on a price-to-earnings ratio of 14.8x 2018E earnings versus 17.1x in the U.S., while the price-to-book value gap is even wider at 1.8x compared to 2.9x.

Is Europe's underperformance over?

MSCI Europe ex UK vs. S&P 500 in USD terms



Trend change underway?

Source - RBC Wealth Management, Bloomberg; data through 5/17/17

We have upgraded European equities to Overweight from Market Weight. Political risk has receded for now, and fundamentals have improved significantly.

Shoots of optimism

We have upgraded European equities to Overweight from Market Weight. Political risk has receded for now, and fundamentals have improved significantly. While we remain alert to the Italian elections' timing and outcome, Europe looks better now than it has for a while. We expect the recent emergence of the eurozone as a destination for international investment funds to continue.

We have been well served in the past by focusing on resilient companies with business models that do not depend on the vagaries of the European economic cycle. While we would continue to focus on these, we would also add exposure to well-capitalised banks and certain cyclicals, such as media. French domestic stocks, particularly in the retail, media, and leisure sectors, could benefit from the new government's measures to boost demand.

Appendix: Macron's moment

Even if well anticipated by polls, Macron's landslide victory, with over 60% of the vote, was more decisive than expected. With this outcome, the probability of a France-induced EU breakup recedes considerably.

Importantly, Macron is fiercely pro-European, a positive for the stability of the EU. The German elections this autumn may provide an opportunity to rekindle the EU integration project. This is key, as a eurozone breakup could still occur inadvertently if national debt trends deteriorate for too long. More integration in the region would be a step towards safeguarding against this possibility, in our view.

Macron campaigned on a platform mixing business-friendly reforms with measures to boost domestic demand. He aims to reduce unemployment from the current 10% to 7% and the fiscal deficit from over 3% of GDP to 1% by 2022.

Sceptics point to a young, untested leader, but his track record so far is interesting. Serving as France's minister of the economy for two years under then-President

President Macron's key suggested measures

Business-friendly/ labour market flexibility	• Reduce the corporate tax rate from 33% to 25%, the EU average • Reduce employers' social security contributions • Maintain the 35-hour work week, but allow some companies to deviate from it • Cap on severance payments • Decentralise collective bargaining from industry level to company level • Penalise companies with a large share of temporary workers
Demand boosting	• Abolish the housing tax for 80% of households • Increase the state-funded "employment bonus" for low-paid workers • Freeze the wealth tax on real estate • Freeze the tax on supplementary hours
Deficit cutting	• Cut 120,000 civil servant jobs over the next five years • Streamline public sector via non-replacement of 25% of retiring civil servants • Eliminate some government departments • Cut public spending from health insurance, unemployment insurance, and local authority spending (somewhat offset by increases in education, training, and defense) • Create universal unemployment insurance scheme that incentivises workers to get back to work

Source - RBC Wealth Management, "En Marche!" programme

François Hollande, he pushed through two laws to tackle France's overly regulated economy. One of those, the eponymous "loi Macron," includes a mixed bag of liberalising measures, ranging from streamlining labour court procedures to reducing the time needed to resolve labour disputes and loosening Sunday trading rules. Frustrated by internal opposition to his reform plans, he left the government to promote his own pro-reform movement.

But reforming the French economy is no easy task, as former Presidents Hollande and Nicolas Sarkozy both found out. France is very attached to its social institutions. Macron will have to act swiftly and decisively to avoid his predecessors' predicament.

Focus article

Time for a quality check

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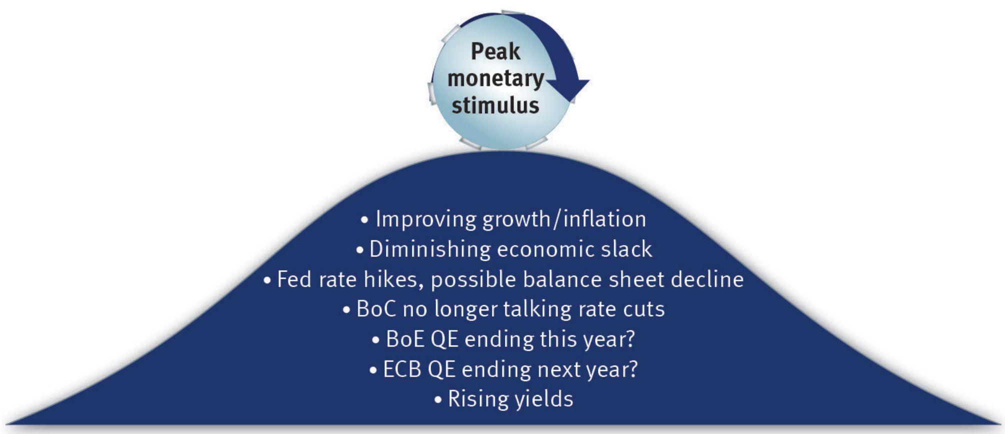
– Gradual "sea change" approaching for global monetary policy and interest rates
– Time to assess risks taken on during the long search for yield

Major central banks have been running intensely accommodative monetary policies since the financial crisis began. Excluding the Federal Reserve, for the most part they still are, but to us it appears the period of peak monetary policy stimulus could soon be behind us. We foresee a long unwinding process during which time government and corporate bond yields could gradually increase. In our opinion, it's time for investors to do a quality check on their portfolios to make sure they haven't inadvertently increased risk in search of higher yields. We believe corporate credit still offers selective yield opportunities, but with stretched valuations now is the time to upgrade portfolio quality.

Monetary stimulus is passing its peak



Source - RBC Global Asset Management

Opportunities as interest rates rise

As central banks gradually move toward a more balanced policy stance, government bond yields are likely to rise at a similarly deliberate pace, reflecting improved growth prospects and receding risks of deflation.

When bond yields go up, bond prices fall. Faced with this, conventional wisdom would say an investor should remain in cash and very short maturities, waiting until higher rates have arrived before re-investing. However, in this case that means accepting a very low coupon return perhaps for several years. For the buy-and-hold investor, in our view, this is a heavier cost than the current circumstances would justify.

Investors holding bonds to maturity will naturally see the path of returns altered by interest rate changes, but their overall return, set when they bought the bond (the yield to maturity) will remain in place. Over the life of the bond, assuming the issuer remains solvent, the investor will continue to receive regular interest payments as well as principal at maturity. Rising interest rates could actually improve the buy-and-hold investors' realised returns thanks to the reinvestment of coupon and any principal repayments at progressively higher interest rates.

Too much of a good thing?

Massively accommodative monetary policy across most major developed economies since the financial crisis has pushed government bond yields down to exceptionally low levels. Investors looking to maintain the level of income in portfolios have increasingly chosen to assume additional risks in search of better yields. Typically that has pushed them towards corporate bonds where the risk of default is higher than for governments and liquidity much lower, especially during periods of market stress.

Corporate credit has provided solid returns with limited volatility over the past three years

	Annual equivalent return (%)	Volatility of returns (%)
US Treasury Total Return Index	2.38%	4.49%
US Corporate Total Return Index	3.90%	5.40%
US High Yield Total Return Index	4.57%	5.23%
European Treasury Total Return Index	4.04%	4.76%
European Corporate Total Return Index	3.43%	2.59%
European High Yield Total Return Index	4.99%	4.54%

Source - RBC Wealth Management, Bloomberg

Corporate credit has recently demonstrated a superior risk-return profile compared to Government bonds.

Moody's BBB Corporate Bond spread

Source - RBC Wealth Management, Bloomberg; data through 5/19/17

Corporate credit spreads (BBB-rated) have narrowed to the tightest levels in a number of years.

As business conditions have improved over the past several years, this appetite for corporate credit has grown steadily. During last year's episode of ultra-low, even negative, government bond yields, this preference for corporate credit became so pronounced that the differential (spread) between the yield on corporate bonds and government bonds narrowed to the tightest level in a number of years.

But we now ask ourselves, was this spread compression justified? Credit fundamentals for both investment-grade and high-yield borrowers, as measured by financial leverage, have worsened at the same time as compensation for assuming credit risk has fallen. It's true the current interest rate environment keeps borrowing costs for corporate issuers at an affordable level, but the large pile of debt that has made its way onto most balance sheets over the past several years—to fund expansion plans or large share buy-back programs—could prove a headwind to corporate bonds as interest rates rise.

Correlation risk: Out of sight, out of mind

The correlation of different financial assets is a topic usually discussed at portfolio construction but is often forgotten thereafter.

In addition to providing reliable income, the fixed income component of a portfolio is supposed to act as a countervailing force when the equity component is under pressure.

In addition to providing reliable income, the fixed income component of a portfolio is supposed to act as a countervailing force when the equity component is under pressure. Government bonds and high-grade corporates usually do just that. When the economy heads into recession, earnings and share prices fall. Funds looking for a safe haven often flow into high-grade bonds pushing bond prices higher, taking some of the sting out of equity losses and giving the investor the financial and psychological staying power to hang in through the downturn.

But the worse the credit characteristics of a particular bond or preferred, the less it acts like a high-grade bond during periods of economic duress and the more it behaves like a stock. As the multi-decade search for yield has pushed investors toward lower-quality credits, it has simultaneously exposed portfolios to more equity-like volatility than intended. So far there has been no discernable cost to investors: they have enjoyed higher incomes than government bonds would have provided, and spreads are pretty well as low as they have been in the past seven years.

Counting on that continuing indefinitely seems to us to be an unreasonable assumption.

Corporate bonds, especially high-yield, display positive correlation to equity markets

	Correlations** vs. Equities*
U.S. Treasury market	-0.37
U.S. corporate bonds	-0.27
U.S. high-yield bonds	0.48
European Treasury market	0.01
European corporate bonds	0.08
European high-yield bonds	0.69

* For U.S. equities, we use the S&P 500 Index and for Europe we use the STOXX Europe 600 Index. ** Correlations are calculated using daily returns over three years. Source - RBC Wealth Management, Bloomberg

Corporate bonds, especially high-yield, display positive correlation to equity markets

Time for a quality check

It would be prudent at this point, when yields and spreads are both so low, to assess portfolios to ensure investors are being fully compensated for taking the risks that are present as well as making sure fixed income holdings offer appropriate portfolio diversification.

... the recent strength in credit markets provides an opportune time to lock in well-earned gains ...

While we feel that select corporate bonds still offer worthwhile yield advantages and that spreads have the capacity to remain at current levels or tighten in some cases, the recent strength in credit markets provides an opportune time to lock in well-earned gains and reduce exposure to positions more susceptible to suffering in a bond market pullback. Reinvesting proceeds into higher-quality bonds would have the natural benefit of increasing credit quality of the total portfolio as well as improving its liquidity profile.

Tweaked

Most major stock markets look like they usually do. On the one hand the long term appears compelling …

- The global economy is improving;
- Credit conditions remain accommodative;
- Reported earnings have surged, corporate guidance has become more upbeat;
- There is no recession in sight; and
- Stock indexes are attractively/ reasonably valued on *forward* earnings.

… while on the other the near term appears problematic, even risky.

- Political and geopolitical risks seem large and extremely fluid;
- The Fed is raising rates while other major central banks are unlikely to ease further;
- China has tightened policy on several fronts, industrial commodity prices have sagged in response;
- Optimism on Energy sector earnings has faded somewhat; and
- Stocks are perceived as expensive when price-to-earnings (P/E) multiples are calculated using the *latest* 12 months' earnings.

It is also likely that a bit of "altitude sickness" sets in sometime this summer: the U.S., Canadian, and British markets have all recently set new all-time highs, while all markets are up "a ton" from last year's spring lows (+33% in the case of the S&P 500). Some period of consolidation of those gains seems likely to be part of the mix over the next 12 months, even if all the favorable long-term factors cited above play out exactly as advertised.

Equity views

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

Source - RBC Wealth Management

While virtually all markets look to have worthwhile year-ahead potential when looked at in isolation, a global equity portfolio can and should lean against risk and toward opportunity.

We have reduced our recommended exposure to U.S. equities to Market Weight from Overweight (see below). Political and policy risks remain hard to handicap for the U.S. economy and for corporate earnings. Our forecast calls for the market to deliver low double-digit returns including dividends in 2017 and potentially a bit less in 2018. Almost two-thirds of this year's projected returns had been booked by the end of May. At more than 20x current earnings a modest curbing of enthusiasm is appropriate, in our opinion.

By contrast Europe (ex-U.K.) deserves more attention. We have raised our recommended exposure to Overweight (see the French connection article on page 4). The European economy continues to perform somewhat better than expected. Sales and earnings have

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been very strong. We expect investors will be rewarded by continued growth in earnings together with some narrowing of the overly large P/E gap between Europe and the U.S. Downside risks posed by any adverse weakening of the currency have diminished as prospects of a populist, anti-EU wave sweeping over the region have come down dramatically in recent weeks.

With no recession anywhere on the horizon, we recommend global portfolios remain modestly Overweight equities.

Regional highlights

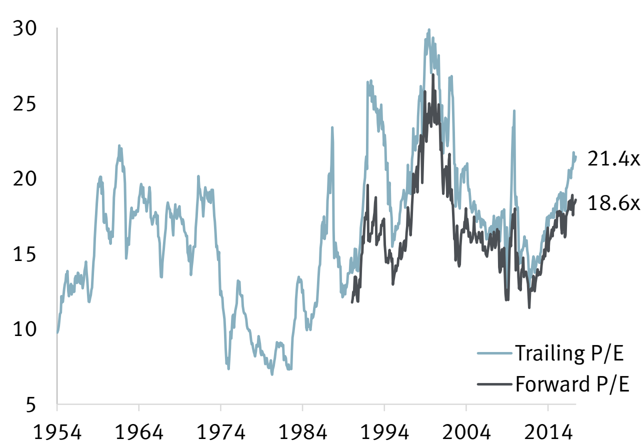
United States

- We recommend investors trim exposure to U.S. equities moderately in portfolios; we have shifted our stance to Market Weight from Overweight.
- First and foremost, with global economic and corporate earnings growth picking up speed, we believe there are more attractive opportunities in other markets, particularly in Europe.
- Second, it now seems more likely that subpar, uneven domestic GDP growth could persist in the next 6-12 months. Prospects for the emergence of pro-growth legislative catalysts have diminished amid ongoing Trump campaign controversies and the appointment of a special counsel. Subpar growth is not necessarily "bad" for the U.S. market—the S&P 500 has surged more than 250% since 2009 amid such "below-trend" conditions. But with other economies finally improving, there are good investment opportunities elsewhere at attractive valuations that should not be ignored.
- Third, there is less room for error with the S&P 500's elevated valuation at 21.4x trailing 12-month earnings and 18.6x the forward consensus estimate, according to Bloomberg.
- Despite this change in view, we are not negative on the U.S. market. Companies' potential earnings power and leadership positions in multiple industries still warrant meaningful investments at the benchmark level. For additional thoughts, see the *Global Insight Weekly*.

Canada

- We maintain a Market Weight recommendation for Canadian equities. Key sectors of the domestic

S&P 500 P/E ratios since 1954



While multiples expand 60% of the time in mid-to-late cycle periods, the "easy" valuation expansion seems to be behind us.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; monthly data through 5/30/17 market—namely, bank and Energy stocks—offer a balanced risk-reward opportunity. We are monitoring risks that we believe have relatively low probabilities of occurring but, were they to, could have considerable consequences for the domestic economy including a correction in major housing markets and a material deterioration in trade relations with the U.S.

- RBC Capital Markets believes risks to Ontario's housing market have increased in the wake of robust home price appreciation, the introduction of a tax on foreign buyers, and tighter conditions in the non-prime mortgage market. While these issues do bear monitoring, underlying credit quality remains solid for the domestic banks.

- The Trump administration's first major import duties were levelled at Canada despite the focus on Mexico and China on the campaign trail. The imposition of duties on softwood lumber is the product of a long-simmering conflict. We are monitoring the potential for retaliatory trade measures on both sides of the border ahead of NAFTA negotiations this summer.

- We remain cautious towards oil & gas producers. We continue to assess the sustainability of robust U.S. production growth over the past seven months against a backdrop of crude oil prices in the $45–$55 per barrel (/bbl) range. RBC Capital Markets moderated its forecast for North American benchmark crude oil prices to reflect, among other factors, U.S. production growth. The revised outlook calls for average prices of $54.50/bbl and $60/bbl in 2017 and 2018, respectively, down from $56/bbl and $63/bbl.

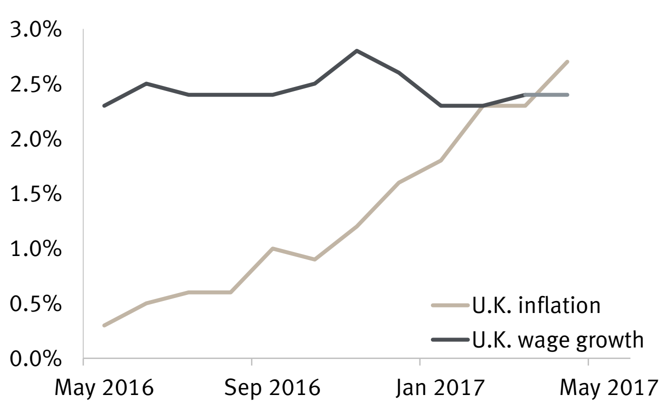
Continental Europe & U.K.

- We are Underweight the U.K. Most other regions face an improving or, at the very least, a steady outlook, while that for the U.K. is much more uncertain due to Brexit.

- Little has happened on that front as Prime Minister Theresa May is preoccupied with campaigning for the June 8 election. The lead of her Conservative Party has eroded since the election was called, but it likely remains healthy enough to enable her to enlarge her majority in Parliament. A recent embarrassing

U.K. Inflation and wage growth

light gray section of U.K. wage growth line is an estimate



Rising inflation is pressuring real wage growth and reducing earning power as it rises.

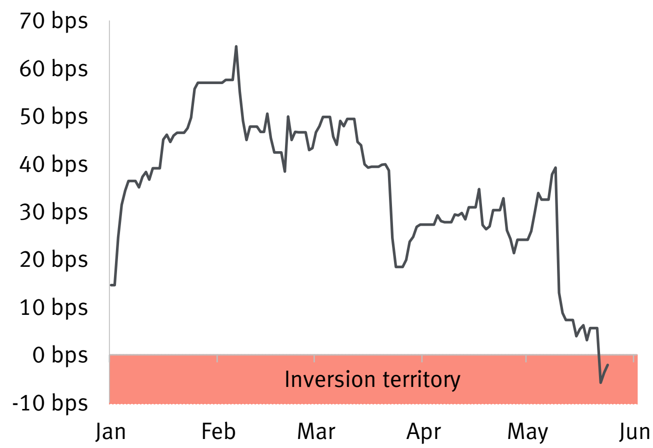
Source - RBC Wealth Management, Bloomberg high profile U-turn on elderly care policies has damaged her "strong and stable leadership" image, and could mean she will have more difficulty keeping her party aligned in the future and particularly during the sensitive Brexit negotiations.

- For now, while the economy continues to perform relatively well, clouds are starting to gather. Real wage growth has increased less than inflation, pointing to a squeeze on disposable income and domestic demand. Unemployment is falling, though the increase in claims could point to an end of this trend in the next few months.
- For now, we continue to prefer U.K. companies exposed to international markets, and to Europe in particular. Selective stocks in domestic sectors which have de-rated markedly also appear to discount the more subdued outlook and offer some value.

Asia

- China's efforts to reduce risks in its financial services sector are dragging down its onshore bond and equity markets. More restrictive regulations have been introduced, especially in shadow banking where the two main parts are the interbank market and so-called wealth management products (WMPs). Both have grown rapidly.
- Recently, the Shanghai Composite Index lost all of its gains from earlier this year while yields have picked up across the government bond yield curve, with 3- to 10-year yields inverting.
- S&P Global Ratings downgraded the Australian banking sector's credit rating by one notch. The ratings agency cited the growth in private sector debt in addition to high property prices, particularly in Sydney and Melbourne. S&P estimates private sector debt to GDP to be 136% in June, up from 117% in 2013. Although S&P believes the outlook for the Australian banks "remains relatively benign by global standards," it also opined that the risk of a "sharp correction" in property prices has increased. The downgrade may provide something of a reality check for Australian equities, which have performed strongly over the past 18 months.
- We remain constructive on Japanese equities, as the earnings outlook is good and valuations are relatively undemanding. A key risk is further yen appreciation as the currency has appreciated by 6% against the dollar in 2017.

Spread on the Chinese 3-yr. and 10-yr. government bond

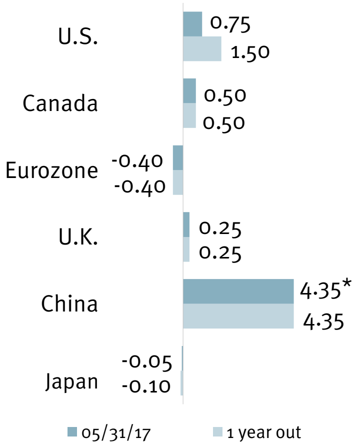


The Chinese yield curve inverted in late May on economic growth concerns.

Source - RBC Wealth Management, Bloomberg

Political sizzle, economic steak

Central bank rate (%)



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

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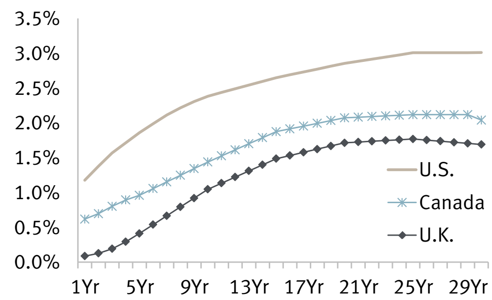
Business Marketing 101 has an old saying—"Sell the sizzle, not the steak"—which suggests consumers buy products on emotion, focusing on the benefits, not its underlying features. Investment decisions often follow the same path, but recent market activity suggests investors have turned their attention away from the "sizzle" to the features of the "steak"—solid and/or improving economic fundamentals.

Over the last year a number of political events—Brexit, the U.S. election, and the recent French election—have provided plenty of sizzle for investors. Stocks, interest rates, and currencies reacted dramatically at first as investors focused on the potential outcomes from these events. But since then the substantive developments from each have been surprising. Brexit has not stalled economic growth in the U.K. or the EU, pro-growth Trumponomics has yet to materialize into substantive legislation, and populist momentum stalled with Macron's sizeable victory in France.

In our view, investors should continue to train their eyes and investment decisions on the global economic steak, where improving fundamentals should provide a bulwark amidst the volatility from noisy political issues. For the U.S. this means slow growth and low inflation will keep the Fed on its gradual path to normalizing policy, while central banks in the U.K. and Europe contemplate removing stimulus in the not-so-distant future. Importantly though, interest rates will likely remain on their lower for longer track.

Sovereign yield curves



Source - Bloomberg

Our regional analysts maintain their selective focus on credit but note that as yield spreads continue to narrow, a "quality is king" focus is ever more important.

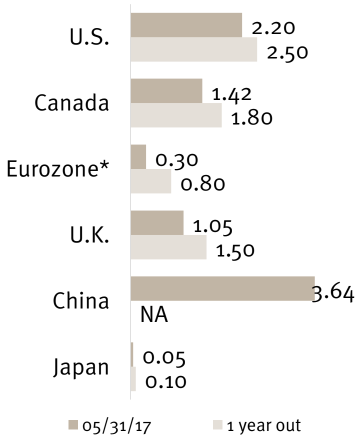
Regional highlights

United States

- The Fed seems all but certain to deliver its fourth rate hike since 2015 at the June 14 meeting to bring the Fed Funds rate to a target range of 1.0%–1.25%. But that may only prove to be a footnote at this relatively significant meeting. Investors will first focus on the quarterly update of economic projections given that the Fed currently forecasts a much-faster pace of rate hikes compared to what the market is priced for. Second, the Fed may use this meeting to lay the groundwork for the process of normalizing its sizeable balance sheet, which RBC Capital Markets expects to begin in September.
- The ongoing rally in corporate bond markets continues to put downward pressure on credit spreads, which has us moving upward on the credit quality spectrum. We see better value in investment-grade credit where the average yield on the Bloomberg

Global fixed income

10-year rate (%)



* Eurozone utilizes German Bunds
Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee

Barclays A-rated corporate index is currently 3%—near a five-year high—compared to near five-year low yields in the non-investment grade markets.

- The prospect of rising rates again has municipal investors piling into the short end of the yield curve, where the 5Y muni/Treasury ratio has plummeted to just 74%, well below a five-year average of 93%. Given our view that the 10Y U.S. Treasury will struggle to move significantly higher, we would still favor buying munis further out on the curve.

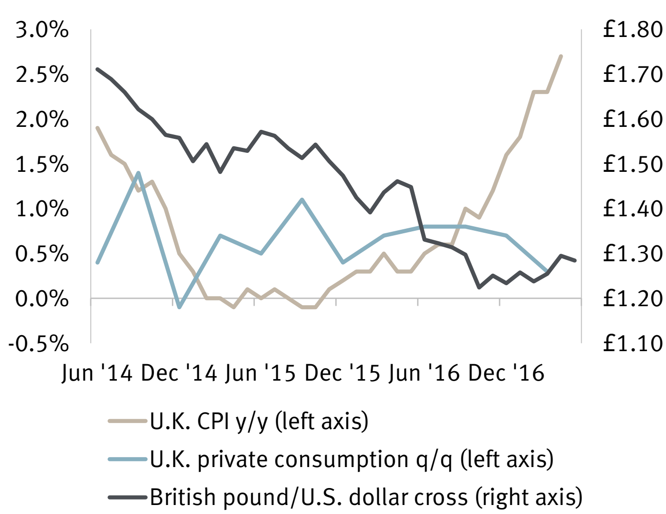
Canada

- The Bank of Canada struck a cautious tone at its statement-only policy meeting in May, focusing on two key areas of uncertainty that continue to constrain its outlook on the economy—U.S. tax and trade policy and record high household debt levels. Combined with a lack of core inflationary pressure and slack in the labour market, this leaves us expecting interest rate hikes to be a story for next year. Government of Canada bond yields fell to year-to-date lows in May. We anticipate yields on short-dated bonds will remain relatively anchored, and we would view any move higher in yields of intermediate maturity bonds as opportunities to reinvest bond ladder positions at higher rates.
- Despite a small selloff in risk assets, Investment-grade credit spreads remain close to their tightest levels in three years. We continue to recommend investors upgrade credit quality within portfolios and be selective. Single-A rated corporate bonds with five- to seven-year maturities remain our sweet spot.
- The preferred share market came under some pressure in May due to lower government bond yields combined with slightly wider credit spreads. We continue to see better opportunities in preferred shares compared to corporate bonds, but investors should tilt portfolios defensively to protect year-to-date price gains.

Continental Europe & U.K.

- The Bank of England's minutes from committee meetings show members focusing on inflation, which has

U.K. inflation accelerating despite slowing consumer spending



Continued weakness in the pound, not domestic strength, has helped push U.K. inflation to a four-year high.

Source - RBC Wealth Management, Bloomberg; data as of 5/30/17 again been higher than expected. Much of this increase is driven by a weaker currency rather than domestic economic strength and therefore is unlikely to drive rates higher in the near future. We believe the longer end of the gilt curve offers better value, with price pressure from excess supply expected to abate. We prefer corporate issuers that have minimised exposure to the outcome of Brexit negotiations, which will continue to dominate headlines and cause volatility.

- Yield premiums on core European sovereign debt have remained relatively stable following Macron's election in France. His victory was more acutely expressed in peripheral Europe, where the spread tightening was more dramatic before eventually giving some of that relief rally back. Investors are likely to approach the upcoming election in Germany and an anticipated Italian vote in 2018 with expectations for stable governments.
- European bond markets are enjoying a good deal of positive sentiment. We dislike "safe-haven" trades like the German bund market, in favour of debt from financial institutions that are considered systemically important to their domestic economies, but also benefit from diverse, international revenues. Subordinated debt continues to offer a decent yield pickup over other investment-grade issues.

Oil market: Brave new world

Commodity forecasts

	2017E	2018E
Oil (WTI $/bbl)	54.50	60.00
Natural Gas ($/mmBtu)	3.17	3.40
Gold ($/oz)	1,280	1,300
Copper ($/lb)	2.65	2.75
Corn ($/bu)	3.72	4.00
Wheat ($/bu)	4.40	5.03

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

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Saudi Arabia needs stable oil prices to fund its military spending and to mollify its citizens. Unfortunately for the Kingdom, it is now again facing abundant U.S. shale growth, much like it did a few years ago. For now, OPEC has found a way to unite, and Saudi Arabia, which has ultimately self-imposed the largest cuts remains the key decision maker. Nevertheless, many other factors will affect oil prices going forward.

U.S. shale reborn

Increased development activity in U.S. shale has been made possible by a relentless focus on cost cutting and technological advancement to enhance well productivity. At $45–$55 per barrel (/bbl), producers can lock in prices with hedging that makes development economically attractive. Oil drilling activity in the Bakken is up nearly double year over year, while oil rig counts in the Permian and Eagle Ford are closer to triple the lows of last spring.

All of this drilling has led to a significant increase in shale wells awaiting completion, up to nearly 4,800 from about 4,000 in the fall of 2016. This resurgence of activity has led the Energy Information Administration to forecast U.S. shale oil production for June 2017 at 5.4 million barrels per day (bbl/d), up 600,000 bbl/d y/y.

With production volumes outside of OPEC generally soft, the tremendous impact of U.S. shale has led the International Energy Agency to forecast year-end 2017 non-OPEC production up 600,000 bbl/d y/y.

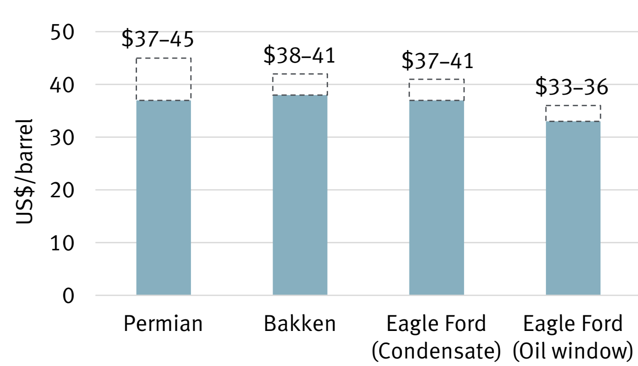
New equilibrium

While the market was broadly balanced in Q1, continued output curtailment from OPEC will be required to offset production growth from the U.S. Avoiding near-term fiscal budget pain and social unrest provide compelling motivations for Saudi Arabia and others to curtail output. However, ceding market share to stabilize price may not be a viable long-term strategy.

Until the economics of U.S. shale erode with perhaps increasing drilling costs or lower quality rock to exploit, we believe the market may be challenged to find equilibrium price substantially higher than $40–$55/bbl.

This new equilibrium range may be pushed up should politics affect output from Iran, ISIS impact volumes from Iraq, or financial stress reduce Venezuelan production.

U.S. shale oil supply cost ranges



Cost cutting and steady technological improvement have lowered the economic viability of U.S. shale oil from the $55–$75/bbl range several years ago.

Source - RBC Capital Markets, RBC Wealth Management

U.S. dollar

Slightly softer inflation and wage growth in May caused the dollar to fall, with the move exaggerated by political noise around an FBI investigation into the Trump administration. Looking through the noise, we remain moderately bullish on the dollar, expecting the tightening labour market will drive the Federal Reserve to hike more than is currently expected by the market.

Euro

With French political risk significantly reduced after the Macron victory, and a weaker U.S. dollar, the euro has rallied to its strongest level since December. Our focus now centres on the European Central Bank. Any sign of stronger fundamentals in Europe filtering through to its policy stance will offer meaningful currency support, but we believe weak inflation pressures will stay its hand for now, containing the currency.

British pound

A weaker dollar and strong retail sales figures over Easter sent the pound briefly above $1.30 for the first time since September. However, with inflation at 2.7%—the highest level since 2013—and wage growth only at 2.4%, consumers' real spending power is eroding. We believe this pressure will only worsen in the coming months, and ultimately send the pound lower despite its recent bounce.

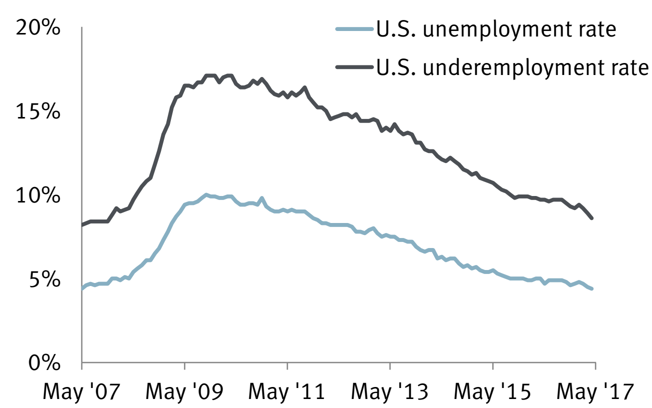
Canadian dollar

A fall in the price of oil, concerns around the housing market, and U.S. trade duties levied against lumber imported from Canada have caused the loonie to come under pressure. There is justification for some weakness, but we believe the risks may have been overstated at this juncture. While there is potential for a further pullback near term, we are constructive over a longer time horizon.

Japanese yen

After the market-friendly French election result, the yen weakened against the dollar, as the currency's safe-haven status lost its lustre. As U.S. political concerns grew, however, these losses have been partially retraced. While it is hard to cut through the noise, we remain bullish on the yen, although volatility is likely to be the biggest winner.

U.S. labour market continues to tighten



Tight labour market should underpin inflationary pressures.

Source - RBC Wealth Management, Bloomberg; data through May 2017

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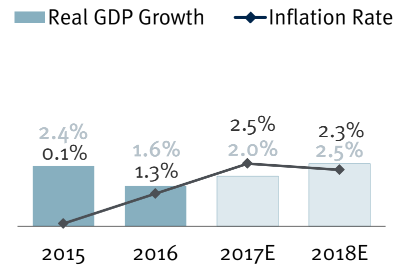
Key forecasts

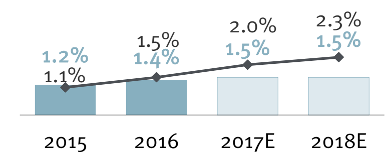
United States — Consumers to drive growth

- Q1 GDP revised higher to 1.2% from 0.7%. Inflation data retreated in April, but import prices rose as the dollar continues to weaken. Payrolls rebounded after weak hiring in March and the unemployment rate fell to 4.4%. Housing moderated amid low available supply, pushing prices higher. April's retail sales rebounded, pointing to a reacceleration of growth as the consumer continues to spend.



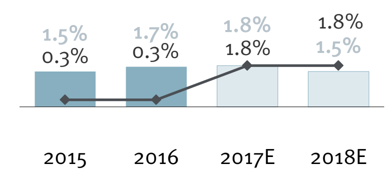
Canada — Short-term growth spurt

- Q1 GDP expected to reaccelerate to 3.8%, but full-year GDP estimate remains at 2.0%. Outsized home price rises remain a headline policy issue. BoC held bank rate at 0.5% in May. April hiring slowed but unemployment rate continues to fall. Wage growth slowed to 0.5% but retail sales reaccelerated. Headline inflation moderated to 1.6% while core inflation nudged down to 1.4%.



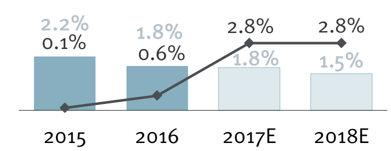
Eurozone — Inflation still muted

- Preliminary Q1 GDP of 1.7% y/y. Growth outlook strengthening. Inflation stubbornly low, keeping ECB patient. Macron wins the French election runoff, equities rallied. Manufacturing and services PMIs continue to strengthen. Industrial output remains robust while employment data is improving throughout the region.



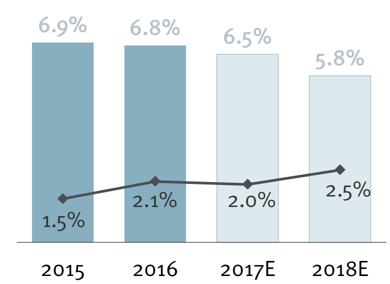
United Kingdom — Signs of slowing

- Wage growth can't keep up with rising inflation, which hit 2.7% y/y. Q1 GDP grew just 0.2% as personal consumption increased a disappointing 0.3%. Nice weather gave April retail spending a boost, showing consumer resilience. Slowing growth and Brexit uncertainty is likely to outweigh above-target inflation, keeping the BoE on the sidelines through the rest of the year.



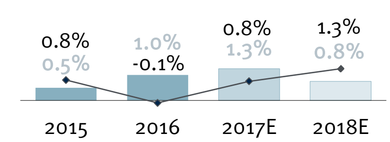
China — Growth moderating

- Economy growing at a healthy clip, but government restrictions on lending and leverage weighing. April retail sales up 10.7%, slowest since October. Industrial production missed, rising just 6.5%. Moody's downgraded China's credit rating to A1 from Aa3, citing elevated debt and potential eroding financial strength. Tighter lending policies should be viewed as a positive for the sustainability of the economy.



Japan — Slow progress

- Real GDP grew 2.2% in Q1, the 5th straight quarter of growth, the longest streak since 2006. Core inflation rose 0.4%, fastest in 2 years. Demand pressures rose slightly, with improving retail sales and personal spending relative to prior quarter. The jobs-to-applicant ratio is at its highest since 1974, signifying a tight labor market, although real wage growth is still negative on a y/y basis, dampening spending expectations.



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

Market scorecard

Index (local currency)	Level	1 Month	YTD	12 Month
S&P 500	2,411.80	1.2%	7.7%	15.0%
Dow Industrials (DJIA)	21,008.65	0.3%	6.3%	18.1%
NASDAQ	6,198.52	2.5%	15.1%	25.3%
Russell 2000	1,370.21	-2.2%	1.0%	18.7%
S&P/TSX Comp	15,349.91	-1.5%	0.4%	9.1%
FTSE All-Share	4,116.08	3.9%	6.3%	20.0%
STOXX Europe 600	389.99	0.7%	7.9%	12.2%
German DAX	12,615.06	1.4%	9.9%	22.9%
Hang Seng	25,660.65	4.2%	16.6%	23.3%
Shanghai Comp	3,117.18	-1.2%	0.4%	6.9%
Nikkei 225	19,650.57	2.4%	2.8%	14.0%
India Sensex	31,145.80	4.1%	17.0%	16.8%
Singapore Straits Times	3,210.82	1.1%	11.5%	15.0%
Brazil Ibovespa	62,711.47	-4.1%	4.1%	29.4%
Mexican Bolsa IPC	48,788.44	-1.0%	6.9%	7.3%
Bond yields	**5/31/17**	**4/28/17**	**5/31/16**	**12 mo chg**
US 2-Yr Tsy	1.282%	1.262%	0.877%	0.40%
US 10-Yr Tsy	2.203%	2.280%	1.846%	0.36%
Canada 2-Yr	0.694%	0.721%	0.614%	0.08%
Canada 10-Yr	1.416%	1.547%	1.319%	0.10%
UK 2-Yr	0.131%	0.075%	0.432%	-0.30%
UK 10-Yr	1.046%	1.085%	1.429%	-0.38%
Germany 2-Yr	-0.713%	-0.733%	-0.514%	-0.20%
Germany 10-Yr	0.304%	0.317%	0.139%	0.17%
Commodities (USD)	**Price**	**1 Month**	**YTD**	**12 Month**
Gold (spot $/oz)	1,268.94	0.1%	10.1%	4.4%
Silver (spot $/oz)	17.33	0.8%	8.9%	8.4%
Copper ($/metric ton)	5,657.75	-0.9%	2.4%	20.5%
Uranium ($/lb)	19.75	-13.2%	-3.1%	-27.5%
Oil (WTI spot/bbl)	48.32	-2.0%	-10.1%	-1.6%
Oil (Brent spot/bbl)	50.31	-2.7%	-11.5%	1.2%
Natural Gas ($/mmBtu)	3.07	-6.3%	-17.5%	34.2%
Agriculture Index	284.14	-1.8%	-2.4%	-8.0%
Currencies	**Rate**	**1 Month**	**YTD**	**12 Month**
US Dollar Index	96.9220	-2.1%	-5.2%	1.1%
CAD/USD	0.7407	1.1%	-0.5%	-3.0%
USD/CAD	1.3500	-1.1%	0.4%	3.1%
EUR/USD	1.1244	3.2%	6.9%	1.0%
GBP/USD	1.2890	-0.5%	4.5%	-11.0%
AUD/USD	0.7430	-0.8%	3.1%	2.7%
USD/CHF	0.9678	-2.7%	-5.0%	-2.6%
USD/JPY	110.7800	-0.6%	-5.3%	0.0%
EUR/JPY	124.5600	2.5%	1.3%	1.1%
EUR/GBP	0.8723	3.7%	2.2%	13.5%
EUR/CHF	1.0882	0.4%	1.5%	-1.7%
USD/SGD	1.3832	-1.0%	-4.4%	0.4%
USD/CNY	6.8180	-1.1%	-1.8%	3.5%
USD/BRL	3.2266	1.6%	-0.7%	-10.6%

The NASDAQ hit numerous record highs as large tech stocks outperformed on strong earnings.

Weak U.S. inflation data has driven the yield curve to its flattest level since before the November election.

Oil prices gave back all of the gains in May following an OPEC meeting that failed to exceed market expectations for further production cuts.

Macron's market-friendly victory in the French presidential election helped strengthen the euro.

Equity returns do not include dividends, except for the German DAX and 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 0.74 means 1 Canadian dollar will buy 0.74 U.S. dollar. CAD/USD -3.0% return means the Canadian dollar has fallen 3.0% vs. the U.S. dollar during the past 12 months. USD/JPY 110.78 means 1 U.S. dollar will buy 110.78 yen. USD/JPY 0.0% return means the U.S. dollar is level with the yen during the past 12 months.

Source - RBC Wealth Management, RBC Capital Markets, Bloomberg; data through 5/31/17.

Research resources

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Rating	Count	Percent	Count	Percent
Buy [Top Pick & Outperform]	843	51.94	285	33.81
Hold [Sector Perform]	679	41.84	149	21.94
Sell [Underperform]	101	6.22	8	7.92

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